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Directive 00-9: Corporate Trust Parents and Qualified S Corporation Subsidiaries

Introduction:

A corporate trust that is a federal S corporation and is the parent of one or more qualified S corporation subsidiaries (QSUBs) will be subject to the Massachusetts personal income tax on all income earned by the corporate trust (hereinafter referred to as a corporate trust parent) and on all income earned by the QSUBs. See Letter Ruling 99-17. The QSUBs will not be subject to the income measure of the corporate excise under G.L. c. 63, § 32(a)(2), § 39(a)(2) or § 32D. *Id.* The QSUBs will, however, be subject to the corporate excise in an amount equal to the greater of (i) the non-income measure of the excise imposed under G.L. c. 63, § 32(a)(1) or § 39(a)(1) or (ii) the \$456 minimum excise. *Id.* This Directive sets out the filing requirements applicable to corporate trust parents and their QSUBs and explains how each must determine its Massachusetts tax liability.

Except as provided herein, this Directive applies to all taxable years subject to any applicable limitations set forth in Chapter 62C of the General Laws. See 830 CMR 62C.3.1(6)(f).

Issue 1:

Will a Letter Ruling 99-17 type reorganization trigger the recognition of any taxable income to an S corporation that becomes a QSUB of a corporate trust parent?

Directive 1:

Generally not. Current Internal Revenue Service (IRS) administrative practice allows Letter Ruling 99-17 type reorganizations to qualify as tax-free reorganizations for federal tax purposes.

Massachusetts law generally adopts the federal provisions allowing for tax-free reorganizations. Thus, a Letter Ruling 99-17 type reorganization will trigger the recognition of income only if it does for federal tax purposes.

Discussion:

The recognition of income with regard to corporate reorganizations is generally governed by federal tax law. The IRS has indicated that it will allow taxpayers to treat Letter Ruling 99-17 type reorganizations as tax-free "F" reorganizations. See Treas. Dec. Int. Rev. 8869 (explaining the newly promulgated Code Section 1361 Regulations). In the alternative, it is also possible that other federal reorganization provisions might result in tax-free treatment for this type of reorganization.

Massachusetts generally adopts the federal provisions allowing for tax-free corporate reorganizations. See Letter Rulings 83-77, 88-1, 95-4. Thus, no income will be recognized for Massachusetts tax purposes as a result of a Letter Ruling 99-17 type reorganization, so long as no income is recognized for federal tax purposes. However, if for any reason, a Letter Ruling 99-17 type reorganization does result in the recognition of income for federal tax purposes it will also trigger the recognition of income for Massachusetts tax purposes.

Issue 2:

Where (i) an S corporation becomes a QSUB of a corporate trust parent pursuant to a reorganization

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described in Letter Ruling 99-17, and (ii) the S Corporation does not close its taxable year for federal tax purposes as a result of the reorganization, (1) how should the corporate trust parent and the QSUB file returns and report income, gross receipts, property, payroll, sales and other relevant tax attributes for the taxable year during which the reorganization takes place?

Directive 2:

The corporate trust parent must file Form 3F (Income Tax Return of Corporate Trust) to report its income for the taxable year. The QSUB must file either Form 355S-A (Domestic S Corporation Excise Return) or Form 355S-B (Foreign S Corporation Excise Return) to report the non-income measure of the excise or the minimum tax for the entire taxable year. The QSUB will have no net income and therefore will not be subject to the net income measure of the corporate excise.

Discussion:

Corporate Trust Parent

The corporate trust parent must include in its return (i) all income that it earns on its own account during the taxable year, (ii) all income earned by the QSUB on or after the effective date of the federal QSUB election, and (iii) all income earned by the S corporation prior to the effective date of the QSUB election. In determining the corporate trust parent's apportionment factors for purposes of apportioning income, the corporate trust parent must take into account the activities of the QSUB, including activities conducted pre-reorganization as an S corporation (*i.e.*, activities conducted before the effective date of the federal election pursuant to which the S corporation became a QSUB), as explained below:

For property factor purposes, the corporate trust parent must treat as its own any property owned by the QSUB in its capacity as a QSUB or S corporation on any relevant date during the taxable year;

For payroll factor purposes, the corporate trust parent must include in its total amount of compensation paid all amounts of compensation paid by the QSUB in its capacity as a QSUB or S corporation during the taxable year; and

For sales factor purposes, the corporate trust parent must include in its total sales all sales made by the QSUB in its capacity as a QSUB or S corporation during the taxable year.

