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Op. No. 65-8

STATE OF HAWAII

DEPARTMENT OF THE ATTORNEY GENERAL

Honolulu, Hawaii 96813

March 29, 1965

Honorable Edward J. Burns
Director of Taxation
State of Hawaii
Honolulu, Hawaii

Attention: Mr. J. A. Bell

Dear Sir:

This opinion is submitted in reply to your request for a determination by the Attorney General's Office of whether Federal Home Loan Banks are National Banks. It appears that certain public accountants on behalf of several savings and loan associations, have filed claims for refund of franchise taxes for the years 1959 to 1962, inclusive, amounting to \$15,068.46. Alleging that Federal Home Loan Banks are National Banks and that under the provisions of Chapter 127, Revised Laws of Hawaii 1955, as amended, and subsection 121-5(c), Revised Laws of Hawaii 1955, as amended, dividends from a National Bank are excluded from the gross income of Banks and other Financial Corporations, these savings and loan associations contend that dividends received by them from the Federal Home Loan Bank of San Francisco should not have been included in the reportable gross income of these savings and loan associations for the period of time in question.

It is our opinion that a Federal Home Loan Bank is not a National Bank. Therefore, dividends from a Federal Home Loan Bank should be included in a Bank or other Financial Corporation's reportable gross income.

Section 127-6, Revised Laws of Hawaii 1955, as amended, and subsection 121-5(c), Revised Laws of Hawaii 1955, as amended, provide that dividends from a National Bank need not be reported in a Bank or other Financial Corporation's gross income.

Chapter 127, Revised Laws of Hawaii 1955, as amended, pertains to the taxation of Banks and other Financial Corporations. Section 127-6 thereof provides in part:

"§ 127-6. Chapter 121 applicable.
All of the provisions of Chapter 121 not inconsistent with the provisions of this chapter, and which may be appropriately applied to the taxes, persons, circumstances and situations involved in this chapter, . . . shall be applicable to the taxes imposed by this chapter, and to the assessment and collection thereof . . ."

Subsection 121-5(c), Revised Laws of Hawaii 1955, as amended, pertains to the exclusion of dividends from a corporation's reportable gross income and provides in part:

"(c). . . The deductions of or based on dividends paid or received, allowed to a corporation under chapter 1, subchapter B, part VIII of the Internal Revenue Code, shall not be allowed. In lieu thereof there shall be allowed as a deduction the entire amount of dividends received by any corporation upon the shares of stock of a national banking association . . ."
(Emphasis added.)

There is a distinction to be made between National Banks and Federal Home Loan Banks, and this distinction clearly shows that Federal Home Loan Banks cannot be categorized as National Banks.

National Banks and Federal Home Loan Banks were created by Congress for different purposes and serve different functions. To understand the differences between these banks, one must look to the legislative history of both to determine what Congress desired to accomplish in the creation of these banks.

The object of the national banking law (The National Bank Act, June 3, 1864, c. 106, 13 Stat. 99) was to provide a uniform and secure currency for the country and to facilitate the operations of the United States Treasury. Mercantile Nat.

Bank v. New York, 121 U.S. 138, 154, (1887). National Banks are instrumentalities or agencies of the federal government and for the most part are governed by the same rules as state banks in so far as their functions, powers, and liabilities are concerned. 10 Am. Jur. 2d, Banks § 5. A National Bank is a body corporate, with power to make contracts, to sue and be sued, and to exercise all incidental powers necessary to carry on the business of banking. Weber v. Spokane Nat. Bank, 64 Fed. 208 (Wash. 1894).

A National Bank is subject to state law so long as the state law does not interfere with the purposes of the bank's creation, does not destroy its efficiency, and does not conflict with certain paramount federal law. State of S.D. v. National Bank of S.D., 219 F. Supp. 842 (S.D. 1963); Ingalls v. Ingalls, 81 So.2d 610 (Ala. 1955); Peoples Sav. Bank v. Stoddard, 102 N.W.2d 777, 83 A.L.R.2d 344 (Mich. 1960).

