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HIGHLIGHTS

	<u>Page</u>
LEGISLATIVE & REGULATORY	Institute Considers Further Steps Regarding Concerns with the Treatment of International Banks Under the SEC's Consolidated Supervised Entity/Alternative Net Capital Rule.....2
	Institute Urges Inclusion of Proposed Capital Equivalency Deposit/Asset Pledge Amendment in Regulatory Reform Legislation.....2
TAX	Institute Commencing Effort to Allow Branches To File Consolidated Returns with Subsidiaries.....2
	IRS Issues Proposed Rules for Securities Valuations.....3
	IRS Relaxes Partnership Withholding Tax Rules.....3
	Institute Continues Earnings Stripping Efforts.....3
	Institute Exploring Further Options Regarding OECD Discussion Draft on Taxation of Permanent Establishments.....4

The Institute's mission is to help resolve the many special legislative, regulatory and tax issues confronting **internationally headquartered** financial institutions that engage in banking, securities and/or insurance activities in the United States.

299 Park Avenue, 17th Floor, New York, N.Y. 10171

Telephone: (212) 421-1611 Facsimile: (212) 421-1119

E-Mail: IIB@IIB.ORG <http://www.iib.org>

Everett Schenk, Chairman Lawrence R. Uhlick, Executive Director

INSTITUTE CONSIDERS FURTHER STEPS REGARDING CONCERNS WITH THE TREATMENT OF INTERNATIONAL BANKS UNDER THE SEC'S CONSOLIDATED SUPERVISED ENTITY/ALTERNATIVE NET CAPITAL RULE

As a follow-up to its extensive communications to senior U.S. and European officials, the Institute is considering further steps to address ongoing concerns with the duplicative and burdensome consolidated supervision requirements imposed on international banks seeking the favorable alternative net capital treatment under the SEC's consolidated supervised entity (CSE) rule and the resulting disparity when compared to the full deference accorded by the EU to the SEC's supervision of U.S. securities firm financial groups. The Institute has also expressed concerns about the competitive inequity resulting from restricting the economic benefit of the CSE rule to only those banks with the largest U.S. broker dealer capital even when other international banks have larger broker dealer capital and operations globally. (Institute submissions and related documents are available on the Institute's web site at <http://www.iib.org/member/Other-Regs/>.)

The Institute has arranged a conference call for interested member banks on June 7th to discuss further collective steps to deal with these concerns.

INSTITUTE URGES INCLUSION OF PROPOSED CAPITAL EQUIVALENCY DEPOSIT/ASSET PLEDGE AMENDMENT IN REGULATORY REFORM LEGISLATION

In a letter dated May 18, 2005 to Rep. Spencer Bachus, Chairman of the Financial Institutions Subcommittee of the House Financial Services Committee, the Institute urged the inclusion of the Comptroller of the Currency's proposed capital equivalency deposit (CED)/asset pledge amendment in regulatory relief legislation. As previously reported, the Comptroller's amendment would eliminate the statutorily mandated 5% capital equivalency deposit for federal branches of international banks in favor of a risk-based approach. Meanwhile, as reported in the April 7, 2005 issue of *International Banking Focus*, the New York State Banking Department is considering providing additional relief under its asset pledge requirement. The Banking Department in December 2002 significantly reduced its asset pledge requirement applicable to state-licensed branches and agencies of international banks, following a multi-year initiative in this area by the Institute and our member institutions. This initiative has resulted in considerable savings each year for our members. (For background, see Institute memoranda and related documents at www.iib.org/member/AssetPledge/).

INSTITUTE COMMENCING EFFORT TO ALLOW BRANCHES TO FILE CONSOLIDATED RETURNS WITH SUBSIDIARIES

As previously reported, following a meeting with the Institute's tax committee, interested member banks and professional liaison firms, the Institute has decided to lobby Congress to amend the tax law to enable branches to file consolidated returns with subsidiaries. A principal benefit of such a change in the law would be to allow losses of U.S. subsidiaries to offset income of the branch and *vice versa*. As currently drafted, the proposal would not modify other aspects of the taxation of branches, such as Treasury Regulation section 1.882-5 governing interest expense and the branch profits tax under section 884 of the Internal Revenue Code.