QSUB

The QSUB will have no federal gross income. Therefore, the QSUB will have no Massachusetts net income and will not be subject to the net income measure of the corporate excise. See Letter Ruling 99-10.

The QSUB will, however, be subject to the non-income measure of the corporate excise for the entire taxable year. See G.L. c. 63, §§ 32(a)(1), 39(a)(1). The QSUB must compute the non-income measure of the corporate excise based entirely on its own assets and liabilities, including assets held and liabilities incurred while the QSUB operated as an S corporation (*i.e.*, before the effective date of the federal election pursuant to which it became a QSUB). The assets and liabilities of the corporate trust parent and those of other S corporation subsidiaries of the corporate trust parent generally do not affect the computation.

Where it is necessary for the QSUB to determine its apportionment percentage for purposes of computing the non-income measure of the excise for the taxable year, the QSUB must determine its apportionment factors based on its own, separately determined, property, payroll and sales, including property, payroll and sales attributable to the period during which the QSUB operated as an S corporation (*i.e.*, before the effective date of the federal election pursuant to which it became a QSUB).

Where the QSUB's taxable year (determined for federal tax purposes) is less than twelve months, the QSUB may prorate its excise under the non-income measure by multiplying the excise by the number of calendar months (including partial months) in its taxable year and dividing the resulting amount by twelve.

If the sum of the QSUB's income and non-income measures is less than \$456, then the \$456 minimum excise applies. See G.L. c. 63, § 32, and § 39.

Issue 3:

Where (i) an S corporation becomes a QSUB of a corporate trust parent pursuant to a reorganization described in Letter Ruling 99-17, and (ii) the S Corporation closes its taxable year for federal tax purposes as a result of the reorganization, (2) how should the corporate trust parent, the S corporation and the QSUB file returns and report income, gross receipts, property, payroll, sales and other relevant tax attributes for the taxable year during which the reorganization takes place?

Directive 3:

The corporate trust parent must file Form 3F (Income Tax Return of Corporate Trust) to report its income for the taxable year. The S corporation must file a short-year return using either Form 355S-A (Domestic S Corporation Excise Return) or Form 355S-B (Foreign S Corporation Excise Return) to report its corporate excise for the taxable year up to the time at which the S corporation's federal taxable year is closed. The QSUB must file a separate short-year return using either Form 355S-A or Form 355S-B to report the non-income measure of the excise or the minimum excise for the period after the S corporation's federal taxable year is closed.

Discussion: Corporate Trust Parent

The corporate trust parent must include in its return all income that it earns on its own account during the taxable year as well as all income earned by the QSUB after the S corporation's federal taxable year is

closed. In determining the corporate trust parent's apportionment factors for purposes of apportioning income, the corporate trust parent must take into account the post-reorganization activities of the QSUB as explained below:

For property factor purposes, the corporate trust parent must treat as its own any property owned by the QSUB on any relevant date after the close of the S corporation's federal taxable year;

For payroll factor purposes, the corporate trust parent must include in its total amount of compensation paid all amounts of compensation paid by the QSUB after the close of the S corporation's federal taxable year; and

For sales factor purposes, the corporate trust parent must include in its total sales all sales made by the QSUB after the close of the S corporation's federal taxable year.

S Corporation/QSUB

The S corporation is treated as a stand-alone S corporation up to the time at which its federal taxable year ends. It must file a short-year Massachusetts S corporation return using either Form 355S-A or Form 355S-B. That return must cover the same period as the S corporation's federal short-year return. See 830 CMR 62.17A.1(3)(g). All of the provisions that generally apply to the computation of the corporate excise for S corporations will apply to that short-year return. Thus, for example, for purposes of determining whether the S corporation is subject to the net income measure of the corporate excise under G.L. c. 63, § 32D, its total receipts must be annualized. See 830 CMR 62.17A.1(11)(c).

