

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:INTL:Br5:PLR-109685-00
Date:

March 19, 2001

Bank =
Country A =
Country B =
Date a =
Date b =
Date c =
Date d =
Date e =
Date f =
Date g =
State A =
City a =
City b =

Dear :

This is in reply to a letter dated Date a, requesting rulings under sections 864 and 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 ruling, it is subject to verification upon examination.

Bank is a publicly held international banking and trust institution incorporated under the laws of Country A. Bank is a publicly-held corporation. Bank maintains branches in Country A and various other countries and currently has a representative office in the United States in City A, State A. Previously Bank was engaged in the active conduct of a banking, financing or similar business within the United States within the meaning of section 1.864-4(c)(5)(i) through the activities of a branch office in City A, a U.S. agency in City B and a branch in Country B whose activities were materially conducted through Bank's U.S. branch office in City A. (Collectively, Bank's "U.S. Branch"). Bank's Country B branch and the City B agency were closed during Bank's taxable year ending Date b while the City A branch was closed on Date c. On Date c, Bank surrendered its

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State A banking license and established a licensed representative office in City a the next day. Bank is an accrual basis taxpayer and has filed a U.S. Income Tax Return for a Foreign Corporation (Form 1120F) with the Internal Revenue Service to report income effectively connected with its U.S. banking trade or business for taxable years prior to Date b based on its fiscal year end of Date d.

Pursuant to its surrender of its U.S. branch banking license on Date c, Bank voluntarily withdrew from its regulated U.S. banking business and currently represents that it conducts trust-related activities in the U.S. through a wholly owned U.S. subsidiary. Prior to terminating its U.S. banking business, certain loans made to U.S. and non-U.S. borrowers, securities, interest rate swaps, undrawn loan commitments, and letters of credit ("Transferred Assets") that were booked at Bank's U.S. branch were transferred to and recorded on the books of Bank's head office in Country A. Bank represents that the interest rate swaps were acquired and held at all times as hedges of customers loans and that both the loans and hedge swaps were timely identified as held for investment and held in such capacity at all times prior to their transfer and subsequently while booked in Bank's home office. Bank also represents that U.S. personnel actively and materially participated in the acquisition of the Transferred Assets and that all income with respect to the Transferred Assets gave rise to effectively connected income prior to their transfer. Accordingly, Bank has indicated that among the Transferred Assets, the average total portfolio of securities described in §1.864-4(c)(5)(ii)(b)(3) does not exceed ten percent of the average total of all the Transferred Assets.

In the head office, the Transferred Assets are accounted for as a separate group of transactions that are funded much the same way Bank, through its former City A branch, funded the Transferred Assets that were formerly booked in Bank's Country B branch. The Transferred Assets and related funding is transacted in and accounted for in Country A as a U.S. dollar denominated book which is translated into Bank's functional currency for Country A purposes. As Transferred Assets are sold from the portfolio, the proceeds of the sale may not be used immediately to retire short-term funding, but rather loaned from the Transferred Asset book to the home office book until such time that a liability on the Transferred Book matures. Bank has represented that, to date, it has not and will not fund a Transferred Asset in contemplation of a sale of that Transferred Asset.

Bank has further represented that its U.S. representative office personnel regularly and continuously assist the head office in selling and restructuring the Transferred Assets and actively and materially participate in the negotiation, credit review, recommendation and preparation of agreements related to such sales and restructurings. The activities performed by the U.S. representative office also include customer relations, market research, credit review, loan administration support, loan sales support, and tax matters. Bank represents that its regular and continuous performance of these activities through its U.S. representative office constitutes a U.S. trade or business and that it will continue to file its tax returns on Form 1120F to report

CC:INTL:Br5:PLR-109685-00

income effectively connected with the active conduct of a banking, financing or similar business within the meaning of §1.864-4(c)(5)(i) for years in which such activities continue.