A number of interested member banks have joined the working group that will participate in making decisions regarding this effort, would attend meetings in Washington and would help defray the costs of the Institute's tax counsel. Additional members would be welcome.

IRS ISSUES PROPOSED RULES FOR SECURITIES VALUATIONS

The Internal Revenue Service has issued proposed guidance for dealers (and electing traders) in securities, commodities, currencies and derivatives (collectively, “securities”) in determining the “marked to market” value of their securities positions under Internal Revenue Code section 475. When finalized, the proposed regulations will provide an elective safe harbor that will permit these taxpayers to use the “fair values” of their positions in securities, as reported on their U.S. GAAP financial statements, as the fair market values of those positions for purposes of section 475, generally without risk of audit challenge to those valuations by the IRS.

In releasing this proposal, the IRS is seeking to avert the sort of audit controversies that have arisen regarding the application of the mark-to-market requirement, including in particular as to the valuation of derivatives and the adjustments that most financial institutions make to mid-market prices to account for credit risks and certain administrative costs. One such audit resulted in the *Banc One* case, in which the Institute joined in an *amicus* brief filed by a group of industry associations.

Unfortunately, the proposed regulations do not provide clear guidance as to their application to foreign financial institutions, and foreign institutions will need to consider whether they have U.S. GAAP financial statements that satisfy the requirements of the safe harbor. The issue arises in the context of U.S. branches of foreign banks as well as cross-border dealing activities of foreign financial institutions. The Institute will be seeking clarifications in this regard from the IRS.

IRS RELAXES PARTNERSHIP WITHHOLDING TAX RULES

The Internal Revenue Service has issued final and temporary regulations under Internal Revenue Code section 1446, dealing with the obligations of a partnership to withhold tax in respect of a foreign partner’s share of the partnership’s U.S. business income. These regulations respond favorably to comments submitted by the Institute and others that the prior rules needed to be relaxed to allow a partnership to take into account losses at the partner level in determining the amount of withholding tax.

In general, the new rules permit a non-U.S. partner that has filed U.S. tax returns for at least 4 years to certify to the partnership the level of net operating loss carryovers that would be available to offset the partner’s share of taxable income from the partnership. Provided certain conditions are satisfied, the partnership may rely on that certification to reduce the amount of withholding tax by up to 90 percent. However, current year losses of the partner may not be taken into account.

While not as generous as they might have been, these new rules nonetheless will ameliorate the problem faced by member banks and their non-U.S. affiliates with U.S. tax losses, in respect of operations conducted through partnerships, where the partnership would be required to withhold tax even though the partner has no tax liability and will be eligible to receive a refund of the withheld tax after it files its tax return for the year.

INSTITUTE CONTINUES EARNINGS STRIPPING EFFORTS

The Institute is continuing to monitor closely developments in Washington regarding possible proposals to amend the “earnings stripping” rules, which limit the amount of interest expense that foreign-owned businesses can deduct under certain circumstances.

Latest indications are that the Treasury Department will not meet the June 30th deadline that Congress set for a report regarding the effectiveness of the existing rules.

The Highway Bill that was recently passed by the Senate included among its revenue provisions a proposal (that had been contained in proposed legislation last year) to extend the earnings stripping rules to corporate partners in respect of partnership debt by applying the earnings stripping rules separately at both the partner and the partnership level. This proposal would inappropriately discriminate against activities conducted through partnerships. The Institute made this point to the Senate Finance Committee staff last year, and if there is continued concern among member institutions, will raise this point again.

**INSTITUTE EXPLORING FURTHER OPTIONS REGARDING OECD
DISCUSSION DRAFT ON TAXATION OF PERMANENT ESTABLISHMENTS**

As the OECD Working Party continues its work on its draft report on the attribution of profits to branches of banks and other permanent establishments (PEs), the Institute continues to explore ways to persuade the OECD to modify its agreed upon method to take account of concerns expressed by the Institute and other industry groups.

In coordination with the European Banking Federation, the Institute is seeking a broader dialogue and unified effort with groups that are being organized by non-financial industries to express their concerns regarding the draft report.

In addition, we continue to believe that if the financial industry wishes to secure improvements in the manner in which PEs will be taxed under the OECD approach, it will be important for banking associations to discuss the industry's concerns with their respective country's tax representatives to the OECD.