FINANCE
NEW • YORK
THE CITY OF NEW YORK
DEPARTMENT OF FINANCE

June 19, 2003

Re: Request for Ruling
Banking Corporation Tax

FLR#034802-006

Dear :

This is in response to your request for a ruling dated April 11, 2003 regarding the application of the issued capital stock tax base (described below) under the New York City Banking Corporation Tax ("Bank Tax") to Bank X, a hypothetical Japanese bank, in the circumstances described below. Additional information was received on April 16 and 17, 2003.

FACTS

Bank X is a banking corporation organized under the laws of Japan. Bank X does business through an authorized branch that operates in New York City (the "City"), and is, therefore, subject to the Bank Tax. Until its last fiscal year, Bank X had outstanding par value stock. Japan recently changed its laws to eliminate par value stock. As a result, Bank X's par stock was converted into no par stock during its last fiscal year. Consequently, as explained below, Bank X's Bank Tax liability on its issued capital stock is greater than what its Bank Tax liability would have been had Bank X been organized in the United States (a "domestic bank") subject to a Bank Tax computed on assets allocated to New York City (the "allocated asset base").

ISSUE

You have requested a ruling as to whether the Bank Tax based on issued capital stock as applied to Bank X violates the U.S.-Japan Tax Treaty when the tax computed on issued capital stock is greater than the tax calculated as if Bank X were a domestic bank subject to a tax on the allocated asset base.

CONCLUSION

Based on the hypothetical facts presented, the Bank Tax computed on issued capital stock, as applied to Bank X, violates the U.S.-Japan Tax Treaty only if Bank X's tax liability is greater than the highest applicable Bank Tax calculated as if Bank X were a domestic bank, and not simply greater than the amount of tax calculated under the allocated asset base.

DISCUSSION

The Administrative Code of the City of New York (the "Code"), imposes the Bank Tax at the highest of nine percent of a taxpayer's entire net income allocated to the City ("allocated entire net income") or one of several alternative taxes (collectively with the tax on entire net income, the "applicable taxes"). *See* Code § 11-643.5. For domestic banks, the starting point for determining allocated entire net income is worldwide income. *See* Code §11-641(a)(1); Internal Revenue Code ("IRC") §§ 61, 63. One of the alternative applicable taxes for domestic banks is computed on the domestic bank's allocated asset base. This tax is imposed at a rate of one-tenth of a mill for every dollar of assets allocated to the City. Code §11-643.5(b)(1). Under the applicable provisions of the Rules of the City of New York ("RCNY"), real and tangible personal property assets are to be valued at cost while loans, investments and other intangible property assets must be valued at book value for purposes of calculating the tax due. See Title 19 RCNY § 3-03(e)(2)(iii). The other applicable taxes for domestic banks are a tax of three percent of taxpayer's alternative entire net income allocated to the City ("allocated alternative entire net income")[1] and a minimum tax of $125. Code §§ 11-643.5(b)(3), 11-643.5(b)(4).

For alien banks, *i.e.* banks organized under the laws of a country other than the United States, the starting point for determining both allocated entire net income and allocated alternative entire net income is effectively connected income and not worldwide income. *See* Code § 11-641(a)(3); IRC §882. In addition, alien banks are not subject to the tax on the allocated asset base. Rather, alien banks are subject to an alternative tax based on the value of the alien bank's issued capital stock. The capital stock-based tax is imposed at a rate of 2.6 mills for each dollar of value of the alien bank's issued capital stock. Code §11-643.5(b)(2)(i). If the stock has a par value, the tax is calculated using the par value,

[1] Alternative entire net income allocated to the City is determined in the same way as entire net income except that certain interest and dividend income that is deducted in determining entire net income is not deducted for purposes of alternative entire net income. *See* Code §§ 11-641.1, 11-641(e)(11) & (12).

but, if the stock does not have par value, the tax is calculated using the actual or market value of the stock, but the market value cannot be less than five dollars per share.[2] *Id.*

In the hypothetical situation presented, Bank X's liability computed under the capital stock base is higher than what its liability would have been had it been a domestic bank subject to the tax on the allocated asset base.

