TIR 17-2: Massachusetts Corporation Excise Treatment of Offshore Investment Companies

A. Purpose

The federal Taxpayer Relief Act of 1997 (the Act) expanded the scope of activities that offshore investment companies may conduct in the United States without being treated as engaged in a trade or business that would subject them to federal income tax on income effectively connected with the conduct of a trade or business in the U.S. See Sec. 1162(a) of the Act, amending Internal Revenue Code (I.R.C.) § 864(b)(2)(A)(ii).

This TIR, which is being issued to revise and restate TIR 98-6[1], explains the application of the Massachusetts corporation excise to offshore investment companies described in I.R.C. § 864(b)(2)(A)(ii) that conduct certain activities in the Commonwealth.[2] Specifically, this TIR provides safe harbor rules based on analogous federal rules under which certain offshore investment companies will not be subject to the Massachusetts corporation excise. It also describes potential security corporation treatment for offshore investment companies that are subject to the corporation excise.

B. Federal Income Taxation of Non-U.S. Corporations

In general, a corporation organized under the law of a foreign country (an offshore company) is subject to the federal income tax (i) under I.R.C. § 882(a) on all of its income that is effectively connected with the conduct of a trade or business in the U.S. (effectively connected income, or ECI) and (ii) under I.R.C. § 881(a) on certain types of non-effectively connected income (non-ECI) having a U.S. source, such as interest, dividends, royalties, and other items of income within the scope of I.R.C. § 881(a).[3] For tax years beginning before January 1, 1998, an offshore company engaged in trading in stocks or securities for its own account (an offshore investment company) was generally not treated as engaged in a trade or business in the U.S., unless its principal office was in the U.S.. See I.R.C. § 864(b)(2)(A)(ii), before its amendment by Sec. 1162(a) of the Act. The I.R.C. did not provide a definition of the term "principal office." However, Treas. Reg. § 1.864-2(c)(2)(iii) provided a safe harbor rule, pursuant to which an offshore investment company was not considered to have its principal office in the U.S. if it carried on all or a substantial portion of the following administrative functions from an office located outside the U.S.

1. communicating with its shareholders,
2. communicating with the general public,
3. soliciting sales of its own stock,
4. accepting subscriptions of new shareholders,
5. maintaining its principal corporate records and books of account,
6. auditing its books of account,
7. disbursing payments of dividends, legal and accounting fees, and officers' and directors' salaries,
8. publishing or furnishing the offering and redemption price of its issued shares,
9. conducting shareholders and board of directors meetings, and
10. making redemptions of its own stock.

These requirements became known as the "Ten Commandments." An offshore investment company that complied with these requirements was generally not treated as engaged in the conduct of a trade or business in the U.S., and thus would not have ECI that would be subject to federal income tax.

Effective for taxable years beginning after December 31, 1997, the Act amended I.R.C. § 864(b)(2)(A)(ii) to eliminate the reference to a principal office in the U.S. (the I.R.C. § 864 Ten Commandments Repeal). Thus, an offshore investment company may maintain a principal office in the U.S. without necessarily being deemed to be engaged in the conduct of a trade or business in the U.S. for federal income tax purposes. As a result, an offshore investment company may now conduct the aforementioned administrative functions in the U.S. without such functions giving rise to ECI subject to federal income tax.

C. Massachusetts Corporation Excise

Except as otherwise provided in G.L. c. 63, § 68C, every business corporation that is organized in or exercises its charter in Massachusetts, that does business in or is qualified to do business in Massachusetts, or that owns or uses any part or all of its capital, plant or other taxable property in Massachusetts is generally subject to the Massachusetts corporation excise under G.L. c. 63, § 39. The excise under G.L. c. 63, § 39 is imposed on a business corporation's tangible property or net worth and on its net income, with a minimum excise of $456 if the excise would otherwise be less than such minimum. A business corporation's net income for Massachusetts purposes is based on its federal gross income, subject to certain modifications. G.L. c. 63, § 30.4.

In general, if a business corporation's employees, agents, or representatives engage in activities on behalf of the corporation, the activities will be imputed to the corporation and thus would subject the corporation to the corporation excise in Massachusetts.

D. Effect of I.R.C. § 864 Ten Commandments Repeal on Massachusetts Corporation Excise

If an offshore investment company, as described above, conducts activities in Massachusetts, it may be considered to be doing business in the Commonwealth and therefore subject to the Massachusetts corporation excise. An offshore investment company that pursuant to I.R.C. § 864(b)(2)(A)(ii) is not engaged in the conduct of a U.S. trade or business would not have ECI that would be subject to federal income tax. If such an offshore investment company also had no non-ECI from U.S. sources, it would have no federal gross income and therefore would not be subject to the net income measure of the corporation excise. However, such an offshore investment company, if it is doing business in the Commonwealth, would be subject to tax on its net worth or tangible property or be subject to the minimum excise.