Federal Home Loan Banks, on the other hand, were created by Congress for purposes and functions different from that of the National Banks. See Federal Home Loan Bank Act, July 22, 1932, c. 552, § 1, 47 Stat. 725. Federal Home Loan Banks were established to provide a permanent system of reserve credit banks for eligible thrift institutions which are engaged in long term, home-financing to meet demands for home mortgage credit. The Federal Home Loan Bank Act provided for the establishment of twelve districts geographically located about the United States. Each district was to establish, as soon as practicable, a Federal Home Loan Bank whose title was to include the name of the city in which it was established. 12 U.S.C. § 1423 (1932). These Federal Home Loan Banks make advances to member institutions upon the security of home mortgages, under prescribed conditions and requirements set forth by the Federal Home Loan Bank Board. 12 U.S.C. § 1430 (1932).

Prior to the enactment of the Federal Home Loan Bank Act of 1932, private financial institutions engaging in loans for the building and purchase of homes, had no access to a dependable source of credit when supplementary funds were needed to meet unanticipated withdrawal or seasonal and other fluctuations in the demand for home mortgage loans. The Federal Home Loan Bank System was established to cope with this problem by providing thrift and home-financing institutions with such a credit facility. See THE FEDERAL HOME LOAN BANKS, The Federal Home Loan Bank System (1961).

The Federal Home Loan Banks do not make loans to private individuals. They merely lend money to member institutions who negotiate with the public for home loan mortgages. 12 U.S.C. § 1430 (1932). Although these banks have no direct dealings with the public, they serve a public purpose by providing a credit reservoir for their members.

The capital stock of these Federal Home Loan Banks are owned by member institutions of the Federal Home Loan Banks. 12 U.S.C. § 1426 (1932). Under the Federal Home Loan Bank Act, three kinds of financial institutions are eligible for membership in the Federal Home Loan Bank System: (1) savings and loan associations (term includes building associations, cooperative banks, building and loan associations, and homestead associations), (2) savings banks, and (3) insurance companies. 12 U.S.C. § 1424 (1932). See THE FEDERAL HOME LOAN BANKS, The Federal Home Loan Bank System (1961).

National Banks are specifically excluded from subscribing for stock of Federal Home Loan Banks. 12 U.S.C. § 1447 (1932). By specifically excluding National Banks from subscribing to the stock of Federal Home Loan Banks, Congress has manifested its intent that National Banks cannot become a part of the Federal Home Loan Banking System.

Congress, in 1933, took further legislative steps to bolster the nation's home financing structure and the Federal Home Loan Bank System when, as part of the Home Owners' Loan Act, it made provisions for the chartering of federal savings and loan associations by the Home Loan Bank Board. 12 U.S.C. § 1464 (1933). The basic purpose of the federal chartering was to meet the need in many communities throughout the country for more adequate thrift and home financing facilities. To accomplish this purpose, the legislation provided for local institutions that would operate on a uniform plan embodying the best practices and principles of savings and loan associations. The federal chartering provisions paralleled in many respects the act creating National Banks in 1863. See THE FEDERAL HOME LOAN BANKS, The Federal Home Loan Bank System (1961). The status of these federal savings and loan associations which were created pursuant to the Home Owners' Loan Act has been clarified by judicial decisions stating that these federal savings and loan associations are not National Banks. Eddy v. Home Federal Savings & Loan Ass'n, 140 P.2d 156 (Calif. 1943); Springfield Institution v. Worcester Fed. Savings & Loan Ass'n, 107 N.E.2d 315 (Mass. 1952); Elworth v. Pacific Federal Savings and Loan of Tacoma, 138 F. Supp. 395 (Or. 1956) U.S. of America

ex rel v. First Federal Savings and Loan, 151 F. Supp. 690, (Wis. 1957).

The question presented in these cases was whether these federal savings and loan associations which were created pursuant to the Home Owners' Act of 1933 were subject to the rules and regulations promulgated for National Banks. In the aforementioned cases, the federal savings and loan associations, in violation of the particular state's statutes, established branch offices in those different states. The states contended that these federal savings and loan associations were National Banks and were therefore subject to state control by virtue of 12 U.S.C. § 36(c) (1927), which provides in part:

"A national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches: (1) within the limits of the city, town or village in which said association is situated, if such establishment and operation are at the time expressly authorized to State Banks by the law of the State in question . . ." (Emphasis added.)

