INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Year(s) Involved:
Date of Conference:

LEGEND:

Foreign Bank =

City =

State Banking Authority =

Tax Year =

U.S. Dollar Amount =

X =

ISSUE:

When a foreign bank's U.S. branch acquires medium term notes ("MTNs") in the interbank market and posts them as collateral at the Federal Reserve Bank Discount

Window to secure funding for its U.S. banking business, is the entire amount of interest income on such securities effectively connected with the conduct of its U.S. banking business, or must the interest income be allocated between effectively connected and non-effectively income under Treas. Reg. § 1.864-4(c)(5)(ii)(*b*)(*3*)?

CONCLUSION:

Because the U.S. branch did not acquire the MTNs in the course of making loans to the public, in the course of distributing such securities to the public, or to satisfy reserve requirements or other requirements similar to reserve requirements established by a U.S. banking authority, the interest income on such securities is not effectively connected income in its entirety. Such interest income must be allocated between effectively connected and non-effectively income under Treas. Reg. § 1.864-4(c)(5)(ii)(*b*)(*3*).

FACTS:

Foreign Bank engages in a banking business in the United States through a branch office ("Branch") located in City. Branch's banking license is issued by State Banking Authority, and Foreign Bank is subject to reserve requirements of the U.S. Federal Reserve System under Federal Regulation D (12 CFR 204). Through the U.S. activities of Branch, Foreign Bank makes loans to the public and takes third-party and interbranch deposits, which are recorded on Branch's books.

In the conduct of its U.S. banking business, Branch actively and materially participated in soliciting and negotiating various liquidity and credit-support commitments with U.S. resident counterparties, including various letters of credit, standby bond purchase agreements, and standby asset purchase agreements (collectively, "Commitments"). The Commitments outstanding during Tax Year obligated Foreign Bank to provide its U.S. counterparties with an aggregate U.S. Dollar Amount of liquidity and credit support. Foreign Bank holds all loans made to the public by Branch for its own account and not for sale to customers. In Tax Year, Foreign Bank reported income earned with respect to the Commitments as income effectively connected with a U.S. trade or business.

The Commitments outstanding during Tax Year constituted over X percent of Branch's total average assets for the year and exposed Foreign Bank to significant liquidity risk. Foreign Bank's internal written policies for liquidity risk management procedures, which were reviewed by the Federal Reserve in the ordinary course of its regulation of Branch, require Branch to maintain ready access to Federal Reserve Bank Discount Window funding to ensure liquidity in the event of a market disruption. To maintain such access, Branch was required under the Federal Reserve Board's Regulation A (12 CFR 201) to post collateral valued at one hundred percent of the funds eligible for ready access.

Accordingly, Foreign Bank acquired certain securities solely to pledge as collateral with the Discount Window. These securities were medium term notes that each had more than one year to maturity from the date they were acquired. The MTNs were issued by commercial banks on the interbank market and were all acquired through the material participation of Branch. Foreign Bank acquired the MTNs through broker/dealers. In certain cases, Foreign Bank subscribed to MTNs prior to their issue date. In other cases, it purchased the MTNs on or after their issue date. None of the MTNs were held on Foreign Bank's books for longer than seven days prior to being placed as collateral at the Discount Window. Foreign Bank treats the MTNs as securities under Treas. Reg. § 1.864-4(c)(5)(v).

LAW AND ANALYSIS:

General rules for determining when income is ECI:

Under section 882, a foreign corporation is taxed on a net basis on income effectively connected with a U.S. trade or business. Section 864(c) defines what income is effectively connected income ("ECI"). This determination depends on whether the income is (a) U.S. source periodical income, or gain or loss from the sale or exchange of capital assets, (b) other U.S. source income, gain or loss, or (c) foreign source income, gain or loss.

Under section 864(c)(2) and Treas. Reg. § 1.864-4(c)(2) and (3), U.S. source periodical income of the types described in sections 871(a), 871(h), 881(a) and 881(c) (i.e., fixed or determinable annual or periodic or "FDAP") and U.S. source gain or loss from the sale or exchange of capital assets is ECI if either (1) it is derived from assets used in or held for use in the conduct of the U.S. trade or business (the "asset-use test") or (2) the activities of such trade or business were a material factor in the realization of such income, gain or loss (the "business-activities test").

Under section 864(c)(3) and Treas. Reg. § 1.864-4(b), all other U.S. source income, gain or loss not covered by section 864(c)(2) is treated as ECI.

