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# "MoneyGram" Tackles Definition of "Bank"

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Many rules in our tax law apply only to "banks," as that term is defined in section 581 of the Internal Revenue Code (the "Code"). Perhaps surprisingly, it is not always obvious whether an entity is or is not a "bank" within the meaning of that provision, and significant tax obligations may turn on that issue. A recent Tax Court case, *MoneyGram International, Inc. v. Commissioner*,[1] interprets and applies the statutory definition in the context of special provisions providing liberal rules under which "banks" may claim deductions for bad debts.

**Background**

MoneyGram International, Inc. and its subsidiaries (collectively, "MoneyGram") provided payment services to consumers and financial institutions. In the case of its consumer-oriented business, MoneyGram sold money orders and provided money transfer services through a variety of agents, including banks, credit unions, supermarkets, convenience stores, and other retail businesses.

Typically, a consumer would pay cash to an agent for the amount of a money order, plus a fee. The form completed by the consumer would state that the agent was not accepting a "deposit." The money order would then be issued in blank, completed by the customer and delivered, and cleared through the banking system, typically within ten days.

The agent would remit the cash received to MoneyGram, either immediately or at intervals of, most commonly, twice a week. MoneyGram would derive revenue from such transactions through the transaction fees and, with respect to international money transfers, from the management of currency exchange spreads.

MoneyGram also provided "payment system" services to financial institutions, including (i) money orders to be sold to clients of the financial institutions and (ii) services (not described in detail in the opinion) to facilitate the issuance of official checks, such as bank checks and teller checks, by the financial institutions.

Many financial institutions would first enter into multi-year payment processing services agreements with MoneyGram, and (when the agreement was executed) provide funds to MoneyGram equal to the financial institution's anticipated daily volume of official checks. A financial institution's account balance with MoneyGram would then be adjusted on a daily basis, with reductions as official checks cleared and additions of additional payments by the financial institution as new official checks were issued and paid for.

Outstanding official checks and money orders were classified on MoneyGram's books as liabilities described as "payment service obligations."

MoneyGram derived revenue from these payment system services through fees received from the financial institutions and through the temporary investment of the funds remitted by the financial institutions until the official checks and money orders cleared.

MoneyGram was registered with the Department of the Treasury as a "money services business" (or "MSB"). It was subject to regulation as an MSB and to various state licensing and regulatory requirements as a money transmitter, including requirements relating to minimum net worth and provision of surety bonds.

MoneyGram was not subject to regulation, however, under title 12 of the United States Code, which governs "Banks and Banking"; and it was not regulated by any Federal banking regulator, such as the Federal Reserve Board, Office of the Comptroller of the Currency, or the Federal Deposit Insurance Corporation.

MoneyGram also did not maintain deposit insurance with the FDIC. It was, however, subject to financial regulation in each state in which it did business, typically by officials of the State banking department.

As of the beginning of 2007, MoneyGram held asset-backed securities valued at approximately $4,200,000,000, in order to maintain compliance with State law requirements concerning permissible assets and minimum net worth. The choice of securities

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was to some extent dictated by regulatory requirements.

Those securities were downgraded to "junk bond" status in many instances and lost much of their value in the financial downturn and severe turmoil in financial markets during 2007 and 2008. That loss in value in turn caused MoneyGram, by the end of 2007, to cease to be in compliance with State law requirements.

To continue in business and satisfy the demands of regulators, MoneyGram underwent a recapitalization in 2008 that included writing down or writing off many of these asset-backed securities, some but not all of which were interests in real estate mortgage investment conduits ("REMIC's"). In respect of the non-REMIC securities MoneyGram claimed losses under Code section 166(a) of more than $500,000,000 in 2007 and a smaller amount in 2008 on account of the securities' partial or complete worthlessness.

Special rules under Code section 165 limit the allowance of a loss attributable to a "security," defined in section 165(g)(2) to include stock in a corporation and a bond, debenture, note, or other evidence of indebtedness issued by a corporation or government with interest coupons or in registered form.

In general, a loss with respect to a debt security is allowable only upon a taxable disposition of the security or if it becomes worthless. Further, a loss by reason of the worthlessness of a security is treated as a loss from the sale or exchange of a capital asset—meaning that, subject to minimal exceptions, such losses can be used solely to offset capital gains.