Based on the foregoing representations, Bank has requested the following five rulings:

1. Income earned by Bank on the Transferred Assets and subject to tax as effectively connected income under section 882 will continue to be taxed under section 882 after the U.S. branch was closed and the State A banking license was surrendered on Date c.
2. Bank will not be subject to tax under section 881(a) on U.S. source income earned by the Taxpayer with respect to the Transferred Assets.
3. For the entire tax year ending Date e, Bank may use the 93 percent fixed ratio under §1.882-5(c)(4) to compute its U.S. connected liabilities.
4. For the year ending Date g, that Bank be allowed to continue using the 93 percent fixed ratio or alternatively, that Bank be allowed to make a new election under §1.882-5(c) to use the worldwide actual ratio.
5. That Bank be allowed to treat liabilities that fund the Transferred Assets in the separately maintained book in the home office as U.S. booked liabilities under §1.882-5(d)(2).

Ruling Request 1

Bank has requested that income earned with respect to the Transferred Assets and which was subject to tax under section 882 as effectively connected income prior to Date c, continue to be treated as effectively connected income subsequent to the closing of the City a branch. The income Bank earns with respect to the Transferred Assets includes income from loans and securities, income from interest rate swaps used to hedge the transferred loans, and fees earned from loan commitments and letters of credit made in favor of U.S. customers.

Section 882(a)(1) provides-

A foreign corporation engaged in trade or business within the United States during the taxable year shall be taxable as provided in section 11, 55, 59A, or 1201(a) on its taxable income which is effectively connected with the conduct of a trade or business within the United States.

In determining the income effectively connected with the conduct of a trade or business within the United States, section 882(a)(2) states-

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In determining taxable income for purposes of paragraph (1), gross income includes only gross income which is effectively connected with the conduct of a trade or business within the United States.

Bank represents that although it has ceased conducting an active regulated banking business in the United States, it never ceased the active conduct of a U.S. trade or business and that the activities of its U.S. representative office continue to constitute the active conduct of a banking, financing or similar business within the United States within the meaning of section 1.864-4(c)(5)(i).

a. Income from Securities

Section 864(c)(1)(A) provides-

In the case of a nonresident alien individual or a foreign corporation engaged in trade or business within the United States during the taxable year, the rules set forth in paragraphs (2), (3), (4), (6) and (7) shall apply in determining the income, gain, or loss which shall be treated as effectively connected with the conduct of a trade or business within the United States.

Section 864(c)(2) provides for the effectively connected treatment of fixed, determinable, annual or other periodic U.S. source income described in section 881(a) under an asset use or business activities test. Section 864(c)(4)(B)(ii) provides for the effectively connected treatment of foreign source interest income only if it is attributable to an office or fixed place of business the taxpayer has in the United States.

Section 1.864-4(c)(5)(ii) provides in relevant part that interest from securities or any gain or loss from the sale or exchange of securities which are capital assets, which is from sources within the United States and derived by a foreign corporation in the active conduct of a banking, financing or similar business in the United States shall be treated as effectively connected for such year with the conduct of that business only if the securities giving rise to such income, gain, or loss are attributable to the U.S. office through which such business is carried on and the securities were acquired in the manner provided in section 1.864-4(c)(5)(ii)(a) or the securities have the characteristics alternatively described in section 1.864-4(c)(5)(ii)(b). Section 1.864-6(b)(2)(ii)(b) applies the principles of section 1.864-4(c)(5)(ii) in determining whether foreign source interest income, gain or loss with respect to securities that are capital assets is attributable to a U.S. office of a banking, financing or similar business.

Section 1.864-4(c)(5)(v) defines securities that give rise to U.S. source income as "any bill, note, bond, debenture, or other evidence of indebtedness, or any evidence of an interest in, or right to subscribe to or purchase, any of the foregoing items." Section 1.864-6(b)(2)(ii)(c) provides the same definition for securities that give rise to foreign source income.

