

# Excise Tax Advisory

Excise Tax Advisories are interpretive statements authorized by RCW 34.05.230.

ETA 3214.2019

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## B&O Tax Exemption for Amounts Received by a Financial Institution from Affiliates

### Purpose

This Excise Tax Advisory (ETA) explains when income a financial institution receives from its affiliates may be exempt from the business and occupation (B&O) tax.

At the end of this ETA is a decision tree that illustrates how this exemption works.

### Overview

RCW 82.04.645 provides a B&O tax exemption for income a financial institution earns from transactions with its affiliates, when those transactions are required to be at arm's-length pursuant to sections 23A and 23B of the Federal Reserve Act ("FRA").<sup>1</sup> Specifically, RCW 82.04.645 states as follows:

This chapter does not apply to amounts received by a financial institution from an affiliated person if the amounts are received from transactions that are required to be at arm's length under sections 23A or 23B of the federal reserve act as existing on June 1, 2010, or such subsequent date as may be provided by the department by rule, consistent with the purposes of this section. For purposes of this subsection, "financial institution" has the same meaning as in RCW 82.04.080.

RCW 82.04.645 does not provide a blanket exemption to a financial institution for all amounts received by an affiliate or all intercompany transactions between a financial institution and an affiliate. Rather, the exemption is only available if a taxpayer satisfies the following three requirements:

1. The taxpayer is a "financial institution".
2. The taxpayer engages in a transaction with an "affiliate".

<sup>1</sup> Sections 23A and 23B of the FRA are codified at 12 U.S.C. §§ 371c and 371c-1, respectively.

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3. The transaction is subject to the arm’s-length requirement imposed by the FRA.

As exemptions are construed narrowly, the taxpayer has the burden of establishing it meets each element of the exemption under RCW 82.04.645.<sup>2</sup>

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**Requirement 1: The taxpayer is a “financial institution”**

A taxpayer eligible for the RCW 82.04.645 exemption must be a financial institution as defined in WAC 458-20-19404(3)(i) *Financial institutions – Income apportionment*.<sup>3</sup> Specifically, financial institution means any of the following:

1. An entity authorized under Title 30A, 31, 32, or 33 RCW to engage in business in Washington, provided that persons authorized to act as a loan servicer pursuant to chapter 31.04 RCW or as a check casher or check seller pursuant to chapter 31.45 RCW shall not be considered a financial institution solely on that basis;
2. An entity registered under the Federal Bank Holding Company Act of 1956, as amended, or registered as a savings and loan holding company under the Federal National Housing Act, as amended;
3. A national bank organized and existing as a national bank association pursuant to the provisions of the National Bank Act, 12 U.S.C. Sec. 21 et seq.;
4. A savings association or federal savings bank as defined in the Federal Deposit Insurance Act, 12 U.S.C. Sec. 1813 (b)(1);
5. Any bank or thrift institution incorporated or organized under the laws of any state;
6. Any corporation organized under the provisions of 12 U.S.C. Secs. 611 to 631;
7. Any agency or branch of a foreign depository as defined in 12 U.S.C. Sec. 3101 that is not exempt under RCW 82.04.315;
8. A production credit association organized under the Federal Farm Credit Act of 1933, all of whose stock held by the Federal Production Credit Corporation has been retired.

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**Requirement 2: The taxpayer engages in a transaction with an “affiliate”**

The financial institution must transact with an “affiliate” to qualify for the RCW 82.04.645 exemption. An affiliate is an entity under common control with the financial institution. “Control,” for this purpose, means “the possession, directly or indirectly, of more than fifty percent of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting shares, by contract, or otherwise.”<sup>4</sup>

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<sup>2</sup> See *Budget Rent-A-Car, Inc. v. Dep’t of Revenue*, 81 Wn.2d 171, 174-75, 500 P.2d 764 (1972).

<sup>3</sup> RCW 82.04.645(1); RCW 82.04.080(2); RCW 82.04.460(2).

<sup>4</sup> RCW 82.04.645(2).

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An affiliate of a financial institution does not qualify for the exemption unless it is a financial institution and meets all of the other requirements of the exemption.

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**Requirement 3: The transaction is subject to the arm's-length requirement imposed by the Federal Reserve Act**

To qualify for the RCW 82.04.645 exemption, the transaction between the financial institution and its affiliate must be one that is required to be at arm's-length.

FRA Section 23B requires certain transactions between "member banks"<sup>5</sup> and affiliates, as that term is defined for FRA purposes (i.e., an "FRA Affiliate") to be conducted as if between non-affiliated companies, in other words, at arm's-length. FRA Section 23A supplies definitions necessary for applying the arm's-length requirement.