Under section 864(c)(4), certain types of foreign source income are treated as ECI--including foreign source dividends, interest, or amounts received for the provision of guarantees of indebtedness--that are derived in the active conduct of a banking, financing, or similar business within the United States and that are attributable to a U.S. office of the taxpayer. Treasury Regulation § 1.864-5(b)(2) describes the scope of this ECI treatment to include foreign source interest and dividends, as well as foreign source gains or losses from the sale of stocks or securities. However, section 865(e)(2) supersedes this regulation with respect to the source of income from the sale of stocks or securities attributable to a U.S. office. Under section 865(e)(2), gain or loss from such sales is U.S. source gain or loss. Thus, such income will be tested for ECI treatment under section 864(c)(2) and Treas. Reg. § 1.864-4 rather than section 864(c)(4) and

Treas. Reg. § 1.864-5. Consequently, this U.S. source gain or loss will be subject to Treas. Reg. § 1.864-4(c)(5)(ii).

Special rules for determining ECI of a U.S. banking, financing, or similar business:

Treasury Regulation § 1.864-4(c)(5) provides special rules for determining ECI treatment when U.S. source FDAP and U.S. source gain or loss from the sale or exchange of capital assets is derived in the active conduct of a banking, financing, or similar business in the U.S. Under Treas. Reg. § 1.864-6(b)(2)(ii)(*b*), the principles in Treas. Reg. § 1.864-4(c)(5) also apply to make the ECI determination when such income is foreign source. Treasury Regulation § 1.864-4(c)(5)(ii) states that its special ECI rules for U.S. banking, financing or similar businesses apply notwithstanding the asset-use and business-activities tests that generally apply to U.S. source FDAP and U.S. source gain or loss from the sale or exchange of capital assets.

Treas. Reg. §1.864-4(c)(5)(i) provides that the U.S. trade or business of a foreign corporation shall be considered a banking, financing, or similar business if the activities of such business consist of (a) receiving deposits of funds from the public, (b) making personal, mortgage, industrial, or other loans to the public, (c) purchasing, selling, discounting, or negotiating for the public on a regular basis, notes, drafts, checks, bills of exchange, acceptances, or other evidences of indebtedness, (d) issuing letters of credit to the public and negotiating drafts drawn thereunder, (e) providing trust services to the public, or (f) financing foreign exchange transactions for the public.

When a foreign corporation engages in a banking, financing, or similar business, Treas. Reg. § 1.864-4(c)(5)(ii) provides that, notwithstanding the asset-use and business-activities tests, U.S. source dividends or interest or U.S. source gain or loss from the sale of stocks or securities that are capital assets shall be treated as ECI only if the stocks or securities giving rise to such income, gain, or loss are attributable to the U.S. office through which such business is carried on and were acquired (1) as a result of, or in the course of making loans to the public, (2) in the course of distributing such stocks or securities to the public, or (3) for the purpose of being used to satisfy the reserve requirements, or other requirements similar to reserve requirements, established by a duly constituted banking authority in the United States. Treasury Regulation §1.864-4(c)(5)(iii) provides that a stock or security will be attributable to a U.S. office only when such office materially participates in soliciting, negotiating, or performing other activities required to arrange the acquisition of the stock or security. The U.S. office does not have to be the only participant involved in the acquisition of the stock or security.

For purposes of the foregoing, Treas. Reg. § 1.864-4(c)(5)(iv) provides two examples of when a stock or security shall be considered acquired as a result of or in the course of making loans to the public. First, it shall be considered to be so acquired where the stock or security is received as additional consideration for the making of the loan. Second, it shall be considered to be so acquired if the stock or security is received in

foreclosure upon a bona fide default of the loan and is held as an ordinary and necessary incident to the active conduct of the business. Treasury Regulation § 1.864-4(c)(5)(iv)(c) provides that a stock or security acquired on a stock exchange or organized over-the-counter ("OTC") market shall be considered not to have been acquired as a result of, or in the course of, making loans to the public.

In addition to providing ECI treatment for stocks and securities acquired in the manners or for the purposes described above, Treas. Reg. § 1.864-4(c)(5)(ii) further provides that U.S. source income, gain or loss from other securities that are not so acquired shall be treated as ECI if they are attributable to the U.S. office and (1) are payable on demand or at a fixed maturity date not exceeding one year from the date of acquisition, or (2) are issued by the United States, or any agency or instrumentality thereof.