The QSUB must file a separate short-year Massachusetts S corporation return using either Form 355S-A or Form 355S-B for the period after the close of the S corporation's federal taxable year. By operation of federal law, all of the QSUB's net income will be attributed to the corporate trust parent. However, the QSUB will be subject to the non-income measure of the corporate excise or the minimum excise for the short taxable year. See G.L. c. 63, §§ 32(a)(1), 39(a)(1). The QSUB must compute the non-income measure of the corporate excise based entirely on its own assets and liabilities. The assets and liabilities of the corporate trust parent and those of other S corporation subsidiaries of the corporate trust parent generally do not affect the computation.

Where it is necessary for the S corporation or the QSUB to determine its apportionment percentage, each must determine its apportionment factors based on its own, separately determined, property, payroll and sales. In determining the non-income measure of the corporate excise for a short taxable year, the non-income measure may be prorated by multiplying the excise by the number of calendar months (including partial months) in the taxable year and dividing the resulting amount by twelve.

Issue 4:

Must a corporate trust parent and its QSUBs obtain separate taxpayer identification numbers?

Directive 4:

Although a corporate trust parent and its QSUB are each separate taxpayers for Massachusetts purposes, the Department of Revenue will process required returns for a corporate trust parent and one of its QSUBs using the corporate trust parent's federal taxpayer identification number. Additional QSUBs owned by the corporate trust parent must obtain separate taxpayer identification numbers.

Discussion:

For federal tax purposes, the IRS does not require all of the participants in a Letter Ruling 99-17 type reorganization to obtain their own taxpayer identification numbers. Rather, the newly created corporate trust parent is permitted to use the previously existing S corporation's taxpayer identification number when reporting the combined activities of the corporate trust parent and the QSUB.

Where the corporate trust parent files in this manner for federal tax purposes, it may use the previously existing S corporation's taxpayer identification number for both the corporate trust parent's personal income tax return (Form 3-F) and the corporate excise return for one of its QSUBs (Form 355A-S or 355B-S). (3) Any required short-year corporate excise returns for the previously existing S corporation should also be filed using that number and a note should be attached to the return stating that the corporate trust and QSUB will subsequently use that number when filing their required returns.

Notwithstanding the foregoing, if the corporate trust parent has multiple QSUBs, only one QSUB may use the same taxpayer identification number as the corporate trust parent for Massachusetts filing purposes. Each additional QSUB must obtain a separate taxpayer identification numbers for use in filing its required corporate excise return.

Issue 5:

How should a corporate trust parent and its QSUB file returns and report income, gross receipts, property, payroll, sales and other relevant tax attributes for post-reorganization taxable years?

Directive 5:

The corporate trust parent must file Form 3F (Income Tax Return of Corporate Trust) to report its income for each taxable year. The QSUB must file either Form 355S-A (Domestic S Corporation Excise Return) or Form 355S-B (Foreign S Corporation Excise Return) to report the non-income measure of the excise or the minimum tax for each taxable year.

Discussion: Corporate Trust Parent

The corporate trust parent must include in its return income that earns on its own account as well as all income earned by the corporate trust parent's QSUB. See TIR 97-6; TIR 99-10. In determining the corporate trust parent's apportionment factors for purposes of apportioning income, the corporate trust parent must treat the sales, property and payroll of its QSUB as its own. See *id.*

QSUB

The QSUB will have no federal gross income. Therefore, the QSUB will have no Massachusetts net income and will not be subject to the net income measure of the corporate excise. See TIR 99-10.

A QSUB will, however, be subject to the non-income measure of the corporate excise or the minimum corporate excise. See G.L. c. 63, §§ 32(a)(1), 39(a)(1). Where it is necessary for the QSUB to determine its apportionment percentage for purposes of computing the non-income measure of the excise, the QSUB must determine its apportionment factors based on its own, separately determined, property, payroll and sales.

Issue 6:

Do the single sales factor apportionment provisions of G.L. c. 63, § 38(l), pertaining to Section 38 manufacturers, apply to a corporate trust (including a corporate trust parent) that is engaged in manufacturing within the meaning the meaning of Section 38(l)?