CC:INTL:Br5:PLR-109685-00

In determining whether a security is attributable to a U.S. office or fixed place of business, section 1.864-4(c)(5)(iii)(a) provides in relevant part that a security “shall be deemed to be attributable to a U.S. office only if such office actively and materially participated in soliciting, negotiating, or performing other activities required to arrange the acquisition of the stock or security.” Bank represents that its U.S. banking branch materially participated in the acquisition of all the securities that are part of the Transferred Assets and that it remains engaged in the active conduct of a banking, financing, or similar business within the meaning of section 1.864-4(c)(5)(i) through the activities of its U.S. representative office.

Based on the representations made, income, gains and losses with respect to securities that are Transferred Assets is subject to tax in the United States as follows:

1. Interest income and gains or losses with respect to securities that give rise to U.S. source interest shall be attributable to Bank’s U.S. office or fixed place of business under section 1.864-4(c)(5)(iii) and shall be effectively connected with Bank’s U.S. trade or business under sections 864(c)(1)(A), 864(c)(2), 1.864-4(c)(5)(ii) and subject to tax under section 882(a).
2. Interest income with respect to securities that give rise to foreign source interest shall be attributable to Bank’s U.S. office or fixed place of business under section 1.864-6(b)(2)(ii)(b) and shall be effectively connected with Bank’s U.S. trade or business under sections 864(c)(1)(A) and 864(c)(4)(B)(ii), and subject to tax under section 882(a).
3. Gains or losses with respect to securities that give rise to foreign source interest shall be attributable to Bank’s U.S. office or fixed place of business under section 1.864-4(c)(5)(iii). For purposes of section 864(c)(7), securities that are Transferred Assets are not property that ceases to be used or held for use in connection with Bank’s banking, financing, or similar business within the United States. Such gains and losses shall be effectively connected with Bank’s U.S. trade or business under sections 864(c)(1)(A), 864(c)(2) and 1.864-4(c)(5)(ii), and subject to tax under section 882(a).
4. A new security acquired by Bank in exchange for a security that is a Transferred Asset, in a transaction subject to recognition under section 1.1001-3, with the material participation (as defined in §1.864-4(c)(5)(iii)) of Bank’s banking, financing or similar trade or business conducted through Bank’s U.S. representative office shall constitute a Transferred Asset. The income, gains and losses with respect to such newly acquired Transferred Asset shall be subject to tax under section 882(a) and shall be effectively connected with Bank’s banking, financing or similar business within the United States in accordance with paragraphs 1, 2 and 3, immediately above.

CC:INTL:Br5:PLR-109685-00

5. A new security acquired by Bank in exchange for a security that is a Transferred Asset, in a transaction subject to recognition under section 1.1001-3, without the material participation (as defined in §1.864-4(c)(5)(iii)) of Bank's U.S. trade or business, shall not constitute a Transferred Asset. Income, gains and losses with respect to such newly acquired Transferred Assets shall not be subject to tax under section 882(a) and shall not be effectively connected with Bank's banking, financing or similar business within the United States.

b. Interest Rate Swaps

Bank has represented that all notional principal contracts were timely identified under the requirements of section 1.1221-2, as hedges of securities that gave rise to effectively connected income prior to their transfer to Bank's home office in Country A. In addition, Bank represents that the securities hedged by the swaps were timely identified as held for investment in accordance with the requirements under section 475.

Section 1.863-7(b)(3) provides-

Notional principal contract income that under principles similar to those set forth in section 1.864-4(c) arises from the conduct of a United States trade or business shall be sourced in the United States and such income shall be treated as effectively connected to the conduct of a United States trade or business for purposes of sections 871(b) and 882(a)(1).

Based on Bank's representations, income with respect to Bank's interest rate swaps constitute notional principal contract income as defined in section 1.863-7(a) which is subject to the source rule provided in section 1.863-7(b)(3). Bank has represented that the swaps were entered into with the active and material participation of the personnel of the U.S. banking branch and that such swaps were held in the active conduct of such business as hedges of securities that give rise to effectively connected income.