The ten-percent rule:

When a security is attributable to the U.S. office through which the banking, financing, or similar business is carried on but does not fit into one of the categories for ECI treatment described above, it falls into a residual category. Securities in this residual category are commonly referred to as "(*b*)(*3*) securities" because the category is defined in subdivision (*b*)(*3*) of Treas. Reg. § 1.864-4(c)(5)(ii). These (*b*)(*3*) securities are subject to a special rule—the Ten-Percent Rule—that limits the amount of their income, gain, or loss that is ECI. To determine the amount that is ECI, the interest income on the (*b*)(*3*) securities or the amount of gain or loss from the sale or exchange of (*b*)(*3*) securities is multiplied by a complex fraction. The numerator of this fraction is fixed at ten percent (hence, the "ten-percent" rule). The denominator is itself a fraction expressing the ratio of (1) the monthly average book value of the (*b*)(*3*) securities over (2) the monthly average book value of the total assets of the U.S. banking, financing, or similar business.

Treasury Regulation § 1.864-4(c)(5)(ii) provides an example of this Ten-Percent Rule limitation. Assume that a U.S. banking branch has $7,500,000 in interest income from (*b*)(*3*) securities and that the ratio of average (*b*)(*3*) securities to the branch's total assets is 15%. In that case, the Ten-Percent Rule fraction is 10% over 15%. Thus, under the Ten-Percent Rule, the amount of interest income from the (*b*)(*3*) securities that shall be treated as ECI is $7,500,000 x (10% / 15%), or $5 million.

Issue and preliminary analysis:

Foreign Bank is a foreign corporation and thus taxable in the U.S. on its ECI. Through the activities of Branch, Foreign Bank engages on a regular and continuous basis in one or more of the activities listed in Treas. Reg. §1.864-4(c)(5)(i). Accordingly, Foreign Bank is engaged in a banking, financing, or similar business in the U.S., and the effective connection of its income from stocks or securities with the active conduct of such business must be determined under Treas. Reg. § 1.864-4(c)(5)(ii). The MTNs are

securities under Treas. Reg. § 1.864-4(c)(5)(v) and attributable to Branch through the material participation of Branch in acquiring the MTNs.

The issue in this Technical Advice Memorandum is whether or not the MTNs are (*b*)(*3*) securities subject to the Ten-Percent Rule. The MTNs are not payable on demand or at a fixed maturity date not exceeding one year from the date of acquisition and were not issued by the United States, or any agency or instrumentality thereof. Thus, the MTNs will be (*b*)(*3*) securities unless they were acquired (1) as a result of, or in the course of making loans to the public, (2) in the course of distributing such stocks or securities to the public, or (3) for the purpose of being used to satisfy the reserve requirements, or other requirements similar to reserve requirements, established by a duly constituted banking authority in the United States.

An objective of the special ECI rules under Treas. Reg. §1.864-4(c)(5) at the time they were promulgated was to distinguish between income from banking activities and income from non-banking investment activities. *See* 1970 TM LEXIS 39 (Dec. 23, 1970). These regulations accomplish this objective by limiting the circumstances under which income, gain, or loss from stocks or securities will be wholly effectively connected with a banking, financing, or similar business in the U.S. Treasury Regulation §1.864-4(c)(5), however, is not a general facts and circumstances-based inquiry into whether the stocks and securities were acquired and used in banking-related activities. Rather, the stocks and securities that are attributable to a banking branch in the U.S. are tested to determine whether they fit within certain specific categories enumerated under Treas. Reg. § 1.864-4(c)(5)(ii). Thus, the regulations provide bright-line categories for classifying stocks and securities into those that give rise wholly to ECI and those for which the income, gain, or loss is allocated between ECI and non-ECI.

<u>Were the MTNs acquired as a result of, or in the course of making loans to the public?</u>

The provision in Treas. Reg. § 1.864-4(c)(5)(ii)(*a*)(*1*), which applies to securities acquired as a result of, or in the course of making loans to the public, will typically apply primarily to the debt securities that the U.S. banking, financing, or similar business originates as loans to its customers. For example, in the case of Foreign Bank, the Commitments—the various liquidity and credit-support commitments that were solicited and negotiated by Branch with U.S. resident counterparties—constitute securities that Foreign Bank acquired in the course of making loans to the public. Accordingly, any income, gain or loss with respect to such Commitments is wholly ECI.

