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STATEMENT OF AUDIT PROCEDURE

DISCRETIONARY ADJUSTMENT FOR IBF WITH FUNDING FROM DOMESTIC SOURCES

I. BACKGROUND

The New York City Bank Tax law provides special tax treatment for a banking corporation that has established an International Banking Facility (“IBF”). This special treatment allows the taxpayer to reduce the tax it would otherwise be required to pay (“IBF benefit”). This benefit was granted as a way of fostering banking transactions with foreign persons from facilities located in New York City. Qualifying transactions, generally those made between the IBF and foreign persons, are treated for New York City Bank Tax purposes as if the transaction occurred in a foreign office of the taxpayer.

Under current law, taxpayers may elect one of two methods to compute this benefit:

- IBF Modification of Income Method (Admin. Code §11-641(f))
- IBF Formula Allocation Method. (Admin. Code §11-642(b)(2)(A))

Under the modification method, the IBF’s “adjusted eligible net income” is deducted from the taxpayer’s entire net income. In computing adjusted eligible net income of the IBF, the taxpayer first computes the IBF’s “eligible gross income” and “applicable expenses” to arrive at the “eligible net income” of the IBF. Two modifications of the IBF’s eligible net income yield the IBF’s “adjusted eligible net income”. One of these modifications ensures that only foreign funding sources are used to fund the IBF’s banking transactions with foreign customers.

Under the formula allocation method, the taxpayer obtains the IBF benefit by excluding from the numerator of its allocation factors (receipts, deposits and wages) the amounts properly attributable to its eligible IBF activity. (Administrative Code section 11-642 (b)(2)((A) (i), (ii) and (iii))

The formula allocation method was enacted as part of the 1985 Bank Tax law in an effort to simplify the taxation of banks in New York State and New York City. At the time of its enactment, the 1985 Bank Tax law was described as “a revenue neutral law”. There was no intent to expand the IBF benefit available to banks under the modification method and allow the IBF benefit to include amounts earned by the IBF from domestic funding. Existing statutory provisions limit the ability of a taxpayer to modify its income allocation percentage by the use of domestic IBF receipts and deposits in computing the IBF benefit. These provisions, however, are not effective where a significant portion of the IBF’s funding is from domestic sources. Thus, in such instances the Commissioner should exercise his or her authority under Section 11-642(a)(6) of the New York City Administrative Code in order to avoid the distortion of entire net income allocated to the City.

II. SCOPE

This Statement of Audit Procedure will give guidance to auditors examining the reasonableness of the amount of IBF receipts excluded by the taxpayer from the numerator of its receipt allocation factor.

III. PROCEDURE

When a taxpayer, with an IBF, elects the formula allocation method, the auditor will review funding for the IBF assets and receipts to ensure that the taxpayer has not distorted its entire net income allocated to New York City.

IBF receipt amounts in excess of what could reasonably have been generated by the eligible funding will not be allowed to distort the taxpayer’s receipt factor. Because it is difficult to precisely determine when a taxpayer’s entire net income allocated to the City is distorted by IBF receipts generated from ineligible funding sources, the auditor will not examine whether there is a potential distortion in allocation of entire net income unless the ratio of ineligible IBF funding (funding from non-foreign sources) to total IBF funding exceeds 20%. This ratio should be calculated on an average daily basis. If the ratio exceeds 20%, the auditor should examine other relevant facts and circumstances before recommending that the Commissioner’s discretion be exercised.

Total IBF funding is the sum of total IBF liabilities and all other sources of the IBF’s funds as computed in accordance with section 3-03 (c)(10)(ii) of Title 19 of the Rules of the City of New York.

IV. EFFECTIVE DATE

This SAP is effective immediately for all open years.

