

Internal Revenue Service

Department of the Treasury

Number: **200125088**
Release Date: 6/22/2001
Index Number: 882.07-02

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:INTL:Br5-PLR-112772-00
Date:

March 28, 2001

Bank =

US-LLC =
Country A =
Country B =
State A =
City A =
Date a =
Date b =
Date c =
Date d =
Date e =
Date f =
Date g =

Dear :

This is in reply to a private letter ruling request dated Date a, requesting rulings under section 882 of the Internal Revenue Code of 1986 (“the Code”). Additional information supplementing the factual representations in the Date a submission, was provided in letters dated Date b, Date c, and Date g. The information submitted for consideration is substantially as set forth below.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Bank is an international banking institution that is incorporated under the laws of Country A and that maintains branches, representative offices, and subsidiaries in Country A and various other countries. As of the Date a date of Bank’s submission, Bank operated a U.S. branch office in State A under a State A banking license through which Bank represents, it was engaged in the active conduct of a banking, financing or

PLR-112772-00

similar business in the United States within the meaning of section 1.864-4(c)(5)(i) of the Income Tax Regulations (“Regulations”). Bank represents that on or about Date d, it surrendered its State A banking license and cease the active conduct of a banking business within the U.S. (For purposes of this ruling, the phrases “on or about Date d” and “Date d” are used interchangeably to mean the date Bank surrendered its State A banking license). Prior to terminating its U.S. banking business, Bank transferred certain assets, including loans and securities booked at the U.S. branch, to a branch in Country B. In its Date b letter, Bank represents that its branch in Country B is not a shell branch for the mere booking of assets and liabilities acquired and managed by Bank outside of Country B, but is staffed by personnel who manage the Country B assets and liabilities within Country B.

Bank represents in its supplemental letter dated Date g, that on or about Date d, Bank established a wholly owned U.S. based limited liability company named US-LLC that it treats as a disregarded entity within the meaning of section 301.7701-2(c)(2). US-LLC’s activities involve managing client funds, advising clients on investment strategies, and handling client trading activities. Bank represents that all of Bank’s activities in the United States have been conducted through US-LLC since on or about Date d and that US-LLC’s activities have constituted a U.S. trade or business of Bank since that time. Bank also represents, however, that such U.S. trade or business does not constitute the active conduct of a banking, financing or similar business in the United States within the meaning of section 1.864-4(c)(5)(i), because none of US-LLC’s activities consist of receiving deposits, making loans to the public, purchasing, selling, discounting, or negotiating for the public on a regular basis notes, drafts, checks, bills of exchange, acceptances, or other evidences of indebtedness, issuing letters of credit to the public and negotiating drafts drawn on the letters, providing trust services for the public, or financing foreign exchange transactions for the public. Subsequent to the termination of its U.S. banking business, a substantial part of the remainder of its worldwide business continues to consist of receiving deposits and making loans, discounting guarantees, and issuing letters of credit.

Bank is a calendar year, accrual basis taxpayer and has filed a U.S. Income Tax Return for a Foreign Corporation (Form 1120F) with the Internal Revenue Service Center in City a to report income effectively connected with its U.S. banking trade or business for tax years prior to the tax years ending on Date e. Bank represents that it was eligible for and made a timely filed election to use the 93% fixed ratio under section 1.882-5(c)(4) to allocate interest expense to its effectively connected income with respect to its U.S. branch banking operation. Bank further represents in its letter of Date c that subsequent to closing its U.S. banking branch, for years ending after Date e, Bank will continue to report as effectively connected income, all income from Bank’s U.S. trade or business conducted through US-LLC and all income and gains with respect to the securities and other assets acquired through the activities of Bank’s former U.S. banking branch that were transferred on Date d to its banking branch operation in Country B.

