BANKING & FINANCIAL INSTITUTIONS ALERT

1/22/15

A Bank or Not a Bank? MoneyGram Fails to Meet the Test in U.S. Tax Court

MoneyGram International Inc., (MoneyGram) the world's second-largest money transfer company, lost its bid before the U.S. Tax Court (the Court) to prove that it is a bank, and in so doing its quest to take advantage of provisions of the U.S. Tax Code regarding the type of tax deductions that banks may take. The adverse decision means that MoneyGram is unable to write off hundreds of millions of dollars in bad securities as ordinary losses. The closely-watched case sets forth some tax law guideposts for other financial institutions that do not fall into the category of conventional banks.

As with many banks and financial sector businesses, MoneyGram's problems started in 2007 when U.S. home prices plunged and the value of the company's mortgage-backed securities (MBS) began to tank. MoneyGram sold most of the securities at steep losses in 2008, and then attempted to deduct the securities as ordinary, as opposed to capital, losses. In the U.S. tax code, only banks may claim losses on instruments like mortgage backed securities as ordinary losses. The IRS disallowed the deductions and MoneyGram went before the Court to prove that it is a bank, and therefore entitled to claim the MBS losses as ordinary.

MoneyGram's claim rested on its argument that it accepts deposits and makes loans like a bank. However, MoneyGram is registered with the U.S. Department of the Treasury as a money services business, and not as a bank (the same holds true at the state level, as no state has incorporated the company or its affiliates as a bank). As noted in the court's opinion, that class of businesses is regulated under a different section of the U.S. Code than the one that applies to banks.

The Internal Revenue Code indicates that in order to qualify as a bank, a financial institution must meet three requirements:

- It must be a bank or trust company that is incorporated and does business under federal or state law;
- A substantial part of its business must come from receiving deposits and making loans and discounts; and
- The institution must be subject to supervision by federal or state banking authorities.

The Court found that MoneyGram failed on all three measures, and therefore failed to meet the "bare requisites" for bank status.

The Court held that MoneyGram's "deposits" are not deposits in the generally understood meaning of the term, because monies are remitted by the company's money order agents, and not customers. In addition, general members of the public cannot make direct deposits with MoneyGram. A similar analysis applied to MoneyGram's claim that it made loans. The "loans" were actually money order proceeds that the company allowed its agents to keep and use temporarily and were not loans made to actual borrowers. The "loans" were tracked on MoneyGram's books as accounts receivable. Finally, the Tax Court noted that, "MoneyGram is not regulated as a 'bank' by the Federal Reserve Board, the [Office of the Comptroller of Currency] or the [Federal Deposit Insurance Corp.], and it is not eligible for membership in the Federal Reserve System," the opinion said. "Rather, it is regulated as [a money services business]. Federal banking regulations specifically exclude MSBs from the definition of 'bank.'"

While heavily fact based, the MoneyGram decision should hold some precedential value to other financial institutions that do not fall into the category of conventional banks. Tax treatment of losses, particularly those similar to the MBS losses in the MoneyGram case, will rely heavily on the nature of the transactions and the relationship between the financial institution and the customer.

Please contact the following Roetzel attorneys for further information:

Brian E. Dickerson
Practice Group Manager – White Collar Litigation and Corporate Compliance
202.570.0248 | bdickerson@ralaw.com

James L. Ervin, Jr.
614.723.2081 | jervin@ralaw.com

Thomas M. Larned
202.697.4892 | tlarned@ralaw.com

Nicole Hughes Waid
202.906.9572 | nwaid@ralaw.com

This Alert is informational only and should not be construed as legal advice. ©2015 Roetzel & Andress LPA. All rights reserved. For more information, please contact Roetzel's Marketing Department at 330.849.6636.