The United States and Japan are parties to the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, July 9, 1972, U.S.–Japan, art. 7, 23 U.S.T. 967 (hereinafter the "Treaty"). Article 7 of the Treaty provides in part: "A permanent establishment which a resident of a Contracting State has in the other Contracting State shall not be subjected in that other Contracting State to *more burdensome taxes than a resident of that other Contracting State carrying on the same activities.*" Treaty, art. 7, ¶ (2) (emphasis added) (hereinafter the "non-discrimination provision"). Under article 3 of the Treaty, a Japanese corporation is a resident of Japan. Treaty, art. 3, ¶ (1)(a). Article 9 of the Treaty defines the term "permanent establishment" to include a branch. *Id.*, art. 9, ¶¶ 1, 2(c). Accordingly, Bank X is entitled to the protection afforded by the Treaty's nondiscrimination provision with respect to its branches in the United States.

Under article 1 of the Treaty, article 7, the non-discrimination provision, applies to "taxes of every kind imposed by a Contracting State *or a political subdivision or local authority thereof.*" Treaty, art. 1, ¶(3) (emphasis added). The Treaty defines terms "Contracting State and the "other Contracting State" to mean the United States or Japan, as the context requires. *Id.*, art. 2, ¶(1)(c). Accordingly, the Bank Tax is subject to article 7 of the Treaty.

The quoted language from article 7 does not specify whether the relevant comparison for purposes of the Treaty is between a Japanese corporation and a corporation incorporated in the United States (a "U.S. corporation") carrying on the same activities, or between the U.S. branch of the Japanese corporation and a U.S. corporation that is carrying on the same activities. However, case law and other authority suggest that, for purposes of the Bank Tax, the relevant comparison is between the tax imposed on a Japanese corporation with a branch in the City and the tax imposed on a U.S. corporation with a branch in the City that is carrying on the same activities. *See* Matter of Reuters Ltd. v. Tax Appeals Tribunal, 82 N.Y.2d 112, 116 (1993) ("[T]he purpose of the nondiscrimination clause is to protect foreign taxpayers against local economic discrimination derived from disparate tax treatment. The ultimate taxpayer … is the corporate entity … not its branch affiliate. Thus, … the potential discriminatory effect of New York's franchise tax [cannot be measured] by reference to … [a] New York branch as an enterprise discreet from its … parent…." The nondiscrimination language in the U.S.-U.K. tax treaty at issue in Reuters is very similar to the nondiscrimination provision.) *See also* Commentary on Organization for Economic Cooperation and Development Model Tax Treaty ("OECD Commentary"), Article 24, ¶¶ 36, 37, 38 (2001) (taking into account the income of the

[2] The $ 125 minimum tax is the same for alien banks as it is for domestic banks. *See* Code § 11-643.5(b)(4).

entire alien entity does not offend a non-discrimination clause if a domestic entity is taxed in the same way); OECD Commentary, Article 24, ¶¶ 38, 39, 40 (1977) (same).[3]

In our opinion, Article 7 of the Treaty precludes the City from imposing a greater Bank Tax liability on a Japanese bank with a branch in the City than would apply to the same bank if it were a domestic bank. *See* Reuters, at 116; Lufthansa v. City of New York, 57 A.D.2d 533 (1st Dept. 1977) *affg. for the reasons stated at* 85 Misc.2d 719 (Supreme Court, New York County 1976). A domestic bank is subject to the highest of the four applicable taxes under section 11-643.5. For this reason, to invoke the non-discrimination provision, Bank X's would have to establish that its highest applicable tax liability as an alien bank is greater than its highest applicable tax liability calculated under all of the applicable taxes as if Bank X, and not just the City branch, were a domestic bank. The comparison would not simply be between Bank X's liability under the capital stock-based tax and the tax liability that would have been imposed on the allocated asset base if Bank X were a domestic bank. *See* Reuters, 82 N.Y.2d at 116; OECD Commentary, article 24, ¶¶ 37, 38 (2001); OECD Commentary, article 24, ¶¶ 39, 40 (1977). Based on the hypothetical facts presented, the tax computed on issued capital stock as applied to Bank X violates the Treaty's nondiscrimination provisions *only if* Bank X's liability calculated thereunder exceeds the highest applicable tax liability calculated under all of the applicable taxes as if Bank X were a domestic bank.

Sincerely,

Devora B. Cohn
Associate Commissioner
For Legal Affairs

[3] The OECD Commentaries are for a model treaty that contains a non-discrimination provision that is very similar to the one in the Treaty.