PLR-112772-00

Requested Ruling 1

For the tax year ending Date e, Bank has requested that for purposes of section 1.882-5(c)(4) of the Regulations, the original timely election made by Bank in its first eligible year to use the 93 percent fixed ratio, continue to apply for determining its U.S.-connected liabilities for the entire year even though Bank ceased its U.S. branch banking operations on Date d within the Date e taxable year.

Section 1.882-5 of the Regulations provides rules for determining the amount of interest expense of a foreign corporation that is allocable under section 882(c) of the Code to income that is (or is treated as) effectively connected with the conduct of a trade or business within the United States. Under these rules, a taxpayer must determine its worldwide liability-to-asset ratio. Section 1.882-5(c)(4) provides in relevant part:

[A] taxpayer that is a bank as defined in section 585(a)(2)(B) (without regard to the second sentence thereof) may elect to use a fixed ratio of 93 percent in lieu of its actual ratio. A taxpayer that is neither a bank nor an insurance company may elect to use a fixed ratio of 50 percent in lieu of the actual ratio.

A bank as defined in section 585(a)(2)(B) is a corporation that would otherwise meet the definition of a bank within section 581 except for the fact that it is a foreign corporation. Section 581 provides in relevant part:

[t]he term “bank” means a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia) or of any State, a substantial part of the business of which consists 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 which is subject by law to supervision and examination by State, or Federal authority having supervision over banking institutions.

Bank has not represented that it is a trust company or that a substantial part of its business in the United States consists of exercising fiduciary powers similar to those permitted to national banks under authority of the Comptroller of the Currency. Accordingly, it will only qualify as a bank within the meaning of section 581 if it engages in the other activities prescribed by the statute. Code section 585(a)(2)(B), by reference to section 581, requires a substantial part of Bank’s business in the United States to involve receiving deposits and making loans and discounts and that Bank be subject to regulatory supervision and examination by a State or Federal regulatory agency.

PLR-112772-00

Bank satisfied the definition of “bank” under section 585(a)(2)(B) and met the definition since the date of its section 1.882-5 election, through the beginning of its taxable year ending on Date e and up until it surrendered its State A banking regulatory license on or about Date d. After Bank relinquished its banking license, Bank was no longer permitted by the relevant bank regulatory authorities to take deposits in the United States. Therefore, although Bank remained engaged in a U.S. trade or business for all of its taxable year ended Date e, Bank ceased to meet the definition of a “bank” within the meaning of section 1.882-5(c)(4) and by reference, section 585(a)(2)(B) on or about Date d, before the end of its taxable year. Accordingly, based on the facts and representations submitted, after Bank surrendered its State A banking license, Bank ceased to meet the definition of a bank for purposes of section 1.882-5(c)(4).

After Date d, income with respect to assets transferred prior to that date from Bank’s former U.S. banking branch to its banking branch in Country B continues to be treated as effectively connected with Bank’s U.S. trade or business in the United States under section 864(c)(6) and gains with respect to dispositions of such property within ten years of Date d, are treated as effectively connected with Bank’s U.S. trade or business under sections 864(c)(7). Although Bank remains engaged in a U.S. trade or business on or about Date d, income with respect to transferred securities (as defined in sections 1.864-4(c)(5)(ii)(v) or 1.864-6(b)(2)(ii)(c)) is not effectively connected with Bank’s U.S. trade or business under sections 864(c)(2) or 864(c)(4)(B)(ii) after Date d, because after that date, Bank is no longer engaged in the active conduct of a banking, financing or similar business under section 1.864-4(c)(5)(i). Accordingly, after Date d, the material participation test under §1.864-4(c)(5)(iii) for determining whether a security is attributable to a U.S. office no longer applies to any of Bank’s securities that were originally attributable to Bank’s U.S. banking branch office prior to the surrender of Bank’s banking license.