(1) *Safe harbors – activities that will not by themselves constitute doing business in Massachusetts for corporation excise purposes when conducted by an offshore investment company.* In TIR 98-6, the Department of Revenue (DOR) announced its determination that under Massachusetts law an offshore investment company would not be considered to be doing business in the Commonwealth if (i) its Massachusetts activities were limited to the following activities and (ii) those activities were conducted through an independent contractor:

- communicating with its shareholders,
- communicating with the general public,
- soliciting sales of its own stock,
- accepting subscriptions of new shareholders,
- auditing its books of account,
- disbursing payments of dividends, legal and accounting fees, and officers' and directors' salaries,
- publishing or furnishing the offering and redemption price of its issued shares,
- making redemptions of its own stock, and
- executing contracts related to the purchase, sale or management of securities.

DOR has now also determined that, given the character and extent of activities of offshore investment companies described in I.R.C. § 864(b)(2)(A)(ii), the holding of shareholders meetings or boards of directors meetings of such an offshore investment company in Massachusetts will not by itself result in the offshore investment company being treated as doing business in the Commonwealth for purposes of G.L. c. 63, § 39. This determination also extends to the holding of boards of directors meetings by non-U.S. companies that serve as management companies for such offshore investment companies described in I.R.C. § 864(b)(2)(A)(ii), provided such meetings are exclusively related to the management of such offshore investment companies.[4]

(2) *Other activities conducted in Massachusetts may constitute doing business in the Commonwealth.* Specifically, and without limitation, it is noted that the following activities conducted in Massachusetts by an offshore investment company may expose the offshore investment company to Massachusetts tax jurisdiction:

- maintaining its principal corporate records and books of account,
- maintaining a place of business, or
- executing contracts.

(3) *Availability of security corporation classification for certain offshore investment companies that are doing business in Massachusetts for corporation excise purposes.* If an offshore investment company described in I.R.C. § 864(b)(2)(A)(ii) is doing business in Massachusetts and subject to the Massachusetts corporation excise, it may apply for security corporation classification if it is engaged exclusively in buying, selling, dealing in, or holding securities on its own behalf and not as a broker. *See* G.L. c. 63, § 38B; 830 CMR 63.38B.1. A security corporation is subject to the higher of an excise on its gross income (based on federal gross income subject to certain modifications), or a minimum excise of $456. G.L. c. 63, § 38B. If such an offshore investment company, in addition to having no ECI (pursuant to I.R.C. § 864(b)(2)(A)(ii)), also has no U.S.-source non-ECI, it would have no federal gross income. Thus, it would be subject only to the minimum excise imposed under G.L. c. 63, § 38B.

/s/Michael J. Heffernan
Michael J. Heffernan
Commissioner of Revenue

MJH:RHF

February 16, 2017

TIR 17-2

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[1] This TIR is being issued as a revision and restatement of TIR 98-6 in order (a) to provide notice of a determination by the Department of Revenue that the holding of certain shareholders meetings or boards of directors meetings of certain offshore investment funds (or of certain foreign companies serving as management companies for such funds) will not be treated as doing business in Massachusetts that would by itself create nexus for corporation excise purposes; (b) to clarify some of the analysis in TIR 98-6 relating to the taxation of U.S. source income derived by corporations organized in foreign countries; and (c) to reflect various technical revisions to the Massachusetts General Laws that have occurred since the issuance of TIR 98-6. TIR 98-6 is superseded by this TIR.

[2] This TIR applies to offshore investment companies organized under the laws of a foreign country that are business corporations within the meaning of G.L. c. 63, § 30.1.

[3] The federal income tax on non-ECI is generally imposed at a flat rate of 30 percent, subject to reduction to a lower rate or to zero pursuant to a bilateral income tax treaty entered into by the U.S. with a foreign country, and collected through withholding at the source by the U.S. payor of such item(s) of income. When a federal income tax treaty reduces the rate of tax on non-ECI to zero, such income is excluded from a business corporation's federal gross income for purposes of determining the corporation's income measure of the corporation excise. *See* TIR 10-16.

[4] The safe harbor rules described in this section apply only for purposes of determining when an offshore investment company is considered to be doing business in the Commonwealth, and may not be relied upon by a corporation organized in the U.S. or under the law of the U.S. or of any U.S. state.

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