Letter Ruling 00-8: Treatment of a Non-Massachusetts Single Member Limited Liability under Chapters 62 and 63 of the General Laws

June 9, 2000

You have requested a ruling regarding the treatment under chapter 63 of the Massachusetts General Laws (G.L.) of a non-Massachusetts single member limited liability company ("SMLLC") that is disregarded as an entity for federal income tax purposes. Specifically, your request pertains to a Delaware LLC that has a corporate trust as its single member and is disregarded as an entity for federal income tax purposes.

You inquire whether the above-mentioned LLC will be disregarded as an entity separate from its owner for purposes of both the income and property components of the corporate excise. *See* G.L. c. 63, §§ 32, 39. We rule that the LLC is not a corporation for purposes of G.L. c. 63, and will therefore not be subject to the corporate excise in any respect.

FACTS

Your ruling request is submitted on behalf of ********** (the "Trust") and its portfolio series, ********** (each a "Fund" and collectively, the "Funds"). The Trust is organized as a Massachusetts business trust and is registered as an open-end, management investment company under the Investment Company Act of 1940, 15 U.S.C. 80a-1, *et seq.,* as amended (the "1940 Act"). The Trust is also a "series company" under Rule 18f-2 of the 1940 Act.

Each Fund is a portfolio series of the Trust and is treated as a separate corporation for federal income tax purposes pursuant to § 851(g) of the Internal Revenue Code of 1986, as amended and in effect for the taxable year (the "Code"). Each Fund qualified as a regulated investment company (a "RIC") under § 851 of the Code in its most recent taxable year and intends to continue to qualify as such in all subsequent years. Each Fund has an investment management agreement with ********** ("Investment Manager") and a sub-advisory agreement with an affiliated sub-advisor. Each Fund has transferable shares and, for Massachusetts tax purposes, is treated as a separate corporate trust, exempt from tax under G.L. c. 62, § 8(b)(i).

Unlike many RICs that invest almost exclusively in a single class of assets, such as equity securities, bonds or money market instruments, each of the Funds invests in all three of these asset classes. More specifically, each Fund allocates its assets within certain parameters set forth in its prospectus among equity, bond and money market asset classes. These asset classes represent categories of securities rather than separate legal entities. However, for certain internal purposes the Investment Manager treats securities within each asset class as if they were held in a separate

fund. For example, each Fund's holdings in money market instruments are treated as if they were held in a distinct fund (referred to for portfolio management purposes as a "sub-portfolio), and responsibility for managing those holdings is delegated to a "sub-portfolio manager" who specializes in money market investments. When the lead manager of each Fund wants to increase or decrease the Fund percentage allocated to money market investments, the lead manager does so by increasing or decreasing the amount of assets allocated to the money market "sub-portfolio," as if the sub portfolio were a separate fund. Similar sub-portfolios are currently maintained for investment-grade bonds, high-yield securities and domestic equities. Different investment professionals manage the sub-portfolios.

In order to evaluate the performance of a Fund, the Investment Manager needs to isolate each distinct sub-portfolio's contribution to the Fund's performance. For example, the Investment Manager needs this information to determine whether a Fund's above-average performance was due to the success of each of its four sub-portfolios or only one, two or three of them. Sub-portfolio-level performance information allows the Investment Manager to fine-tune its investment strategies to enable the Funds to provide shareholders with potentially higher-returns.

To enhance performance-tracking, the Investment Manager plans to have each Fund organize, pursuant to 6 Del. C. § 18-101, *et seq.*, a Delaware SMLLC (with that Fund as the sole member) and to contribute substantially all of its equity securities to that SMLLC.[1] For federal income tax purposes, under the Check-the-Box Rules (as described below), each of the SMLLCs will be disregarded as an entity separate from its owner.[2] Accordingly, the addition of the SMLLCs will not change the federal income tax treatment of the Funds.

DISCUSSION

The corporate excise applies to domestic and foreign corporations as defined under G.L. c. 63. The corporate excise contains both an income and property measure. A domestic or foreign corporation that is subject to the excise is typically required to add the two measures together to compute its tax. *See* G.L. c. 63, §§ 32, 39. In cases in which the income and property measures of the excise sum to an amount that is less than $456, the corporation is subject to a $456 minimum excise. *See id*.

In 1995, the legislature provided for the formation of LLCs under state law, and also provided for the state taxation of LLCs when formed under state law or the laws of another jurisdiction (the "1995 Legislation"). *See* St. 1995, c. 281.