Thus, to satisfy this element of the RCW 82.04.645 exemption, the taxpayer must establish that:

- (1) it is the type of entity subject to FRA Section 23B,
- (2) the income it seeks to exempt was received from a type of transaction that is required to be at arm's-length under FRA Section 23B, and
- (3) the amounts received from the transaction were received from an FRA Affiliate.

While FRA Section 23B does allow various exceptions and exclusions from the arm's-length requirement, such exceptions and exclusions cannot apply to the transactions the taxpayer seeks to exempt under RCW 82.04.645.

For example, the relationship between the member bank and the entity transacted with must fall within one of the categories of affiliation described in FRA Sections 23A and 23B, summarized generally as follows:

- (1) Any company that controls the taxpayer and any other company that is controlled by the company that controls the taxpayer;
- (2) A financial subsidiary<sup>6</sup> of the taxpayer;
- (3) A company under common control with the taxpayer;
- (4) Any investment fund with respect to which the taxpayer or affiliate thereof is an investment adviser; or
- (5) A company determined by the Federal Reserve Board via regulation or order to be an affiliate of the taxpayer.

If the entity transacted with by the member bank fits into none of these categories, it is not an FRA Affiliate and its transactions with the taxpayer cannot be exempt under RCW 82.04.645. If the entity falls within one of the above categories, but also falls into one of the exceptions to the FRA Affiliate definition, the transaction does

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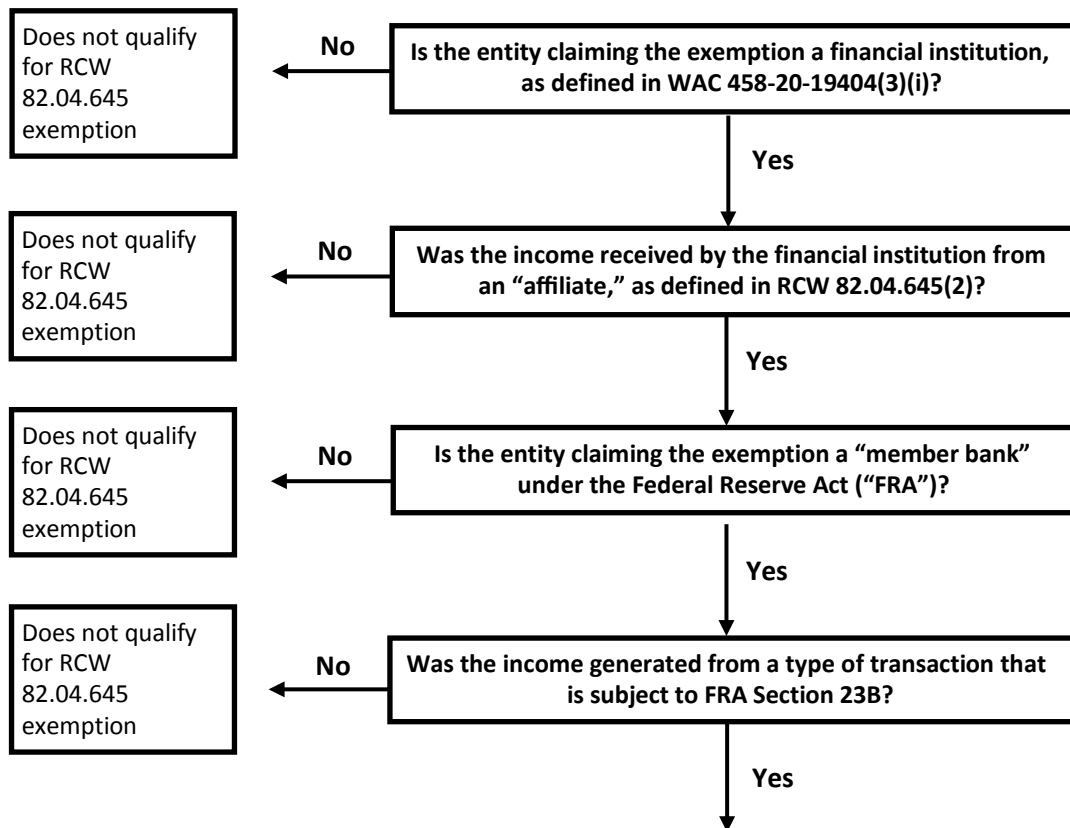
<sup>5</sup> The term "member bank" means "any national bank, State bank, or bank or trust company which has become a member of one of the Federal reserve banks." 12 U.S.C. § 221.