The examples in Treas. Reg. § 1.864-4(c)(5)(iv), however, demonstrate a recognition that a banking business may acquire other securities in addition to an original customer loan as a result of or in the course of making such customer loan. In both examples—that of receiving the security as additional consideration for making the loan and that of acquiring the security through foreclosure upon default of the loan—the U.S. banking business is acquiring the security directly or indirectly from the customer as property in

payment of an amount due under the terms of the original customer loan or under the terms of other agreements with customer incident to originating such loan.

In contrast to these examples, Treas. Reg. § 1.864-4(c)(5)(iv)(*c*) provides that when the U.S. banking business acquires a security on an exchange or on an OTC market, the security is not considered to have been acquired as a result of, or in the course of, making loans to the public. A significant difference between acquiring securities on an exchange or organized OTC market and the examples described in § 1.864-4(c)(5)(iv)(*a*) and (*b*) is that the acquisitions on the exchange or organized OTC markets are not acquisitions from customers and are not acquired through the origination of a customer loan or incident to the terms of such original customer loan.

Foreign Bank acquired the MTNs from commercial banks on the interbank market through broker-dealers. The interbank market is an organized OTC financial market through which banks loan funds to one another. Because the interbank market is an organized OTC market and the MTNs are not customer loans, Treas. Reg. § 1.864-4(c)(5)(iv)(*c*) excludes such securities from the category of securities acquired in the course of making loans to the public. Most securities acquired by a bank on the interbank lending market have a term of one week or less. Although such short-term securities would be excluded from Treas. Reg. § 1.864-4(c)(5)(ii)(*a*)(*1*) for the reason that they are acquired on an organized over-the-counter market, they will nonetheless qualify for full ECI treatment under § 1.864-4(c)(5)(ii)(*b*)(*1*) as a result of being payable on demand or at a fixed maturity date not exceeding one year from the date of acquisition. Accordingly, most securities acquired by a bank on the interbank market will give rise to income that is wholly ECI. However, because the MTNs have terms that exceed one year, they are not captured under this inclusion for short-term securities.

Foreign Bank acquired the MTNs solely to pledge as collateral with the Federal Reserve Bank Discount Window in order to ensure liquidity to fund its outstanding Commitments in the event of a market disruption. Arguably, for this reason, such acquisition could be viewed as directly related to Foreign Bank's U.S. banking activity. However, such activity does not satisfy the more narrow requirement of Treas. Reg. § 1.864-4(c)(5)(ii)(*a*)(*1*) that the acquisition be a result of or in the course of making loans to the public. Foreign Bank may, for example, have acquired U.S. equities on an exchange to post as collateral to secure funding for the purpose of making customer loans. Treasury Regulation § 1.864-4(c)(5)(iv)(*c*) would exclude such stocks from the category of stocks acquired in the course of making loans to the public because those stocks were acquired by Foreign Bank on an exchange rather than from the origination of a customer loan or incident to the terms of a customer loan. The MTNs are excluded for the same reason that they were acquired on an organized over-the-counter market and not incident to the activity of making customer loans.

<u>Were the MTNs acquired in the course of distributing such stocks or securities to the public?</u>

Treas. Reg. § 1.864-4(c)(5)(ii)(*a*)(*2*) provides full ECI treatment for income from securities acquired in the course of distributing such securities to the public. Foreign Bank did not act as an underwriter or market maker with respect to the MTNs, and upon acquiring the MTNs, Foreign Bank did not distribute them to the public. Rather, Foreign Bank acquired the MTNs solely to hold for its own account and to post as collateral at the Discount Window. Therefore, Foreign Bank did not acquire the MTNs in the course of distributing them to the public.

Were the MTNs acquired for the purpose of being used to satisfy the reserve requirements, or other requirements similar to reserve requirements, established by a duly constituted banking authority in the United States?

Treas. Reg. § 1.864-4(c)(5)(ii)(*a*)(*3*) provides full ECI treatment for income from securities acquired for "the purpose of being used to satisfy the reserve requirements, or other requirements similar to reserve requirements, established by a duly constituted banking authority in the United States." Banking authorities establish minimum reserve requirements for certain banks that take deposits. These reserve requirements determine a minimum amount of cash that the bank cannot lend out but must hold in its vault or on deposit with the banking authority.