Directive 6:

Yes. A corporate trust (including a corporate trust parent) must apportion its income in the same way as a corporation. Thus, if a corporate trust parent is engaged in manufacturing within the meaning of Section 38(l), it is subject to the single sales factor apportionment provisions of that section.

Discussion:

A corporate trust (including a corporate trust parent) that derives income from business activity which is taxable both in Massachusetts and in another state must apportion its income to Massachusetts using the apportionment provisions applicable to corporations under G.L. c. 63, § 38. See G.L. c. 62, § 8(a); 830 CMR 63.38.1(3). Corporations that are engaged in manufacturing within the meaning of G.L. c. 63, § 38(l)(1) and that are eligible to apportion their income must use the single sales factor apportionment formula set forth in G.L. c. 63, § 38(l)(2). Thus, a corporate trust must determine whether it is engaged in manufacturing based on the definition applicable to corporations under G.L. c. 63, § 38(l)(1). If a corporate trust is engaged in manufacturing under that definition and is otherwise eligible to apportion its income, then the corporate trust is subject to the single sales factor apportionment provisions of G.L. c. 63, § 38(l).

Issue 7:

In determining whether a corporate trust parent is engaged in manufacturing within the meaning of Section 38(l), how are the activities of the corporate trust parent's QSUB taken into account?

Directive 7:

The QSUB's activities are attributed to the corporate trust parent for purposes of applying the single sales factor apportionment provisions of Section 38(l) as explained in the discussion below.

Discussion:

A corporate trust parent is generally required to treat its QSUB's activities as its own for purposes of determining nexus, net income, total receipts (if applicable), and apportionment factors. See TIR 97-6. [\(4\)](#) Thus, for purposes of applying the definition of a manufacturing corporation under G.L. c. 63, § 38(l)(1), an S corporation parent (including a corporate trust parent) must take into account the gross receipts, payroll, and tangible property of its QSUB in the manner explained below.

The gross receipts of the QSUB must be characterized as either (i) derived from the sale of goods manufactured by the QSUB or (ii) derived from other sales. The QSUB's gross receipts, characterized in this manner, are attributed to the S corporation parent for use by the S corporation parent in determining whether it is engaged in manufacturing within the meaning of G.L. c. 63, § 38(l)(1). In applying that definition, gross receipts derived from the sale of goods manufactured by the QSUB are treated as gross receipts derived from the sale of goods manufactured by the S corporation parent. All other gross receipts of the QSUB are treated as gross receipts derived from other sales by the S corporation parent.

The payroll of the QSUB must be characterized as either (i) paid to employees working in the QSUB's manufacturing operations or (ii) paid to other employees. The QSUB's payroll, characterized in this manner, is attributed to the S corporation parent for use by the S corporation parent in determining whether it is engaged in manufacturing within the meaning of G.L. c. 63, § 38(l)(1). In applying that definition, payroll paid to employees working in the QSUB's manufacturing operations is treated as payroll paid to employees working in the S corporation parent's manufacturing operations. All other payroll of the QSUB is treated as paid to other employees of the S corporation parent.

The tangible property of the QSUB must be characterized as either (i) used in the QSUB's manufacturing operations or (ii) used in other activities. The tangible property, characterized in this manner, is attributed to the S corporation parent for use by the S corporation parent in determining whether it is engaged in manufacturing within the meaning of G.L. c. 63, § 38(l)(1). In applying that definition, tangible property used in the QSUB's manufacturing operations is treated as tangible property used in the S corporation parent's manufacturing operations. All other tangible personal property of the QSUB is treated as tangible property used in other activities of the S corporation parent.

Issue 8:

How should a corporate trust parent and its QSUB claim tax credits for which they are eligible?

Directive 8:

A corporate trust parent and its QSUB must determine and apply their credits separately. However, in determining its separate credit, the corporate trust parent may take into account the activities of its QSUB as explained in the discussion below.

