

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

TSB-A-86 (5) C
Corporation Tax
January 30, 1986

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION

PETITION NO. C850520A

On May 20, 1985, a Petition for Advisory Opinion was received from Banco Popular de Puerto Rico, Box 2708, G.P.O., San Juan, Puerto Rico 00936.

The issue raised is whether, for taxable years 1975 through 1980, New York State has the authority to tax net U.S. source interest income earned on U.S. government obligations acquired by the foreign office of a banking corporation organized under the laws of a U.S. possession merely because that bank has an operating branch in New York State and the Internal Revenue Code requires that the interest from such securities be included in U.S. Federal taxable income pursuant to section 882(e) of the Internal Revenue Code.

Petitioner is a foreign banking corporation organized under the laws of Puerto Rico, a U.S. possession. For the taxable years at issue, Petitioner maintained banking branch offices in Puerto Rico, New York and California. Petitioner's offices in Puerto Rico had U.S. obligations as part of its investment portfolio. Such obligations were acquired by the home office and the physical securities were held at the Petitioner's offices in Puerto Rico or at correspondent banks. The New York and California branches did not purchase, fund or maintain the securities and did not know when the home office purchased or sold the securities. The interest income from such securities was recorded in the accounts of the Puerto Rican branches. The interest income from such securities was not effectively connected with the conduct of a trade or business within the U.S.

Pursuant to section 882(e) of the Internal Revenue Code, a bank organized in a U.S. possession that receives interest income from U.S. obligations which is not effectively connected with the conduct of a trade or business within the U.S. must treat such interest income as income which is effectively connected with the conduct of a trade or business within the U.S. Thus, Petitioner's interest income from U.S. obligations is included in Federal taxable income.

For the taxable years at issue, section 1455(a) of Article 32 of the Tax Law provided that the basic tax was 12 percent of the taxpayer's entire net income, or portion thereof allocated to New York State, for the taxable year.

Since the enactment of Article 32 entire net income has been defined in section 1453(a) as "total net income from all sources which shall be the same as the entire taxable income which the taxpayer is required to report to the United States treasury department, except as hereinafter provided." For the taxable years at issue, section 1453(b) through (h) of Article 32 provided for the modifications required by section 1453(a). However, there is no modification to exempt interest income from U.S. obligations which is treated as income effectively connected with the conduct of a trade or business within the U.S. pursuant to section 882(e) of the Internal Revenue Code.

For the taxable years at issue, the only regulations promulgated in accordance with section 1453 of Article 32 pertain to the modification for international banking facilities which is not herein at issue.

The regulations promulgated in accordance with Articles 9-B and 9-C of the Tax Law, the predecessors to Article 32, apply only to the extent that such regulations conform with the provisions of Article 32 and only in the absence of regulations promulgated in accordance with Article 32. In a letter to Commerce Clearing House, Inc., dated February 26, 1973, the Director of the Corporation Tax Bureau made the following statement:

"Inasmuch as the provisions of Article 32 conform with Articles 9-B and 9-C, except in areas of privilege period and Federal conformity, regulations issued under Articles 9-B and 9-C remain applicable except when they are in conflict with the provisions of Article 32. Federal taxable income is the starting point in computing entire net income and therefore Federal regulations applicable to such computation will be followed."

Therefore, a taxpayer that has interest income from U.S. obligations that is included in Federal taxable income pursuant to section 882(e) of the Internal Revenue Code must include such interest income in entire net income.

For the taxable years at issue, section 1454(a) of Article 32 provided that when entire net income is derived from business carried on both within and without New York State, such entire net income may be allocated within and without New York State under the rules and regulations prescribed by the Tax Commission. However, for the taxable years at issue, there were no regulations promulgated in accordance with section 1454 of Article 32 regarding allocation methods. Therefore, the allocation methods described in Part 35 of the Tax on State Banks, other Financial Corporations and National Banking Associations regulations issued under Articles 9-B and 9-C remain applicable. Petitioner states that for the taxable years at issue it allocates entire net income within and without New York State by using the principles of separate accounting.

Since interest income from U.S. obligations that is treated as income which is effectively connected with the conduct of a trade or business within the U.S. pursuant to section 882(e) of the Internal Revenue Code is not recorded on the books or records of the branches within the U.S., the portion of such interest income that is attributable to New York State is determined as follows:

1. To the extent that it is possible to determine the amount of such interest income from U.S. obligations that were used to meet Federal and State reserve requirements, multiply the amount of such interest income by a fraction the numerator of which is the amount of deposits within New York State for the taxable year that were subject to reserves and the denominator of which is the amount of total deposits for the taxable year that were subject to reserves.

2. Multiply the remaining amount of such interest income by a fraction the numerator of which is gross income (excluding such interest income) within New York State for the taxable year that was included in the computation of entire net income and the denominator of which is total gross income (excluding such interest income) for the taxable year that was included in the computation of entire net income.

Accordingly, when computing its tax under Article 32 of the Tax Law for taxable years 1975 through 1980, Petitioner must include in entire net income the interest income from U.S. obligations that is treated as income effectively connected with the conduct of a trade or business within the U.S. pursuant to section 882(e) of the Internal Revenue Code. However, since Petitioner states that it allocates entire net income within and without New York State by the principles of separate accounting such interest income is allocated within New York State by the method stated herein.

DATED: January 30, 1986

s/FRANK J. PUCCIA
Director
Technical Services Bureau

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