The "duly constituted banking authority" that sets such reserve requirements in the United States is the Board of Governors of the Federal Reserve System. The Federal Reserve Board's Regulation D sets the minimum dollar amount of a depository institution's reserve requirement by applying a ratio of required reserves to certain categories of net transaction accounts (e.g., deposit accounts, such as checking accounts) held at the bank. Depository institutions that are subject to Regulation D may only hold their reserves in one of two possible forms—either as vault cash or as reserve deposits with Federal Reserve Banks.

Treasury Regulation § 1.864-4(c)(5)(ii)(*a*)(*3*) contemplates the acquisition of stocks or securities for the purpose of satisfying reserve requirements established by a duly constituted U.S. banking authority. However, under Regulation D, neither stocks nor securities count as satisfying such reserve requirements. This present disconnect between the Treasury regulation and current U.S. federal banking regulation is a result of the historical evolution of banking regulation since the issuance of Treas. Reg. § 1.864-4(c)(5).

In particular, Treas. Reg. § 1.864-4(c)(5)(ii)(*a*)(*3*) was promulgated prior to the enactment of the Depository Institutions Deregulation and Monetary Control Act of 1980 (Pub. L. No. 96-221, 94 Stat. 132). Prior to this Act, only banks that were members of the Federal Reserve System were required to comply with the Federal Reserve Board's reserve requirements. State chartered banks that did not belong to the Federal Reserve System were required to comply with state banking authority reserve requirements

rather than those of the Federal Reserve. While the Federal Reserve Board has historically required reserves to be held exclusively as vault cash or as reserve deposits with Federal Reserve Banks, the reserve requirements of state banking regulatory authorities differed widely during the period of time when states had authority to set such reserve requirements. Historically, state reserve requirements were thought to help ensure bank liquidity and to protect depositors in the event of bank insolvency.[1] Because states were not trying to control national monetary policy through reserve requirements, they could expand the type of items that satisfy reserve requirements beyond cash. According to an article published by the research division of the Federal Reserve Bank of St. Louis in 1978,[2] each state that imposed reserve requirements at that time allowed vault cash and demand deposits to count as reserves. However, in twenty two states, banks were also allowed to count various proportions of income-earning assets; and in six states, banks were allowed to meet all of their reserve requirements with interest-earning assets. Such assets were generally unpledged U.S. Treasury securities or state and local government securities. The article does not list debt issuances of commercial banks as assets that would satisfy local reserve requirements set by any state banking authority.

Thus, at the time Treas. Reg. § 1.864-4(c)(5)(ii)(*a*)(*3*) was promulgated, a wide variety of assets could be used by foreign banks to satisfy reserve requirements, depending on whether the foreign banks were members of the Federal Reserve System or were regulated by one or more particular states.[3] Treasury Regulation § 1.864-4(c)(5)(ii)(*a*)(*3*) addressed the situation—which is no longer a possibility under current law—that a foreign bank branch that was state regulated might acquire stocks or securities to satisfy state reserve requirements, or other state requirements that were similar to reserve requirements but that were not explicitly called “reserve requirements.”

Because the MTNs are not vault cash or reserve deposits, they cannot be used by Foreign Bank to satisfy the Federal Reserve Board reserve requirements under Regulation D and were not acquired for the purpose of satisfying such reserve requirements. The MTNs, however, were acquired to satisfy collateral requirements set by the Federal Reserve Bank for access to its Discount Window. Thus, the issue is whether the Discount Window collateral requirements are “similar to reserve requirements.”

Reserve requirements are uniform requirements that some fraction of the deposit accounts held at a depository bank be held in reserve and not lent out or used to meet

[1] Carl M. Gambs, *Federal Reserve Membership and the Role of Nonmember Bank Reserve Requirements,* Federal Reserve Bank of Kansas City Monthly Review, 3-13 (February 1979).
[2] R. Alton Gilbert and Jean M. Lovati, *Bank Reserve Requirements and Their Enforcement: A Comparison Across States*, Federal Reserve Bank of St. Louis Monthly Review, 22-33 (March 1978).
[3] Prior to the International Banking Act of 1978, the authority to regulate and supervise foreign bank branches and agencies resided almost exclusively with the states.

customer demands. Regulation D imposes uniform reserve requirements on all depository institutions "for the purpose of facilitating the implementation of monetary policy by the Federal Reserve System[4]." The reserve requirements facilitate this policy by ensuring a predictable demand for Federal Reserve balances, which in turn enhances the Federal Reserve's control over the federal funds rate.[5]

