

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

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Date:
May 7, 2002

Bank =
BankUS =
Bank b =
Bank c =
Date a =
Date b =
Date c =
Date d =
Date e =
Date f =
Date g =
Month a =
Month b =
banking license=
City a =
City b =
Country a =

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"). 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 the United States and various other countries. Prior to Date b Bank operated a US branch office in City a under a banking license through which Bank represents it was engaged in the active conduct of banking, finance, or similar business within the meaning of Regulation 1.864-4(c)(5)(i). Bank's operations

satisfied the definition of "bank" under code sections 581 and 585(a)(2)(B). Bank represents that it surrendered its banking license on Date b.

Bank represents that surrendering its banking license required it to sell certain assets, including loans, loan commitments, and letters of credit to its US affiliate BankUS. The assets and liabilities recorded on the US branch's books and records were eliminated by Date d. Bank represents that it also transferred debt securities that were attributable to its U.S. office under section 1.864-4(c)(5)(iii), to its foreign branch office in City b in Month a. Bank represents that deposits ceased to be taken on its books and records during Month b.

Bank continued to hold a banking license even after it had transferred its assets and liabilities, and ceased to take deposits, because it continued to operate a US banking business with all transactions recorded on its City b books and records rather than on City a books and records. Bank represents that it surrendered its banking license on Date b. During this time, Bank's U.S. business involved marketing its foreign exchange products, making markets in interest rate derivatives, and trading emerging market currency and bonds. Throughout this time, even after Month b when Bank stopped taking deposits in its U.S. branch, Bank continued to file its U.S. tax returns using the fixed ratio method applicable to banks that it had elected under section 1.882-5(c)(4).

Bank represents that it relinquished its banking license when its parent on Date g purchased and merged Bank b into Bank c. Bank also represents that the merged corporation applied for a ruling with the banking license regulator that allowed Bank c to act as agent for Bank in City a without requiring it to have a banking license because Bank allowed City a employees to have discretion to book transactions on Bank's City b balance sheet. For U.S. tax purposes, Bank represents that as a result of the exercise of Bank c's discretionary activities conducted in the United States on behalf of Bank, that it continues to have a US permanent establishment under Article 7 of the United States-Country a Double Tax Convention entered into force on Date c.

REQUESTED RULING 1

For the tax year ending Date d, Bank requests that it be entitled to use the ninety three percent fixed ratio described in section 1.882-5(c)(4) for the entire taxable year.

REQUESTED RULING 2

For the tax year ending Date e, Bank requests permission to change its election pursuant to section 1.882-5(a)(7) from the fixed ratio method described in Regulation 1.882-5(c)(4) to the

actual ratio method described in 1.882-5(c)(2)(i) to determine its US connected liabilities under regulation 1.882-5(c). Bank represents that it can no longer use the 93 percent fixed ratio as of Date d because it no longer satisfied the definition of a "bank" under section 585(a)(2)(B) as a result of its cessation of taking deposits as a substantial part of its U.S. trade or business.

DISCUSSION

Section 1.882-5 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. 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(c)(4) provides:

ELECTIVE FIXED RATIO METHOD OF DETERMINING U.S. LIABILITIES. 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 the 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 is a banking institution resident in Country a that would meet the requirements of section 581 if it were a U.S. domestic corporation. It 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, Bank 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 consist of taking deposits and making loans and discounts, and that it be subject to regulatory supervision and examination by a State or Federal regulatory agency.

Bank only satisfied the definition of "bank" under section 585(a)(2)(B) through the end of its taxable year ending Date d, regardless of whether it continued to possess a banking license after this date. Possession of a banking license does not imply that an entity is a bank. Although Bank remained engaged in a U.S. trade or business after Date d, it stopped taking deposits and therefore failed to meet the definition of a "bank" within the meaning of section 1.882-5 and by reference, sections 585(a)(2)(B) and 581. Accordingly, based on the facts and representations submitted, after Bank ceased to take deposits, it could no longer apply the 93 percent elective fixed ratio method, permitted only to a taxpayer that is a bank, under 1.882-5(c)(4). Since after Date d Bank did not qualify as a bank under section 1.882-5(c)(4), it must request permission to switch to the actual ratio or automatically be subject to the 50% fixed capital ratio pursuant to 1.882-5(c)(4). Under section 1.882-5(a)(7), 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 ending Date e without the consent of the Commissioner.

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.

Based solely on the facts and representations submitted, Bank is permitted to 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 d 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.

RULING NUMBER 2

For the year ended Date e, Bank may switch to the actual ratio method prescribed in section 1.882-5(c)(2) by filing an amended tax return for such year. An amended return with respect to this election for the taxable year ended Date e may be satisfied by furnishing a written statement that includes this private letter ruling in the same manner prescribed by section 1.482-1(h)(2)(iii)(B) within 60 days of the date of this letter and without regard to the requirements of section 1.6664-2(c)(3). If Bank switches to the actual ratio for the taxable year ending Date e, 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. If Bank does not switch to the actual ratio for the taxable year ending Date e by filing an amended return, Bank may make the election with its original timely filed return (including extensions) for the year ended Date f. If Bank makes the actual ratio election for the year ended Date f, Bank must remain on the actual ratio for a minimum of five years even if Bank obtains another banking license in the United States and begins banking operations that qualify it as a bank within the meaning of section 585(a)(2)(B) (without regard to the second sentence thereof) during that minimum five year period. For any year as of the taxable year ended Date e that Bank does not make an actual ratio election, Bank's fixed ratio will be fifty percent.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences or any aspect of any transaction or item not discussed or referenced in this letter.

A copy of this letter must be attached to any income tax return to which it is relevant, including any amended or 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)