Section 864(c)(6) provides-

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,

CC:INTL:Br5:PLR-109685-00

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 year referred to in subparagraph (A).

Section 864(c)(7) provides that “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.”

Beginning after Date c, based solely on the facts and representations submitted, income, expense, gains and losses with respect to the notional principal contracts shall be subject to tax in the United States as follows:

1. Income with respect to the notional principal contracts shall be U.S. source income and treated as effectively connected with Bank’s U.S. trade or business under sections 1.863-7(d), 864(c)(1)(A) and section 864(c)(6) and subject to tax under section 882(a).
2. Expense with respect to the notional principal contracts shall be directly allocated to Bank’s U.S. source effectively connected income under sections 882(c) and 1.861-8.
3. The notional principal contracts that are Transferred Assets and that are properly identified under the requirements of sections 475 and 1.1221-2 as hedges of securities that are capital assets that give rise to effectively connected income are not assets that cease to be held in connection with Bank’s U.S. trade or business. Gains and losses with respect to the disposition of such notional principal contracts shall be effectively connected under section 864(c)(1)(A) and 864(c)(2) and subject to tax under section 882(a).
4. Notional principal contracts that are Transferred Assets and that hedge securities that do not give rise to effectively connected income are property that ceases to be used or held for use in connection with the

CC:INTL:Br5:PLR-109685-00

conduct of Bank's banking, financing, or similar trade or business within the United States under section 864(c)(7)(A). Gains on the disposition within 10 years of Date c of such notional principal contracts 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 notional principal contracts 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 notional principal contracts shall not be allocable under sections 1.861-8, 865 or 882(c) as a deduction against Bank's effectively connected income.

c. Loan Commitment Fees

Bank represents that U.S. personnel performed the material activities in the U.S. trade or business and entered into the transactions which secure the availability of funds upon the need as agreed to with Bank's U.S. based resident customers. Based on Bank's representations, the fee income with respect to the loan commitment fees shall be subject to tax in the United States as follows:

1. The loan commitment agreements are (other transaction(s)) within the meaning of section 864(c)(6)(B).
2. Income with respect to the loan commitment agreements shall be treated as U.S. source effectively connected income under section 864(c)(6) and subject to tax under section 882(a).

d. Letters of Credit Fees

Bank represents that its Transferred Assets include letter of credit contracts that were entered into in the United States with U.S. resident customers prior to Bank's closing of its U.S. banking branch on Date c and that all income with respect to the letter of credit transactions would have been effectively connected if Bank had continued to hold the contracts in its U.S. trade or business.

i. Acceptance and Confirmation Fees

Acceptance and confirmation fees earned from letters of credit are sourced by analogy to interest, Bank of America v. U.S., 680 F.2d 142 (Cl. Ct. 1982) and are generally sourced by the residence of the obligor pursuant to section 861(a)(1). Under 864(c)(6), if the issuance of the confirmation and acceptance commissions would have been effectively connected income in the years the letters of credit were issued, the commissions will be effectively connected income in subsequent years regardless of whether Bank maintains a trade or business in the U.S. Bank represents that U.S.

CC:INTL:Br5:PLR-109685-00

personnel materially participated in issuing, confirming, and advising the letters of credit.

ii. Negotiation and Advisement Fees

Negotiation commissions charged for letters of credit are charged for the performance of personal services. Bank of America v. U.S., 680 F.2d 142 (Cl. Ct. 1982). Advisement fees, where the plaintiff informs the beneficiary of the letter of credit that a letter has been issued in his favor, are also charged for the performance of personal services.

Compensation for services performed in the U.S. is sourced in the United States Section 861(a)(3). Consequently, Bank's fee income related to the negotiation and advisement services performed in its U.S. banking branch is U.S. source income. Bank represents that the negotiation and advisement fees would have been effectively connected income if earned in the years the letters of credit were issued.