The 1995 Legislation generally adopted the federal classification of LLCs for purposes of the application of G.L. c. 62 and the corporate excise, *i.e.*, G.L. c. 63, § 30, *et seq.* *See* G.L. c. 62, § 17; G.L. c. 63, §§ 30.1, 30.2. In particular, G.L. c. 62, § 17 provides that an LLC that elects federally to be treated as a partnership is taxed under the partnership provisions of that section. In addition, G.L. c. 63, §§ 30.1 and 30.2 provide that an LLC that does not elect to be treated as a partnership for federal income tax purposes is treated as a corporation for purposes of the application of the corporate excise. At the time of the enactment of these provisions an LLC could only be classified as a corporation or a partnership for federal income tax purposes. *See* TIR 97-8.

The 1995 Legislation does not permit the formation of a SMLLC under state law. *See* G.L. c. 156C, § 2(5). Consequently, the only SMLLCs that can be subject to state tax are SMLLCs that are formed under the laws of another jurisdiction. However, since SMLLCs were not formally recognized under federal tax law at the time of the 1995 Legislation, that legislation does not specifically address the tax treatment of a SMLLC. Under the 1995 Legislation as it applied at the time of its enactment, a SMLLC was considered either a corporation or a partnership for state tax purposes depending upon its classification for federal income tax purposes. *See* TIR 97-8.

Subsequent to 1995, the IRS promulgated rules that specifically address the tax characterization of a SMLLC. *See* Treas. Reg. § 301.7701 (the "Check the Box Rules"). Under the Check the Box Rules, a SMLLC can elect to be treated either as a corporation or as a disregarded entity. *Id*. If the SMLLC elects to be treated as a disregarded entity and it is owned by a corporation it will be considered a branch or division of its owner. A SMLLC that elects to be treated as a disregarded

entity and is owned by a natural person is considered to be a sole proprietorship.

When a SMLLC elects to be treated as a corporation for federal income tax purposes, the SMLLC is a corporation within the meaning of G.L. c. 63, § 30.2, and consequently is subject to both the income and property measures of the corporate excise. However, when a SMLLC chooses to be treated as a disregarded entity, the SMLLC is neither a corporation nor a partnership for federal income tax purposes. As to the latter result, a SMLLC cannot be deemed a partnership under federal income tax law since the federal definition of a partnership requires that there must be more than one partner. *See* Treas. Reg. § 301.7701-3(a).

For purposes of state taxation, when a SMLLC chooses to be treated as a disregarded entity, that SMLLC is not a partnership under G.L. c. 62, § 17 since that section only applies to an LLC that is classified as a partnership for federal income tax purposes. In addition, a SMLLC that chooses to be disregarded as a separate entity is not a corporation for purposes of the corporate excise. *See* Directive 00-4; s*ee also* TIR 97-8. Therefore, when an SMLLC elects to be treated as a disregarded entity it is not subject to the income or property measures of the corporate excise, or to the minimum excise.

In evaluating the application of the corporate excise or the income tax provisions of G.L. c. 62, a SMLLC that elects to be treated as a disregarded entity will be treated as a branch or division of its owner or as a sole proprietorship. Hence, for purposes of this analysis, all of the tax attributes of the SMLLC, as well as its property and activities, are attributed to the single member. This interpretation furthers the statutory intention expressed in G.L. c. 62, § 17 and G.L. c. 63, § 30.2 to reflect the tax characterizations that are applied to an LLC under federal law.[3]

Very truly yours,

/s/Frederick A. Laskey

Frederick A. Laskey
Commissioner of Revenue

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[1] The Investment Manager also plans to have the Funds create three distinct legal entities to hold their investment-grade bond, high-yield and money market assets. None of the entities will be structured as SMLLCs.

[2] A single-member unincorporated entity by default will be disregarded for federal income tax purposes unless it makes an affirmative election to be treated as an association taxable as a corporation. The Trust on behalf of the Funds represents that neither SMLLC will elect to be treated as an association taxable as a corporation for federal income tax purposes.

[3] In contrast, a SMLLC that elects to be disregarded as an entity separate from its owner for federal income tax purposes retains its separate identity for purposes of the local property tax. *See Nashoba Communications Limited Partnership v. Bd. of Assessors of Danvers*, 429 Mass. 126 (1999).