New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-89(15)C
Corporation Tax
December 18, 1989

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C890606A

On June 6, 1989, a Petition for Advisory Opinion was received from Philip L. Krevitsky, C.P.A., 277 Park Avenue, New York, New York 10172.

The issue raised by Petitioner, Philip L. Krevitsky, C.P.A., pertains to Article 32 of the Tax Law for taxable years ended 1985 and after. The question is whether a New York banking corporation, utilizing the "IBF modification" pursuant to section 1453(f) of the Tax Law, may adjust federal taxable income to reflect the income and expenses attributable to interbranch transactions between its New York international banking facility (hereinafter "IBF") and its foreign branches that are included in the computation of the IBF eligible net income.

A New York commercial bank (hereinafter "bank") has an IBF in New York and files its returns on a calendar year basis. For taxable years ended 1985 and after, the bank's foreign branches were the IBF's primary source of funds for making loans to third party foreign persons.

The bank contends that, for federal income tax purposes, the bank reflects interbranch income and expenses at gross when reporting federal taxable income and, as a result, corresponding interbranch transactions between the IBF and foreign branches are offset or wash. The bank asserts that the net effect of reporting interbranch transactions at gross, is equivalent to excluding income and expenses attributable to transactions between its IBF and its foreign branches, since the IBF is not recognized as a separate legal entity for federal income tax purposes.

The bank also contends that when it utilizes the IBF modification to arrive at entire net income, a distortive result is produced when gross income and gross expenses attributable to interbranch transactions between its IBF and its foreign branches wash in the calculation of federal taxable income. Therefore, the bank argues that before the IBF modification is made to arrive at entire net income, federal taxable income must be modified to restore the income and expenses included in the calculation of IBF eligible net income when such income and expenses have otherwise been offset or in effect eliminated in such federal taxable income.

Pursuant to section 1453(a) of the Tax Law, the starting point for computing entire net income is federal taxable income. For federal income tax purposes, an IBF is not recognized as a separate legal entity. Therefore, for federal income tax purposes, when the taxpayer's IBF borrows money from a foreign branch of the taxpayer, the interest expense of the IBF equals the interest income of the foreign branch. The same is true when the IBF lends money to a foreign branch of the taxpayer, the interest income of the IBF equals the interest expense of the foreign branch. As a result, interbranch transactions are offset or a wash.

When computing entire net income for taxable years 1985 and after, federal taxable income must be modified as required by sections 1453(b) through (k).

Section 1453(f) provides a modification for the adjusted eligible net income of an IBF. For taxable years 1985 and after, section 1453(f) provides, in pertinent part:

> [p]rovided the taxpayer has not made an election ... there shall be allowed as a deduction in determining entire net income, to the extent not deductible in determining federal taxable income, the adjusted eligible net income of an international banking facility...

Section 1453(f) further provides, in pertinent part:

> (1) The eligible net income of an international banking facility shall be the amount remaining after subtracting from the eligible gross income the applicable expenses.
>
> (2) Eligible gross income shall be the gross income derived by an international banking facility from:
>
> (A) making, arranging for, placing or servicing loans to foreign persons...
>
> (B) making or placing deposits with foreign persons which are banks or foreign branches of banks (including foreign subsidiaries or foreign branches of the taxpayer) or with other international banking facilities; or
>
> (C) entering into foreign exchange trading or hedging transactions related to any of the transactions described in this paragraph.
>
> (3) Applicable expenses shall be any expenses or other deductions attributable, directly or indirectly, to the eligible gross income described in paragraph two of this subsection.
>
> (4) Adjusted eligible net income shall be determined by subtracting from eligible net income the ineligible funding amount, and by subtracting from the amount remaining the floor amount.
>
> . . .

> (8) For the purposes of this subsection the term 'foreign person' means
> . . .
> (C) a foreign branch of a domestic corporation (including the taxpayer),
> . . .

Section 1453(f) was added by Chapter 288 of the Laws of 1978. Section one of such Chapter states that "the legislature intends by the enactment of this act to permit the establishment of New York based international banking facilities for the purpose of making loans to or accept [sic] deposits from certain foreign customers, free from ... state ... taxes." Such section also states that:

> provisions permit a domestic bank to make loans to and accept deposits from specified foreign customers through their New York based international banking facility under essentially the same conditions which exist outside the United States where that business is conducted now.
>
> The legislature further intends ... to provide for the exemption of the income of an international banking facility ... subject to a tax floor provision to maintain revenues from international business which is currently conducted from New York sites and, therefore, taxable ....

A memorandum of the Rules Committee regarding Chapter 288 of the Laws of 1978 (NY Legislative Annual, 1978, p. 198), states that:

> if the international banking facility should suffer a loss, the loss may not be taken against the income of the taxpayer's other branches ....
>
> A further limitation is placed on the amount of the exemption to protect revenues currently derived from existing business with foreign customers recorded on the books of the taxpayer's New York branches. . . . The limitation is based on a floor amount ....

As shown above, the eligible activities of an IBF are exempt from the franchise tax. However it was not intended that such exemption would reduce the tax revenue from the taxpayer's other activities.

A bank computes its IBF modification using the principles of separate accounting, as required by section 1453(f) of the Tax Law and Subpart 18-3 of the Franchise Tax on Banking Corporations Regulations. When computing such IBF modification, an improper result is achieved if the bank's entire net income does not include income and expenses attributable to interbranch transactions between its New York IBF and its foreign branches, because the IBF modification does recognize such transactions. The result would be an IBF modification for income and expenses that were not included in the computation of entire net income before the IBF modification. That is, the IBF modification would reduce the entire net income of the taxpayer's other activities, which, as shown herein, was not the intent of the Legislature. Therefore, the bank's entire net income as

determined before the IBF modification is allowed must recognize the interbranch income and expenses included in the computation of the IBF eligible net income. (Hessische Landesbank - Girozentrale, Advisory Op Comm T & F, May 16, 1988, (TSB-A-88(12)C)).

Therefore for taxable years 1985 and after, the bank must compute entire net income pursuant to section 1453(a) in accordance with the legislative intent outlined above. Before the IBF modification is made, the bank must modify federal taxable income to recognize the income and expenses included in the computation of the IBF eligible net income of its New York IBF when such income and expenses are not otherwise included in such federal taxable income or in the other modifications contained in section 1453. That is, the bank's entire net income must recognize the income and expenses attributable to interbranch transactions between the New York IBF and the bank's foreign branches. When computing the IBF modification pursuant to section 1453(f) for taxable years ended 1985 and after, the bank includes income and expenses attributable to interbranch transactions between the New York IBF and the bank's foreign branches in determining the eligible net income of its New York IBF. It should be noted, that the eligible net income of the New York IBF must be reduced by (1) the ineligible funding amount, computed pursuant to section 1453(f)(5) of the Tax Law and section 18-3.10 of the Franchise Tax on Banking Corporations Regulations, and (2) the floor amount, computed pursuant to section 1453(f)(6) of the Tax Law and section 18-3.11 of the Franchise Tax on Banking Corporations Regulations.

DATED: December 18, 1989

s/FRANK J. PUCCIA
Director
Technical Services Bureau

NOTE: The opinions expressed in Advisory Opinions
are limited to the facts set forth therein.