MoneyGram had no capital gain net income during 2007 or 2008. It sought, however, to take advantage of special rules regarding losses from debt securities that are applicable to a bank as defined in section 581. If MoneyGram was a bank as defined in that section, then (1) Code section 582 would authorize MoneyGram to claim losses with respect to the debt securities by reason of partial worthlessness under section 166(a)(2) (to the extent of the amount charged off on its books), as well as by reason of complete worthlessness, and (2) the losses so claimed under section 166 would generally be characterized as ordinary deductions, rather than as capital losses—thereby more likely resulting either in a tax benefit in the year of the write-off or in a net operating loss that could be carried back or forward.

Presumably to provide further support (or at least not to undercut) MoneyGram's position that it was entitled to such deductions as a bank as defined in section 581, MoneyGram's 2008 tax return described its business activity as "banking" (a description not used by it in prior years) and its products and services as "financial services" (rather than as "money/wire transfers" as described in prior years). No significant change in the nature of MoneyGram's operations occurred from 2007 to 2008. The IRS determined that MoneyGram was not a "bank," as defined in section 581, and that the bad debt deductions it claimed for 2007 and 2008 under section 166 with respect to debt securities were therefore not allowable. MoneyGram petitioned the Tax Court for review of the resulting tax deficiency, and the parties filed cross-motions for summary judgment on this issue.

**Discussion**

The court analyzed the definition of the term "bank" in section 581 as having three components: that the entity must be a "bank or trust company" incorporated and doing business under the laws of the United States or of any State; that a substantial part of its business must consist of "receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under authority of the Comptroller of the Currency"; and that it must be subject to supervision by a State or Federal authority over banking institutions.

In respect of the first component, neither MoneyGram nor any of its subsidiaries had been chartered as a bank. The court acknowledged that an incorporated entity not chartered as a bank could nonetheless be a bank for this purpose if it possessed the "essential attributes" of a bank in accepting deposits and making loans or purchasing debt at a discount.[2]

The court concluded, however, that MoneyGram's practice of receiving and holding funds for temporary investment could not be viewed as accepting deposits, because, unlike typical deposits, the funds were not repayable to the depositors at a fixed time or on demand, but rather were paid to third party payees when official checks and money orders cleared.

The court also noted that the amounts that MoneyGram was entitled to receive from its agents were not classified on its books as loans to the agents, but rather as accounts receivable. Further, while banks normally charge interest on loans, MoneyGram charged no interest on the amounts due it from its agents unless payment was past due. Also, MoneyGram did not use "deposits" from its agents to make loans to other agents or anyone else; rather, the accounts receivable arose from payments that its agents owed to MoneyGram but had not yet paid to MoneyGram.

The court further concluded that, in respect of the second component of the requirements of section 581, no meaningful part of MoneyGram's business consisted of receiving deposits and making loans. The court noted that the funds received by MoneyGram from its agents and from financial institution customers were not placed with MoneyGram for safekeeping, or for extended periods of time, as part of MoneyGram's capital structure; rather, it was generally expected that those funds would be used to make payments to payees either simultaneously with the payment to its agent (in respect of money transfers), or within a few days where the funds related to money orders and official checks that had been issued but not yet cleared.

The second component of section 581 requires not only the receipt of deposits but also the making of loans as a substantial part of the business of a bank. The court found the circumstance that MoneyGram did not routinely collect interest, or book amounts owed to it as loans, as indicative that MoneyGram was not in the business of making loans.

Having concluded that MoneyGram did not meet either of the first two components of the requirements of the definition of a bank, the court found it unnecessary to consider whether MoneyGram met the third requirement, relating to supervision by banking authorities.

The court dealt briefly with MoneyGram's further argument that, as a matter of policy, MoneyGram should be allowed bad debt deductions with respect to its holdings of asset-backed securities. MoneyGram argued that it did not hold securities for speculation or profit, but rather because it was required to do so by reason of government regulation and as part of its regular course of business.

The court's response was that MoneyGram's position was not different from that of many other businesses (such as insurance companies) that could contend that they incur investment losses in the ordinary course of business, and that the court could not disregard the clear Congressional determination to limit the benefits of an ordinary deduction from the partial or full worthlessness of loans acquired in the form of securities to banks.

The court therefore concluded that MoneyGram was not a bank as defined under section 581, and therefore was not entitled to the benefits of section 582.

**Observations**

The result reached by the court is arguably harsh, taking into account the regulatory requirements and business exigencies that caused MoneyGram to hold large amounts of debt securities and then to suffer adverse business consequences from the rapid decline in value of the securities during financial market disruptions. The result seems, however, to be in line with what would generally be expected under the statutory regime.

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**1** 144 T.C. No. 1 (2015).

**2** See, e.g., *Staunton Industrial Loan Corp. v. Commissioner*, 120 F.2d 930 ($4^{th}$ Cir. 1941).