The federal savings and loan associations contended that Congress had authorized only the Federal Home Loan Bank Board to set the rules and regulations for the operation of these savings and loan associations and therefore state laws were not applicable in controlling the establishment of the branches or agencies. 12 U.S.C. § 1464 (1933).

It was held in all of these cases that these federal savings and loan associations were not subject to the national banking laws. In the Eddy case, supra, the court stated,

". . . building and loan associations under the Home Owners' Act are not national banks and the duties of the two materially differ. As to national banks, congress expressly left open a field for state regulation and the application of state law; but as to federal savings and loan associations, Congress made plenary, pre-emptive delegation to the Board to organize, incorporate, supervise, and regulate, leaving

no field for state supervision." (Emphasis added.)

In the U.S. v. First Federal Savings and Loan case, supra, the court also held that savings and loan associations were not subject to state laws but were subject to the rules and regulations set forth by the Federal Home Loan Bank Board. In distinguishing savings and loan associations from National Banks, the court stated,

"These savings and loan associations do some of the same things which banks do, obviously. But they do not do a general banking business. They are set up under the declared Congressional purpose to provide thrift institutions in which people may invest their funds and to provide for the financing of homes. There is no danger of any single association becoming a giant monopoly. Its investment area is limited. The associations themselves can only be set up when in the judgment of the Board, those who apply for the charter are persons of good character and responsibility and there is a need for the institution in the community and a probability of its success . . ."

At page 698, the court said,

"Since the National Banking Act is wedded to the policy of conformity to State usages and laws, what the state and Judicial court of the State of Massachusetts stated in the case of Springfield Institution v. Worcester Fed. Savings and Loan Ass'n, 107 N.E.2d 315 (1952), at page 318 is significant,

'We see no reason to suppose that Congress intended that the Board should make regulations which should not be of

uniform application throughout the country. See Hopkins Federal Savings and Loan Association v. Cleary, 296 U.S. 315. It does not ensue because formerly under the national bank law the power to establish branches was withheld, First National Bank in St. Louis v. State of Miss., 263 U.S. 640, that Congress did likewise in the Home Owners' Loan Act. See Eddy v. Home Federal Savings and Loan Ass'n."

Furthermore, Congress has manifested its intent not to curtail the power of the Federal Home Loan Bank Board with respect to the establishment of branches and agencies of the federal savings and loan associations. Proposals were introduced into Congress to limit the Board's power in this respect in 1949, 1953, and 1955 but Congress failed to enact any of these proposals into law. (S. 2006, H.R. 4710, 81st Cong., 1st Sess. (1949); S. 975, 83rd Cong., 2nd Sess. (1954); S. 972, H.R. 5364, 84th Cong., 1st Sess. (1955)).

We now turn to the question of whether the legislature of Hawaii intended to exclude dividends from stocks other than from a National Bank in a Bank or other Financial Corporation's gross income. The language of subsection 121-5(c), Revised Laws of Hawaii 1955, as amended, clearly states that a corporation may deduct from its gross income dividends received from stock of a national banking association. A search of the legislative committee reports prepared prior to the enactment of subsection 121-5(c) in 1957 (which first permitted the deduction for dividends received from a national banking association), does not reveal any reasons for the enactment of the deduction nor any desire by the legislature to expand the deduction to include dividends other than from a national banking association. The statute is plain and unambiguous and must be given its obvious meaning. P.U.C. v. Narimatsu, 41 Hawaii 398 (1956), In re Taxes, Pacific Refiners, 41 Hawaii 615 (1957). It appears that the legislature intended that only dividends from a National Bank be deductible from the gross income of a Bank or other Financial Corporation.

To summarize, it is our opinion that Federal Home Loan Banks are not National Banks. Federal Home Loan Banks were created for a purpose different from that of National Banks; said purpose

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being to serve as a credit reserve for member institutions in the home-financing field. Furthermore, the Federal Home Loan Bank laws specifically exclude National Banks from obtaining shares of stock of Federal Home Loan Banks. Since all stock of the Federal Home Loan Banks are held by member institutions of the Banks, Congress has intentionally excluded National Banks from becoming part of the Federal Home Loan Bank System. Also, cases on federal savings and loan associations established pursuant to the Federal Home Loan Bank System have consistently held that these savings and loan associations are not National Banks.

Respectfully submitted,

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APPROVED:

/s/ Bert T. Kobayashi

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