For taxable years beginning after Date b, based solely on the facts and representations submitted, Bank is subject to tax on the Letters of Credit that are part of the Transferred Assets as follows:

1. The acceptance and confirmation letters of credit entered into prior to Date c by Bank's U.S. trade or business with U.S. resident customers of Bank are "other transaction(s)" within the meaning of section 864(c)(6)(B) and the income earned with respect to such transactions after Date c is U.S. source income effectively connected with Bank's U.S. trade or business under section 864(c)(6) and is subject to tax under section 882(a).
2. The negotiation and advisory letters of credit entered into by Bank's U.S. trade or business prior to Date c are transactions from which all income should properly accrue prior to Date c. The income earned with respect to such transactions is U.S. source income effectively connected with Bank's U.S. trade or business under section 864(c)(2) and is subject to tax under section 882(a).

Ruling Request 2

Bank has requested that no tax be imposed under section 881(a) on U.S. source income earned by Bank with respect to the Transferred Assets. Based on Bank's representations under Requested Ruling 1, none of the interest income with respect to the Transferred Assets is subject to allocation under section 1.864-4(c)(5)(ii)(b)(3) and all income with respect to all of the Transferred Assets is subject to tax under section 882(a). Accordingly, no income with respect to the Transferred Assets is subject to tax under section 881(a).

CC:INTL:Br5:PLR-109685-00

As provided in Ruling 1, securities acquired by Bank without the material participation of the U.S. office or fixed place of business that are received in exchange for Transferred Assets in a transaction that is subject to recognition under section 1.1001-3 do not constitute Transferred Assets.

Ruling Request 3

Bank has requested that it be permitted to use the 93% fixed ratio under section 1.882-5(c)(4) to compute its U.S. connected liabilities for the entire taxable year ending Date e.

Section 1.882-5 provides rules for determining the amount of interest expense of a foreign corporation that is allocable under section 882(c) 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, U.S. connected liabilities must be determined by multiplying such liabilities by the taxpayer's actual worldwide liability-to-asset ratio. Section 1.882-5(c)(4) provides that 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.

Section 585(a)(2)(B) treats a foreign bank as a bank with respect to its activities effectively connected with a U.S. trade or business if it would meet the requirements of section 581 but for the fact it is a foreign bank. Section 581 defines a "bank" in relevant part to be:

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 does not meet the definition of a bank under section 581 after Date c because it represents that after that date, it is no longer engaged in the banking business under the laws of the United States or any State and it does not meet the other requirements of the statute with respect to its activities within the United States. However, Bank represents that a substantial part of its worldwide business both before and after Date c has and will continue to consist of receiving deposits, making loans and discounts, and exercising fiduciary powers.

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

an 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

CC:INTL:Br5:PLR-109685-00

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 represents that it timely elected under section 1.882-5(a)(7) to use the fixed ratio in determining its Step-Two U.S.-connected liabilities. Bank needs to switch to the actual ratio (as determined under section 1.882-5(c)(2)) in order to allocate an appropriate amount of interest expense associated with the funding of its effectively connected income. However, for the taxable year ended Date e, Bank requests to continue using the 93 percent fixed ratio for the entire year rather than change to the actual ratio for a portion of the year thus necessitating separate 1.882-5 allocations for the year.

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.

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 Date c, before the end of its taxable year ended Date e. 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 pro-ration 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 a bank under section 585(a)(2)(B). Further, the regulation requires that the actual ratio for the taxable year or the fixed ratio be applied. Accordingly, the regulations contemplate that the method

CC:INTL:Br5:PLR-109685-00

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.

Bank satisfied the definition of a bank under section 585(a)(2)(B) and met the definition since the date of its election, through the beginning of its taxable year ending on Date e and during that year until it surrendered its State banking regulatory license on Date c. However, although Bank ceased to satisfy the definition of a bank under section 585(a)(2)(B) after Date c, Bank represents that it remained engaged in a trade or business for the entire twelve month period ending on Date e.