Section 864(c)(6) provides-

(6) Treatment of Certain Deferred Payments, etc.- For purposes of this title, in the case of any income or gain of a nonresident alien individual or a foreign corporation which-

(A) is taken into account for any taxable year, but

(B) is attributable to a sale or exchange of property or the performance of services (or any other transaction) in any other taxable year,

the determination of whether such income or gain is taxable under section 871(b) or 882 (as the case may be) shall be made as if such income or gain were taken into account in such other taxable year and without regard to the requirement that the taxpayer be engaged in a trade or business within the United States during the taxable

PLR-112772-00

year referred to in subparagraph (A).

Section 864(c)(7) provides-

(7) Treatment of Certain Property Transactions.- For purposes of this title, if-

(A) any property ceases to be used or held for use in connection with the conduct of a trade or business within the United States, and

(B) such property is disposed of within 10 years after such cessation,

the determination of whether any income or gain attributable to such disposition is taxable under section 871(b) or 882 (as the case may be) shall be made as if such sale or exchange occurred immediately before such cessation and without regard to the requirement that the taxpayer be engaged in a trade or business within the United States during the taxable year for which such income or gain is taken into account.

Since Bank will not be engaged in a banking, financing or similar business after Date d, interest income with respect securities that were acquired with the material participation of Bank's U.S. branch office in a year prior to the year ending date e, will be income taken into account under section 864(c)(6)(A) that is attributable to "any other transaction" in another year and therefore, shall be treated as effectively connected with a trade or business of Bank in the United States under section 864(c)(6). For years ending after Date e, all interest income with respect to securities acquired through Bank's U.S. branch office prior to Date d shall be treated as effectively connected with a U.S. trade or business of Bank in the same manner under section 864(c)(6). Income with respect to all other assets acquired through Bank's U.S. trade or business prior to the year ending Date e that also gave rise to effectively connected income, gain or loss prior to their transfer to Bank's office in Country B or elsewhere outside the United States, shall also be effectively connected with Bank's U.S. trade or business in the same manner under section 864(c)(6).

For the year ending Date e, all U.S. source interest income for the year with respect to securities that were acquired before Date d, but within the year with the material participation of Bank's former U.S. banking office, is effectively connected with Bank's U.S. trade or business under sections 864(c)(2) and 1.864-4(c)(5)(ii) for U.S. source interest and under sections 864(c)(4)(B)(ii) and 1.864-5(a) for foreign source interest. Income, gains or losses with respect to the disposition prior to Date d of securities first transferred to Bank's banking branch in Country B, is effectively connected with Bank's banking, financing or similar business under sections 864(c)(2) and 1.864-4(c)(5)(ii).

Because Bank is no longer engaged in the active conduct of a banking, financing

PLR-112772-00

or similar business under section 1.864-4(c)(5)(i) after Date d, as of that date, all securities that were previously acquired with the material participation of Bank's U.S. office prior to the surrender of Bank's banking license on Date d, and which were transferred to Bank's banking branch in Country B, shall be property that "ceases to be used or held for use in connection with the conduct of a trade or business within the United States" within the meaning of section 864(c)(7)(A)." Accordingly, income or gain with respect to the disposition within 10 years of Date d, of such securities previously held for use in Bank's U.S. banking, financing or similar business shall be treated as effectively connected with a U.S. trade or business of Bank under section 864(c)(7) whether or not Bank continues to operate an advisory or other U.S. trade or business that does not constitute a banking, financing or similar business. Income or gain with respect to the disposition of other assets that gave rise to effectively connected income, gain or loss that were transferred to Bank's offices in Country B or elsewhere outside the United States shall also be treated as effectively connected with Bank's U.S. trade or business under section 864(c)(7).

Because Bank will be taxed after Date d on interest income with respect to assets that were originally acquired as part of a banking, financing or similar business, it will be necessary for Bank to use either a 93 percent fixed ratio or an actual ratio of its average worldwide liabilities to average worldwide assets in order to allocate an appropriate amount of deductible interest expense against income that is treated as effectively connected with Bank's U.S. trade or business for the year ended Date e.