Discussion:

A corporate trust parent is a personal income tax taxpayer and may claim only those credits allowed under Chapter 62. A QSUB is a corporate excise taxpayer and may claim only those credits allowed under Chapter 63. A corporate trust parent may take into account its QSUB's activities when determining its credits under Chapter 62. Alternatively, the QSUB may determine its credits separately and apply them to reduce the non-income measure of the corporate excise. However, the same activity cannot generate a credit for both the corporate trust and the QSUB. Thus, where the QSUB engages in an activity that can generate a credit under either Chapter 62 or Chapter 63 (e.g., the Economic Opportunity Area credit under G.L. c. 62, § 6(g) or G.L. c. 63, § 38N), the corporate trust parent and the QSUB may agree to take that activity into account in determining the credit for either the corporate trust parent or the QSUB, but not both. In contrast, where the QSUB engaged in activity that generates a credit under Chapter 63 only (e.g., the investment tax credit under G.L. c. 63, § 31A), the credit can be claimed only by the QSUB.

Issue 9:

How are distributions from a corporate trust (including a corporate trust parent) treated when received by resident and nonresident taxpayers?

Directive 9:

Resident beneficiaries of a corporate trust (including resident beneficiaries of a corporate trust parent) are subject to the personal income tax on all distributions made by the corporate trust out of tax-free earnings and profits. G.L. c. 62, § 8(c). See G.L. c. 62, § 8(c), as amended by St. 2000, c. 159, § 122. Nonresident beneficiaries are not subject to the personal income tax on distributions received on account of their investments in a corporate trust.

Discussion: Resident Beneficiaries

Resident beneficiaries of a corporate trust are subject to the personal income tax on distributions out of a corporate trust's tax-free earnings and profits. See G.L. c. 62, § 8(c). Tax-free earnings and profits

include the following amounts:

Category 1. Certain income earned by the corporate trust prior to taxable years beginning (i) after December 31, 1970 and (ii) during any period during which the corporate trust was not subject to the personal income tax by reason of the fact that it had elected not to file with the Commissioner an agreement to pay tax, G.L. c. 62, § 8(c); and

Category 2. Income earned by the corporate trust during taxable years beginning on or after July 1, 2000, for which the corporate trust's Massachusetts apportionment percentage is less than ten percent, G.L. c. 62, § 8(b)(iii); and

Category 3. Income earned by a corporate trust during taxable years beginning on or after July 1, 2000, that is properly apportioned to another state under 62, § 8(a) and G.L. c. 63, § 38. [\(5\)](#)

Nonresident Beneficiaries

In general, investment income is not considered Massachusetts source income under G.L. c. 62, § 5A. Thus, nonresidents are generally not subject to the Massachusetts personal income tax on distributions received on account of their investments in corporate trusts. However, amounts received as compensation for (i) services provided to a corporate trust, including but not limited to services provided as an employee, contractor, agent, representative, director, officer or trustee, or (ii) property provided to a corporate trust, will be subject to tax if such amounts are Massachusetts source income under G.L. c. 62, § 5A.

Issue 10:

How should a corporate trust (including a corporate trust parent) determine the amount of its

distributions that consist of tax-free earnings and profits) within the Categories set forth in Directive 9?

Directive 10:

In general, distributions by a corporate trust (including a corporate trust parent) are considered to be made first out of tax-free earnings and profits, to the extent thereof. See G.L. c. 62, § 8(c). A credit for taxes paid to other tax jurisdictions may be available for resident corporate trust beneficiaries with respect to distributions of tax-free earnings and profits in Categories 2 and 3. In order to trigger the availability of the credit, a corporate trust may treat a distribution of tax-free earnings and profits as coming first out of Category 2 and Category 3 earnings and profits to the extent thereof.

Discussion:

A distribution by a corporate trust (including a corporate trust parent) will be considered to be made out of tax-free earnings and profits up to the amount of the corporate trust's tax-free earnings and profits. See G.L. c. 62, 8(c). Such distributions are subject to the personal income tax at the beneficiary level when received by resident beneficiaries. Resident beneficiaries may be eligible for a credit for taxes paid by the corporate trust to other jurisdictions with regard to distributions of Category 2 and 3 tax-free earnings and profits. *Id.* The Commissioner will explain the computation of the credit in a subsequent regulation. In order to trigger the availability of the credit, a corporate trust may treat a distribution of tax-free earnings and profits as being made from Category 2 and 3 tax-free earnings and profits, to the extent thereof, before treating the distribution as being made out of Category 1 tax-free earnings and profits.