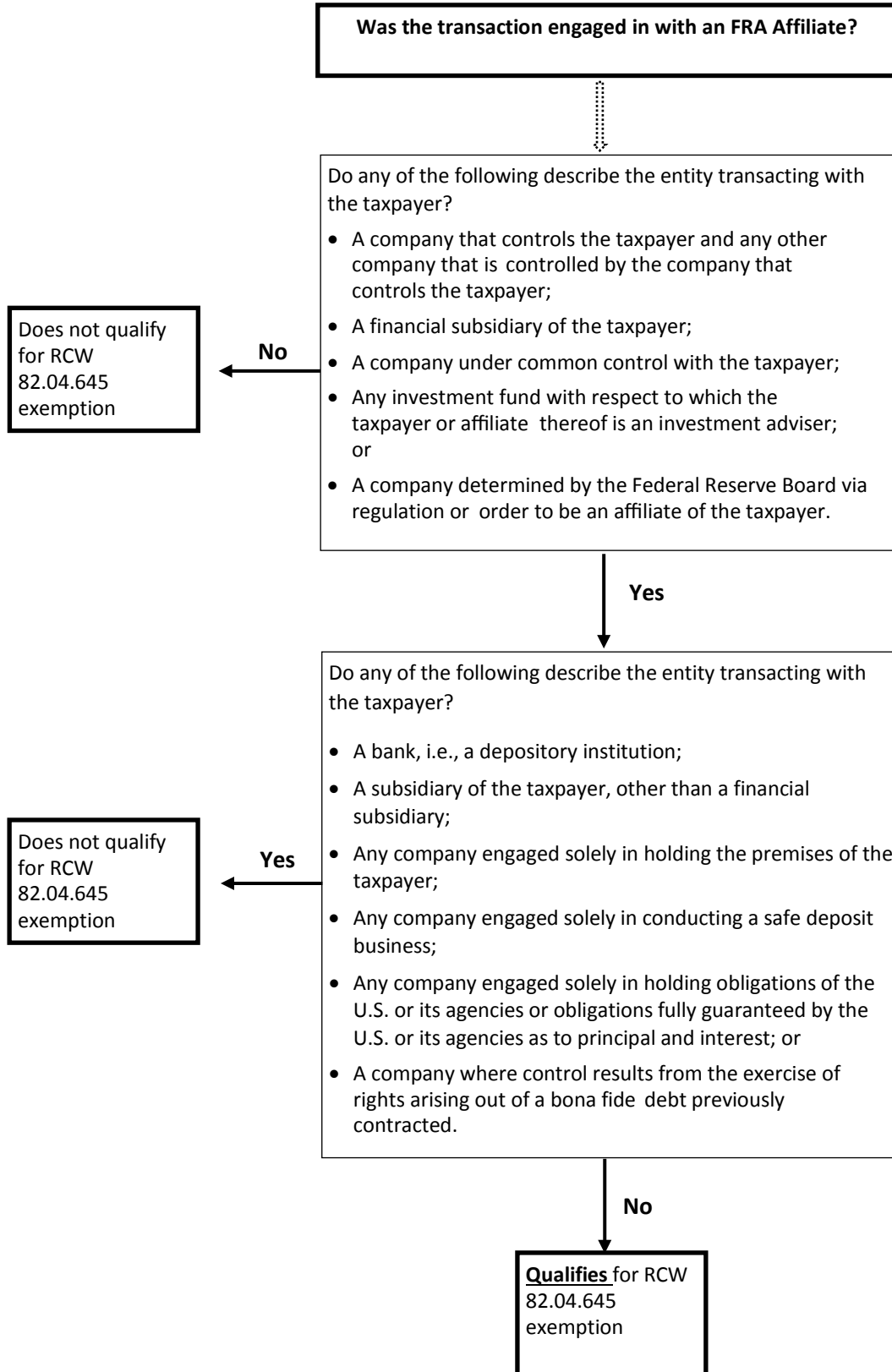
<sup>6</sup> A "financial subsidiary" is generally a bank subsidiary that engages in activities forbidden to the parent bank. See 12 U.S.C. §§ 371c(e)(1), 24a(g)(3).

not qualify for the RCW 82.04.645 exemption. The exceptions to the FRA Affiliate definition are summarized generally as follows:

- (1) A bank, i.e., a depository institution;
- (2) A subsidiary of the taxpayer, other than a financial subsidiary;
- (3) Any company engaged solely in holding the premises of the taxpayer;
- (4) Any company engaged solely in conducting a safe deposit business;
- (5) Any company engaged solely in holding obligations of the United States or its agencies or obligations fully guaranteed by the United States or its agencies as to principal and interest; or
- (6) A company where control results from the exercise of rights arising out of a bona fide debt previously contracted.

**Decision tree for  
RCW 82.04.645  
exemption**





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