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

N E W   Y O R K   C I T Y   D E P A R T M E N T   O F   F I N A N C E

UPDATE ON AUDIT ISSUES

B A N K I N G
C O R P O R A T I O N

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Interest Income on obligations of N.Y. State, its political subdivisions, or U.S.

I. ISSUE

Is a banking corporation entitled to the 22½% deduction for interest earned on government obligations it holds as inventory or in its trading accounts?

I. CITE

Pursuant to N.Y.C. Adm. Code § 11-641(e)(12) a deduction of "twenty-two and one half percent of interest income on obligations of New York State, or of any political subdivision thereof, or on obligations of United States, other than obligations held for resale in connection with regular trading activities, " is available to banking corporation tax filers.

I. RECOMMENDATIONS

The New York City Department of Finance has consistently maintained that there are many reasons a banking corporation may hold government obligations for resale in connection with regular trading activities. For example, the Department of Finance has determined that the 22-½% deduction is not available with respect to interest income from government obligations held:

in the trading accounts,
in the inventory accounts,
for the purpose of reselling for short-term profit,
to hedge positions taken in the trading account, and
to hedge against fluctuations in value of inventory.

The Department of Finance recognizes that interest income from government obligations held by a banking corporation for investment purposes are entitled to the 22-½% deduction. Examples of qualified investments for 22-½% exclusion are government obligations held:

in the investment account,
to satisfy the minimum capital requirements of a regulatory agency,
to meet a regulatory agency's liquidity requirements, and
to manage a banking corporation's overall risk in connection with the management of its assets and liabilities (general risk management).

The New York State Department of Taxation and Finance originally considered interest earned on government obligations which a banking corporation traded for its own account, or which were held by a banking corporation to manage risks as part of its market making activities in swaps and other derivatives, as eligible for the 22 ½% deduction.

In 2004, NYS issued a technical services bulletin in which they changed this position. Upon further review, NYS said that “a better reading of the statutory position is that a banking corporation is not entitled to the 22 ½% deduction for interest earned on any government obligations it holds as inventory or it holds in its trading accounts.” NYS TSB-M-04 (3)(C), 5/19/2004.

NYS applied the revised interpretation of the statute to years beginning on or after January 1, 2004. The NYC Department of Finance consistently applied its position regarding which holdings qualify for the 22-½% deduction, so its interpretation applies to all open periods.