After tax-free earnings and profits income in Categories 1, 2 and 3 are exhausted, the remaining portion of a corporate trust distribution is treated as a distribution of income previously taxed to the corporate trust, to the extent of such previously taxed income. Distributions of income previously taxed to the corporate trust (*i.e.*, income apportioned to Massachusetts) are not subject to the personal income tax at the beneficiary level. The amount of each category of tax-free earnings and profits and the amount of income previously taxed to the corporate trust must be reduced to take into account the portion of such amounts that are distributed.

Each beneficiary is treated as receiving a share of the distribution as characterized at the corporate trust level. A beneficiary's share of the distribution within each relevant characterization or category must be determined by (i) multiplying the full amount of the distribution received by the beneficiary by the entire amount of the corporate trust's distribution within that characterization or category (determined at the corporate trust level) and (ii) dividing the resulting amount by the entire amount of the corporate trust distribution to all beneficiaries. Distributions to resident and nonresident beneficiaries must be characterized and categorized in the same manner.

In order to properly characterize its distributions, a corporate trust must maintain sufficient records to distinguish the portion of any distribution attributable to each category of tax-free earnings and profits and income that was previously taxed at the corporate trust level.

Issue 11:

Where an S corporation becomes a QSUB of a corporate trust parent pursuant to a Letter Ruling 99-17 type reorganization, how should the corporate trust parent treat S corporation income that was previously taxed as S corporation distributive income to the shareholders of the S corporation before the reorganization?

Directive 11:

Income that (i) was taxed to the shareholders of the S corporation as distributive S corporation income prior to the reorganization and (ii) has been retained by the corporation after it becomes a QSUB should not be subjected to tax again. As explained in the discussion below, such income may be treated as a tax-free S corporation distribution when distributed to the corporate trust parent's beneficiaries.

Discussion:

For federal tax purposes, all distributions of the QSUB's earnings will be treated as having been made by the corporate trust parent under IRC § 1361(b)(3). However, for Massachusetts purposes a corporate trust parent and its QSUBs are separate taxable entities. Therefore, the Commissioner will permit corporate trust parents and their subsidiary corporations to retain their separate identities for purposes of characterizing distributions of S corporation income earned before the Letter Ruling 99-17 reorganization and the related QSUB election. Thus, with regard to any QSUB, a corporate trust

parent can make tax free distributions up to the amount of income previously taxed to the S corporation shareholders that the QSUB could have distributed on a tax-free basis under the Massachusetts S Corporation Regulation, 830 CMR 62.17A.1(10), if the Letter Ruling 99-17 reorganization and QSUB election had not taken place. The amount of such income is determined on the last day of the QSUB's operations as an S corporation by reference to (i) the shareholders' Massachusetts adjusted basis (in the case of an S corporation with no Massachusetts earnings and profits) or (ii) the Massachusetts accumulated adjustments account (in the case of an S corporation with Massachusetts earnings and profits). See 830 CMR 62.17A.1(10)(d). Adjusted basis and accumulated adjustments accounts are reduced to take into account distributions and are not increased as a result of the QSUB's or the corporate trust parent's activities.

Issue 12:

Where an S corporation becomes a QSUB of a corporate trust parent pursuant to a Letter Ruling 99-17 type reorganization, what happens to any S corporation earnings and profits derived from a prior taxable year during which the S corporation was treated as a C corporation for Massachusetts tax purposes?

Directive 12:

Income that (i) was earned by an S corporation prior to the reorganization pursuant to which it became a QSUB, (ii) was taxed to such S corporation under the corporate excise in a taxable year during which the corporation was treated as a Massachusetts C corporation and (iii) has been retained by such S corporation after the reorganization, will retain its identity as C corporation earnings and profits as provided below.

