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

TSB-A-88 (12)C
Corporation Tax
May 16, 1988

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C870602B

On June 2, 1987, a Petition for Advisory Opinion was received from Hessische Landesbank - Girozentrale, 499 Park Avenue, New York, New York 10022.

The issue raised is whether, under Article 32 of the Tax Law for taxable years ended 1982, 1983 and 1984, an alien banking corporation may determine entire net income by excluding from gross income the interest income received from branches of the bank located outside the United States, while including interbranch income in determining the eligible gross income of its international banking facility ("IBF") for purposes of the IBF modification. Also, would the same principles apply for taxable years ended 1985 and after when Petitioner does not make the election to use the IBF formula allocation method.

Facts

Petitioner is an alien banking corporation organized in the Federal Republic of Germany. It has conducted a banking business in the United States and has had an IBF in New York State since 1981. Petitioner files its return on a calendar year basis. In the ordinary course of its business, payments have been made between various branches of Petitioner. These payments have consisted primarily of interest on funds loaned between branches. Some, but not all, of the payments made between branches have been recorded on the books of the IBF.

For federal income tax purposes, Petitioner includes in taxable income, pursuant to Internal Revenue Code ("IRC") section 882(a), "only gross income which is effectively connected with the conduct of a trade or business within the United States." Petitioner states that payments made by one branch of the bank to another branch (whether those branches are located within or without the United States) are not gross income to the bank, because they do not represent an accession to wealth to the taxpayer. Any such payments made between branches of the same corporation are not includible in gross income under IRC section 61 and, therefore, are not includible under IRC section 882.

Petitioner believes that it should properly exclude the interest and other payments received from its branches located outside the United States when determining New York entire net income. For taxable years beginning prior to January 1, 1987, section 1453 of Article 32 of the Tax Law defined entire net income as "the same as the entire taxable income which the taxpayer is required to report to the United States treasury department, except as hereinafter provided." Petitioner states that it properly excluded, from its federal gross income, interbranch income received from its foreign branches and that such income from foreign branches is not listed as an adjustment to federal taxable income in sections 1453(b) through (e) or in the regulations promulgated thereunder.

Petitioner also believes that the eligible net income of the IBF should include payments of interest received from foreign branches of Petitioner, together with the applicable expenses, notwithstanding that entire net income does not include such interbranch payments. Section 1453(f) of the Tax Law, and the regulations promulgated thereunder, provide that when computing entire net income a modification is allowed for the adjusted eligible net income of the IBF ("IBF modification").

It is Petitioner's understanding that in computing New York entire net income before allocation (under the law as in effect for 1981-1984 and under the IBF modification method after 1984) interest income from foreign branches of the taxpayer is properly includible in IBF eligible net income, but it is not included in entire net income before the modification for IBF adjusted eligible net income. A corollary of this understanding is that expenses from foreign branches of the taxpayer are properly includible in the computation of IBF eligible net income, but are not included in the computation of entire net income before the modification for IBF adjusted eligible net income.

Discussion

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, a corporation computes its federal taxable income by excluding income and expenses attributable to interbranch transactions, since only one legal entity is involved. For federal income tax purposes, an IBF is not recognized as a separate legal entity. Therefore, federal taxable income does not include income and expenses attributable to transactions between a taxpayer's IBF and the taxpayer's foreign branches.

When computing entire net income, federal taxable income must be modified as required by sections 1453(b) through (i) for taxable years 1982, 1983 and 1984, and by sections 1453(b) through (k) for taxable years 1985 and after.

Section 1453(f) provides a modification for the adjusted eligible net income of an IBF. For taxable years 1982, 1983 and 1984, section 1453(f) provided, in pertinent part:

> [t]here shall be allowed as a deduction from entire net income, to the extent not deductible in determining federal taxable income, the adjusted eligible net income of an international banking facility.

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.

For all taxable years at issue, section 1453(f) 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

(A) an individual who is not a resident of the United States,

(B) a foreign corporation, a foreign partnership or a foreign trust, as defined in section seventy-seven hundred one of the internal revenue code of nineteen hundred fifty-four, other than a domestic branch thereof,

(C) a foreign branch of a domestic corporation (including the taxpayer),

(D) a foreign government of an international organization or any agency of either, or

(E) an international banking facility ....

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, section 38.3 of the Tax on State Banks, Other Financial Corporations and National Banking Associations regulations for taxable years beginning prior to January 1, 1985 and Subpart 18-3 of the Franchise Tax on Banking Corporations regulations for taxable years beginning on or after January 1, 1985. 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 never 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 income and expenses included in the computation of the IBF eligible net income.

Conclusion

For taxable years 1982, 1983, 1984, 1985 and after, Petitioner must compute entire net income pursuant to section 1453(a) in accordance with the legislative intent outlined above. Before the IBF modification is made, Petitioner 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, Petitioner's entire net income must recognize the income and expenses attributable to interbranch transactions between the New York IBF and Petitioner's foreign branches. When computing the IBF modification pursuant to section 1453(f) for taxable years ended 1982, 1983, 1984, 1985 and after, Petitioner includes income and expenses attributable to interbranch transactions between the New York IBF and Petitioner's foreign branches in determining the eligible net income of its New York IBF.

DATED: May 16, 1988

s/FRANK J. PUCCIA
Director
Technical Services Bureau

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