According to the Federal Reserve, the Discount Window serves two primary functions.[6] First, like the reserve requirement, it functions as a tool for stabilizing demand for Federal Reserve balances. When markets are disrupted, the Discount Window becomes a source for increasing the supply of balances. In addition, the Discount Window provides liquidity for depository institutions by serving as a source of temporary funding. Any depository institution borrowing from the Discount Window must, by law, secure its loan with collateral, which can be in the form of loans that are not past due and most investment-grade securities.[7] The collateral requirement gives the Reserve Banks first priority to take possession of and sell such collateral in the event a borrower is in default on its Discount Window borrowing.[8]

Although the Discount Window collateral requirement and the reserve requirements are both established by the Federal Reserve, there is a clear functional distinction between the requirements. (This functional distinction also exists when comparing historical state reserve requirements and Discount Window collateral requirements.) The collateral requirement is not uniformly imposed as a continuous requirement of all depository institutions. Depository institutions voluntarily seek to borrow funds at the Discount Window and pledge collateral only when they seek to gain or maintain eligibility to borrow at the Discount Window. The amount of collateral required to be pledged at the Discount Window is not a fraction of the deposit accounts held at a depository bank. Banks are required to pledge an amount that fully collateralizes the amount of Discount Window credit they choose to be eligible to access. In addition, the collateral required does not need to be held as cash but may be held in the form of income-earning securities.[9]

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[4] 12 C.F.R. § 204.1(b) (2013).
[5] Federal Reserve System, *Purposes and Functions*, "The Implementation of Monetary Policy," 27, 41 (9th ed. 2005), *available at* http://www.federalreserve.gov/pf/pf.htm
[6] *Id.* at 45.
[7] *Id*. at 50.
[8] *Id*.
[9] Assets commonly pledged to secure discount window advances include obligations of the United States Treasury; obligations of U.S. government agencies and government sponsored enterprises; obligations of states or political subdivisions of the U.S.; collateralized mortgage obligations; asset-backed securities; corporate bonds; money market instruments; residential real estate loans; commercial, industrial, or agricultural loans; commercial real estate loans; and consumer loans. See *Federal Reserve Collateral Guidelines, available at* http://www.newyorkfed.org/banking/collateral_pledging.html

Reserve requirements set by the Federal Reserve serve to facilitate monetary policy and do not function to collateralize any liability of a depository bank. Although the historical state reserve requirements were thought to help ensure bank liquidity, such state reserves served at most to promote a general minimum threshold of liquidity and did not function as a collateral account with respect to any specific transaction. In contrast, the Federal Reserve's collateral requirement for Discount Window lending is transaction-specific and collateralizes the full fair market value of a bank's Discount Window borrowings. In substance, the collateral requirements of the Discount Window are not materially different from collateralization arrangements in commercial secured lending agreements. The fact that the collateral requirements of the Discount Window—unlike those in commercial lending agreements—happen to be imposed by the Federal Reserve Bank does not make them similar to reserve requirements. The fact that collateral may be posted at the Discount Window before the loan is drawn upon does not affect this conclusion.

Given the history of bank reserve requirements described briefly above, it is reasonable to conclude that the reference to "other requirements similar to reserve requirements" was included in Treas. Reg. § 1.864-4(c)(5)(ii)(*a*)(*3*) for the purpose of ensuring that the broad variety of requirements that functioned like reserve requirements established by the state banking authorities at the time the regulation was issued would be clearly covered by the provision. The phrase "similar to reserve requirements" was not intended to broaden the scope of Treas. Reg. § 1.864-4(c)(5)(ii)(*a*)(*3*) to reach other Federal Reserve requirements that are not directly related to, and may at best be only remotely analogous to, a reserve requirement. Accordingly, the Federal Reserve Board's collateral requirements for access to the Discount Window are not "similar to reserve requirements" within the meaning of Treas. Reg. § 1.864-4(c)(5)(ii)(*a*)(*3*).

Conclusion:

The foregoing analysis demonstrates that Branch did not acquire the MTNs in the course of making loans to the public, in the course of distributing such securities to the public, or to satisfy reserve requirements or other requirements similar to reserve requirements established by a duly constituted U.S. banking authority. Accordingly, the entire interest income on the MTNs is not effectively connected with the conduct of its U.S. banking business under Treas. Reg. § 1.864-4(c)(5)(ii)(*a*) and must be included under the ten-percent rule formula to determine the allocation percentage of effectively connected income under Treas. Reg. § 1.864-4(c)(5)(ii)(*b*)(*3*).

CAVEAT(S):

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.