Based solely on the submitted facts and representations, Bank will be permitted to remain on the 93 percent fixed ratio method for the entire tax year ending on Date e since Bank satisfied the definition of bank under section 585(a)(2)(B) for a substantial part of the tax year which included the beginning of the tax year.

Ruling Request 4

Bank has requested that if it is not allowed to use the 93 percent fixed ratio for the year ending Date g and subsequent years in determining U.S.-connected liabilities for the taxable year ending Date g, that it be permitted to make a new election under section 1.882-5(c) to use the actual ratio in determining U.S. connected liabilities.

Based solely on the facts and representations submitted, Bank is subject to the following treatment under section 1.882-5 for taxable years beginning after Date e:

1. Bank does not satisfy the definition of a bank under section 585(a)(2)(B). Accordingly, the fixed ratio applicable to Bank under section 1.882-5(c)(4) for tax years beginning after Date e is 50 percent.
2. Bank may elect to apply the actual ratio method prescribed in section 1.882-5(c)(2) in the manner provided by section 1.882-5(a)(7) for the tax year ending Date g. If Bank so elects, it is required under section 1.882-5(a)(7) to use the actual ratio for a minimum period of five years before Bank may elect the fixed ratio.

Ruling Request 5

Bank requests that it be permitted to treat liabilities booked at its head office in Country A which are used to fund the Transferred Assets as U.S. booked liabilities under section 1.882-5(d)(2)(ii).

Under section 1.882-5, a liability is a U.S. booked liability if it is properly reflected on the books of a U.S. trade or business. Section 1.882-5(d)(2)(i). A liability is properly reflected on the books of the U.S. trade or business of a foreign corporation that is a bank as described in section 585(a)(2)(B) (without regard to the second sentence thereof) if the bank enters the liability on a set of books relating to an activity

CC:INTL:Br5:PLR-109685-00

that produces effectively connected income before the close of the day on which the liability is incurred and there is a direct connection or relationship between the liability and that activity. Section 1.882-5(d)(2)(iii). However, for the reasons stated in Ruling 3, after Date c, Bank no longer qualifies as a bank as described in section 585(a)(2)(B) (without regard to the second sentence thereof) because it does not meet the statutory requirements of section 581 with respect to its trade or business operations within the United States. Accordingly, Bank may not determine its eligibility to treat the funding of the Transferred Assets as U.S. booked liabilities under section 1.882-5(d)(2)(iii). Instead, after Date c, Bank must determine its eligibility to treat the offshore funding of the Transferred Assets by foreign personnel as U.S. booked liabilities under the requirements of section 1.882-5(d)(2)(ii) which is applicable to a foreign corporation that is not a bank.

Section 1.882-5(d)(2)(ii) provides in relevant part-

(A) *In general.* A liability, whether interest bearing or non-interest bearing, is properly reflected on the books of the U.S. trade or business of a foreign corporation that is not a bank as described in section 585(a)(2)(B) (without regard to the second sentence thereof) if-

- (1) The liability is secured predominantly by a U.S. asset of the foreign corporation;
- (2) The foreign corporation enters the liability on a set of books relating to an activity that produces ECI at a time reasonably contemporaneous with the time at which the liability is incurred; or
- (3) The foreign corporation maintains a set of books and records relating to an activity that produces ECI and the District Director or Assistant Commissioner (International) determines that there is a direct connection or relationship between the liability and that activity. Whether there is a direct connection between the liability and an activity that produces ECI depends on the facts and circumstances of each case.

Bank represents that all newly acquired funding that is posted to and accounted for on the separate set of books it maintains in its home office to account for the Transferred Assets is entered onto such books before the close of the day on which the liability was incurred. Bank also represents that the book is fully accounted for through a subsidiary ledger in Country A and that no liabilities are acquired to fund Transferred Assets in contemplation of their sale or disposition.

