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NEW YORK CITY DEPARTMENT OF FINANCE

UPDATE ON AUDIT ISSUES

IBF

Bank Tax Audit International Banking
Facility and Transactions with
Offshore Facilities (shell).

June 2006

I. ISSUE

This issue pertains to corporations that have an International Banking Facility (IBF) located in New York City and have elected to use the IBF formula allocation method. Are IBF deposits and loans with offshore facilities / shell operations considered eligible transactions? Are these IBF deposits and loans deemed to be transactions with a foreign person?

I. CITE

Under the NYC Administrative Code, Section 11-641 (F)(8), which defines the term "foreign person" for New York City tax purposes, loans made by an international banking facility to an offshore facility/shell and deposits placed with an IBF by an off shore facility/shell do not generate eligible gross income. In addition, any liabilities and sources of funds that an IBF receives from an offshore facility/shell constitute ineligible deposits.

An offshore facility/shell is an operation which may be reflected 1) separately in the taxpayer's books and records or 2) as part of a bonafide office or a branch. In essence, a shell operation is one where none or nearly none of the activities associated with the shell are actually conducted by the shell. Typically, the shell has little or no substance at its claimed offshore location. At most, a set of books is maintained, a brass plate is on a door, and a designated agent is named at an offshore location. The bank which created the shell actually conducts all of the activities attributed to the shell, in New York or elsewhere in the United States. The bank merely books all transactions as offshore.

Furthermore, eligible gross income under the IBF formula allocation method does not include 1) gross income from transactions with branches of the taxpayer or 2) gross income that is not eligible income under the IBF modification method (which includes not effectively connected income of an alien bank's IBF).

I. RECOMMENDATION

Corporations that have an IBF located in New York City and have elected to use the IBF formula allocation method must properly reflect their entire net income allocation percentage and their alternative entire net income allocation percentage. To properly reflect the allocation percentage for the receipts and deposits factors, corporations must include gross receipts generated from IBF assets placed with offshore facilities in the numerator (deemed New York City receipts) and include in the numerator for deposits, liabilities placed with an IBF by the offshore facilities (deemed New York City deposits).