Section 1.882-5(c)(1) provides:

Determination of total amount of U.S.-connected liabilities for the taxable year.

(1) *General rule.* The amount of U.S.-connected liabilities for the taxable year equals the total value of U.S. assets for the taxable year (as determined under paragraph (b)(3) of this section) multiplied by the actual ratio for the taxable year (as determined under paragraph (c)(2) of this section) or, if the taxpayer has made an election in accordance with paragraph (c)(4) of this section, by the fixed ratio.

Section 1.882-5(b)(3) provides:

Computation of total value of assets. The total value of U.S. assets for the taxable year is the average of the sums of the values (determined under paragraph (b)(2) of this section) of U.S. assets. For each U.S. asset, value shall be computed at the most frequent, regular intervals for which data are reasonably available. In no event shall the value of any U.S. asset be computed less frequently than monthly (beginning of taxable year and monthly thereafter) by a large bank (as defined in section 585(c)(2)) and semi-annually (beginning, middle and end of taxable year) by any other taxpayer.

PLR-112772-00

Sections 1.882-5(b)(3) and (c)(1) do not provide for the determination of the total value of U.S. assets and U.S.-connected liabilities under split-year or pro rata methods to arrive at combined total values for the full taxable year. Rather, a taxpayer's elected method must be applied to its total value of U.S. assets for the entire taxable year to determine its U.S.-connected liabilities. No proration of assets is provided for in section 1.882-5(b)(3) to determine the U.S.-connected liabilities attributable to the period that Bank met the definition of Bank under section 585(a)(2)(B). Further, section 1.882-5(c)(1) requires that "the actual ratio for the taxable year" or the fixed ratio be applied. Accordingly, the regulations contemplate that the method used by a taxpayer under a proper election for determining the total value of U.S.-connected liabilities must be applied for an entire taxable year.

Requested Ruling 2

For its taxable year ending Date f, Bank requests that it be permitted to switch to the actual ratio method provided for in section 1.882-5(c)(2)(i) to determine its U.S.-connected liabilities under section 1.882-5(c).

For taxable years beginning after Date e, Bank can no longer use the 93 percent fixed ratio method in determining its U.S.-connected liabilities because as of Date d, Bank no longer satisfies the definition of a "bank" under section 585(a)(2)(B)(without regard to the second sentence thereof). Accordingly, if Bank does not change its original election from the fixed to the actual ratio, Bank will be required to use a fixed ratio of 50 percent under the requirements section 1.882-5(c)(4).

Section 1.882-5(a)(7)(i) provides in relevant part:

[a]n elected method must be used for a minimum of five years before the taxpayer may elect a different method. To change an election before the end of the requisite five-year period, a taxpayer must obtain the consent of the Commissioner . . . The Commissioner . . . will generally consent to a taxpayer's request to change its election only in rare and unusual circumstances.

Bank is not eligible to make a new election with respect to the computation of its U.S.-connected liabilities under section 1.882-5(c) for the year ended Date f without the consent of the Commissioner. Although Bank remains engaged in a U.S. trade or business, it is no longer engaged in the active conduct of a banking, financing or similar business. However, Bank will continue to have income treated as effectively connected with a U.S. trade or business under sections 864(c)(6) with respect to assets originally acquired and funded in a former banking, financing or similar business. Accordingly, Bank needs to change its original election made under section 1.882-5(c)(4) from the fixed ratio to the actual ratio of average worldwide liabilities to worldwide assets in order to allocate an appropriate amount of interest expense

PLR-112772-00

associated with Bank's funding of its effectively connected income.