Based on the facts and representations submitted, Bank's liabilities that are acquired to fund the Transferred Assets held in a separate book in Country A are treated under section 1.882-5 as follows:

1. The U.S. dollar liabilities that are entered onto the same U.S. dollar denominated book in which the Transferred Assets are accounted for

CC:INTL:Br5:PLR-109685-00

relate to an activity that produces ECI at a time reasonably contemporaneous with the time at which the liability is incurred within the meaning of section 1.882-5(d)(2)(ii)(A)(2). Consequently, the liabilities properly acquired to fund the Transferred Assets shall constitute U.S. booked liabilities that are properly reflected on the books of Bank's U.S. trade or business under sections 1.882-5(d)(2)(i) and (ii).

2. A funding of a Transferred Asset or group of Transferred Assets in contemplation of its sale or disposition may be disregarded by the Commissioner or his delegate and treated as not properly reflected on the books of Bank's U.S. trade or business under sections 1.882-5(d)(2)(i) and (ii).

Summary

Based on Bank's representations, Bank is subject to tax in the United States in accordance with its ruling requests as follows:

Ruling Request 1

All income with respect to the Transferred Assets which is not allocated under section 1.864-4(c)(5)(ii)(b)(3) shall be subject to tax under section 882(a). Any securities that are acquired in a sale or disposition without the material participation of Bank's U.S. trade or business shall not constitute Transferred Assets. However, any newly acquired securities that are acquired with the material participation of Bank's U.S. trade or business office shall constitute Transferred Assets and be subject to tax under section 882(a). Losses on the disposition of notional principal contracts that do not properly hedge one or more securities that are Transferred Assets at the time of disposition shall be treated as losses with respect to property that ceases to be used or held for use in Bank's U.S. trade or business. Under section 864(c)(7), losses with respect to such notional principle contracts shall not be treated as effectively connected with Bank's U.S. trade or business and shall not enter into the determination of Bank's gross effectively connected income under section 882(a)(2). Such losses may not be allocated as a deduction against effectively connected income under section 1.861-8, 865 or 882(c).

Ruling Request 2

All income with respect to the Transferred Assets which is not allocated under section 1.864-4(c)(5)(ii)(b)(3) shall not be subject to tax under section 881(a).

Ruling Request 3

Bank may continue to use the 93 percent fixed ratio under section 1.882-5(c)(4) for the tax year ended Date e.

Ruling Request 4

CC:INTL:Br5:PLR-109685-00

For the tax year ending Date g, Bank may change to the worldwide actual ratio provided by section 1.882-5(c)(2) in the manner provided by section 1.882-5(a)(7). If Bank adopts the worldwide ratio for the year ending Date g, Bank must remain on such method for a minimum of five years.

Ruling Request 5

Bank's funding of the Transferred Assets that is managed and accounted for in Bank's home office personnel in Country A shall constitute U.S. booked liabilities under sections 1.882-5(d)(2)(i) and (ii). Any liability acquired in contemplation of the sale of a Transferred Asset may be disregarded by 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, at any time, Bank's U.S. representative office has been or will be engaged in a U.S. trade or business;

Whether any of the Transferred Assets are securities as defined in sections 1.864-4(c)(5)(v) and 1.864-6(b)(2)(ii)(c);

Whether Bank's securities give rise to effectively connected income under section 1.864-4(c)(5)(ii) and (iii) in whole or in part;

Whether income with respect to any security that gives rise to U.S. source income is subject to tax under section 1442;

Whether Bank funded one or more Transferred Assets in contemplation of sale;

Whether any of the liabilities acquired to fund the Transferred Assets constitute bank deposits described in section 871(i), original issue discount described in section 871(g) or portfolio indebtedness described in section 881(c), or whether interest with respect to such liabilities is subject to tax under section 884(f)(1)(A) or section 1442.

Further, Bank did not request and no opinion is expressed concerning the U.S. tax treatment with respect to the Transferred Assets under an income tax treaty in force between Country A and the United States.

CC:INTL:Br5:PLR-109685-00

A copy of this letter must be attached to any income tax return to which it is relevant, including any previously filed return. This ruling is directed only to the taxpayer requesting it. Section 6110(j)(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.

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