Discussion:

The tax imposed on corporate trust distributions under G.L. c. 62, § 8(c) applies to income that has previously not been subject to tax under Chapter 62. Income that was subject to the net income measure of the corporate excise in a prior C corporation year is subject to tax at the shareholder level when distributed by an S corporation. See 830 CMR 62.17A.1(10)(d)2.c. Chapter 62 does not permit S corporation shareholders to change this treatment by transferring their shares to a corporate trust. Therefore, such C corporation earnings and profits are subject to tax at the beneficiary level when distributed.

The amount of an S corporation's earnings and profits, if any, should be reflected in the S corporation's earnings and profits account immediately prior to the election pursuant to which it became a QSUB. See 830 CMR 62.17A.1(10)(c). The amount of the S corporation's Massachusetts earnings and profits account as of the effective date of the election is treated as C corporation earnings and profits when distributed and is subject to tax when received by resident beneficiaries.

Issue 13:

Where a QSUB of a corporate trust parent has (i) income previously taxed to S corporation shareholders as describe in Directive 11 or (ii) C corporation earnings and profits as described in Directive 12, what ordering rules apply for purposes of characterizing distributions?

Directive 13:

A distribution by a corporate trust parent of a QSUB with (i) income previously taxed to S corporation shareholders or (ii) C corporation earnings and profits should characterize its distributions as set forth in the discussion below.

Discussion:

In the absence of a specific statutory ordering rule, distributions by a corporate trust parent of a QSUB with previously taxed S corporation income or C corporation earnings and profits should characterize its distributions in the following order.

1. First, the distribution should be characterized as a tax-free distribution of income previously taxed to S corporation shareholders to the extent permitted under Directive 11 and to the extent of such income. The amount of such income is not increased by any of the activities of the QSUB or corporate trust parent.

2. Second, the distribution should be characterized as a distribution of earnings and profits accumulated by the corporate trust as described in Directives 9 and 10, to the extent of the corporate trust's tax-free earnings and profits and previously taxed earnings and profits. A corporate trust's earnings and profits are increased as a result of QSUB income being attributed to the corporate trust.

3. Third, the distribution should be characterized as a distribution by an S corporation in excess of the amounts that may be distributed free of tax under 830 CMR 62.17A.1(10). C corporation earnings and profits described in Directive 12 must be taken into account at this point in the manner provided 830 CMR 62.17A.1(10)(d). Thus, C corporation earnings and profits are deemed to be distributed after previously taxed S corporation income and corporate trust earnings and profits.

The amounts in all relevant accounts must be reduced to account for amounts deemed distributed under this Directive.

Frederick A. Laskey,
Commissioner of Revenue

December 15, 2000

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Footnotes:

¹.As discussed in Directive 1, above, the IRS will allow a Letter Ruling 99-17 type reorganization to be treated as a tax-free reorganization under IRC § 368(a)(1)(F). An "F" reorganization does not require the S corporation to close its taxable year. ([Return to text](#))

².As discussed in Directive 1, above, the IRS will allow a Letter Ruling 99-17 type reorganization to be treated as a tax-free reorganization under IRC § 368(a)(1)(F). An "F" reorganization does not require the S corporation to close its taxable year. However, "F" reorganization treatment is not mandatory. It is, therefore, possible that a taxpayer may treat a Letter Ruling 99-17 type reorganization in such a way as to require the S corporation to close its taxable year. ([Return to text](#))

³ It is the Department's understanding that the Internal Revenue Service had at one time advised some taxpayers that a new taxpayer identification number was required in order to process the corporate trust parent's election to be treated as a corporation for federal tax purposes. Where this has happened, the corporate trust parent may continue to use the previously existing S corporation's taxpayer identification number for Massachusetts purposes provided that it also uses the previous tax identification number for federal filing purposes. ([Return to text](#))

⁴.Under TIR 97-6, the activities and attributes of a QSUB are generally required to be attributed to its S corporation parent. In addition to the specific activities and attributes listed in TIR 97-6, manufacturing activities will also be attributed to an S corporation parent for purposes of determining whether the S corporation parent is a Section 38 manufacturer. ([Return to text](#))

⁵.There are several other categories of tax-free earnings and profits relevant to specialized corporate trusts such as Regulated Investment Companies (RICs), holding companies, and Real Estate Mortgage Investment Conduits (REMICS). See G.L. c. 62, § 8(b). ([Return to text](#))