

Client Alert

A report
for clients
and friends
of the Firm **April 2008**

NYC Finance Department Issues Audit Guidance to Financial Services Firms Engaged in Repo and Securities Lending Activities

On March 31, 2008, the New York City Department of Finance issued a Statement of Audit Procedure with respect to the tax treatment of repurchase agreements and securities lending transactions for financial service firms regularly engaged in such activities for purposes of the general corporation tax and unrelated business tax.

The Statement provides that, for such financial services firms, reverse repurchase agreements that constitute qualified debt instruments with durations of not more than six months are treated as cash, subject to taxpayer election as business or investment capital. For such taxpayers, interest expenses arising out of repurchase agreements would be subject to a rebuttable presumption that such interest is directly attributable to reverse repurchase agreements and would be netted against the earnings derived from reverse repurchase agreements. Thus, if the reverse repo is elected to be treated as business capital, repo interest expenses will be directly attributable to business capital. If the reverse repo is elected to be treated as investment

capital, such expenses will be attributable to investment capital. The presumption can be rebutted if the taxpayer's activities with respect to repurchase agreements are (i) segregated on its books and records and on an operational basis from reverse repurchase agreements and (ii) entry into repurchase agreements is effected on a stand-alone basis unrelated to any material degree, including as hedges, to reverse repurchase agreements.

Where a financial services firm regularly engages in securities lending and borrowing transactions, resulting income and expenses are to be treated as business income and expenses.

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For more information, please contact:

Charles E. Dropkin
212.969.3535 – cdropkin@proskauer.com

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