Based solely on the facts and representations submitted, Bank shall allocate interest expense under section 1.882-5 in the manner provided below and subject to the following conditions:

Ruling number 1:

Bank shall remain on the 93 percent fixed ratio method for the entire taxable year ending on Date e since Bank satisfied the definition of bank under section 585(a)(2)(B)(without regard to the second sentence thereof) for a substantial part of the tax year which included the beginning of the year. This ruling is subject to the following conditions at all times after Date d including, where indicated, taxable years ending after Date e:

1. Interest income, taxable year ended Date e: For the year ended Date e, interest income with respect to securities (as defined in section 1.864-4(c)(5)(v) or 1.864-6(b)(2)(ii)(c)) that were attributable to Bank's U.S. office under section 1.864-4(c)(5)(iii) or section 1.864-6(b)(2)(ii)(b) prior to the surrender of Bank's banking license on or about Date d, shall be effectively connected with Bank's U.S. trade or business under sections 864(c)(2) and 864(c)(4)(B)(ii) (for securities acquired in the year ending Date e) and treated as effectively connected with Bank's U.S. trade or business under section 864(c)(6) (for securities acquired in years prior to the year ended Date e), and subject to tax in the United States under section 882(a).
2. Interest income, taxable years after Date e: For all years ended after Date e, all interest income with respect to securities that were attributable to Bank's U.S. office under section 1.864-4(c)(5)(iii) or section 1.864-6(b)(2)(ii)(b) prior to the surrender of Bank's banking license on or about Date d, shall be treated as effectively connected with Bank's U.S. trade or business under section 864(c)(6) and subject to tax under section 882(a)
3. Other income: Income with respect to other assets transferred from the U.S. trade or business that were formerly acquired or used or held for use in the active conduct of Bank's former banking, financing or similar business shall be treated as effectively connected with Bank's U.S. trade or business under section 864(c)(6) and subject to tax in the United States under section 882(a).
4. Section 864(c)(7) treatment: All securities transferred from Bank's U.S. office to Bank's office in Country B or elsewhere outside the United States

PLR-112772-00

shall, after Date d, be property that “ceases to be used or held for use in connection with the conduct of a trade or business within the United States” within the meaning of section 864(c)(7). Securities that were attributable to Bank’s U.S. office under section 1.864-4(c)(5)(iii) or section 1.864-6(b)(2)(ii)(b) before Date d that were originally booked outside the United States shall be treated in the same manner after Date d, as securities transferred from Bank’s U.S. banking office. All other property transferred to Bank’s office in Country B or elsewhere outside the United States shall also be property that “ceases to be used or held for use in connection with the conduct of a trade or business within the United States” within the meaning of section 864(c)(7)” as of the date of such transfer. Gains with respect to the disposition within 10 years of Date d of all assets transferred from Bank’s U.S. office, shall be treated as effectively connected with Bank’s U.S. trade or business under section 864(c)(7) and subject to tax under section 882(a). Losses on the disposition of such securities and other assets that cease to be held in connection with Bank’s U.S. trade or business are treated as not effectively connected with Bank’s U.S. trade or business within the United States under section 864(c)(7) and shall not enter into the determination of Bank’s gross income under section 882(a)(2). In addition, losses with respect to such assets described in this paragraph shall not be allocable under sections 1.861-8, 865 or 882(c) as a deduction against Bank’s effectively connected income.

Ruling number 2

For the year ended Date f, Bank may switch to the actual ratio method prescribed in section 1.882-5(c)(2) in the manner provided in section 1.882-5(a)(7)(i) subject to all of the conditions described for the treatment of income, gains and losses in Ruling number 1, above. If Bank does switch to the actual ratio for the taxable year ending on Date f, Bank must remain on such method for a minimum of five years and may not make a new election before the end of such requisite period without the consent of the Commissioner or his delegate.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter including whether income with respect to any security that gives rise to U.S. source income is subject to tax under sections 881(a) or 1442. Further, Bank did not request and no opinion is expressed concerning the U.S. tax treatment of Bank under an income tax treaty in force between Country A and the United States.

A copy of this letter must be attached to any income tax return to which it is

PLR-112772-00

relevant, including any previously filed return.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely,
Paul Epstein
Senior Technical Reviewer
Branch 5, Office of Associate Chief
Counsel (International)