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## Letter Ruling 91-3: Security Corporation Holding Beneficial Interests of a Business Trust

July 17, 1991

You have asked whether (Parent Company) will continue to be classified as a security corporation under G.L. c. 63, § 38B(a) after acquiring all the shares of a business trust.

### I. Facts

The Parent Company is a Massachusetts corporation currently classified as a security corporation under G.L. c. 63, § 38B(a). Among the securities that the Parent Company now holds are all the outstanding shares of an operating subsidiary, (Subsidiary Corporation), a Delaware corporation.

The Subsidiary Corporation currently owns all the outstanding shares of two second-tier subsidiaries, a Delaware corporation, and , a British corporation.

The business group described above is contemplating an internal restructuring and an expansion of its business activities. The restructuring will involve the formation of a business trust <sup>1</sup> and two new operating subsidiaries, which will be organized as corporations. The Parent Company will hold all the beneficial interests of the business trust (the Holding Company) which will in turn hold, directly or indirectly, all the shares of the existing and newly formed operating subsidiaries. The business group plans to organize its operating companies under the control of a single entity, the Holding Company, in order to monitor and coordinate its operations while keeping its separate business activities in separate corporations.

The Parent Company will have no direct rights to manage or control the business of the Holding Company. The Parent Company will merely have voting rights as a beneficial owner of the business trust to elect management and vote on certain extraordinary events. For Massachusetts tax purposes, you anticipate that the Holding Company will be a corporate trust that will satisfy the definition of a "holding company" under G.L. c. 62, § 8, and that will therefore be exempt from income taxation under the provisions of that section.

### II. Issue

May the Parent Company maintain its classification as a security corporation under G.L. c. 63, § 38B(a) if it acquires all the shares of a Massachusetts business trust (i.e. Holding Company) in the transaction described above?

### III. Discussion

General Laws chapter 63, section 38B(a) provides favorable tax treatment to any corporation "engaged exclusively in buying, selling, dealing in, or holding securities in its own behalf and not as a broker." When determining whether a corporation classified under G. L. c. 63, § 38, may acquire a particular instrument, a two-fold inquiry must be pursued: first, is the instrument a "security;" and, second, is it a security acquired and held for investment purposes? A corporation may be classified as a security corporation only if both of these questions are answered affirmatively. State Tax Commission v. PoGM Co., 369 Mass. 611 (1976).

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## A. Interests in a Business Trust as "Securities"

G.L. c. 63, § 38B, requires that a security corporation hold securities. Although characterizing any instrument as a security in the context of securities regulation will not necessarily establish the interest as a security for purposes of section 38B, nevertheless, such a characterization is significant to the determination of whether it is the type of instrument the Legislature intended security corporations to hold. See Letter Ruling 89-10.

In general, securities have been characterized for purposes of securities regulation by, *inter alia*, the following attributes: (1) they are marketable, *United States v. Leslie Salt Co.*, 350 U.S. 383, 393-394; (2) they pay or accrue dividends or interest, *Valley Stream Teachers Federal Credit Union v. Commissioner of Banks*, 376 Mass. 845, 858 (1978); (3) they appreciate (or depreciate) in value, *id.*; (4) they confer voting rights, *id.*; and (5) they may be pledged or hypothecated, *Principe v. the McDonald's Corp.*, 463 F.Supp. 1149 (1979). Shares of a business trust have been considered to be securities under these general standards. See *Securities and Exchange Commission v. Perry*, CCH Federal Securities Law Services 90,117 (N.D.Okla. 1938); see also *Hecht v. Malley*, 265 U.S. 44 (1923); *Commissioner of Revenue v. Northeast Petroleum Corporation*, 401 Mass. 44, 47 (1987). Furthermore, the Sale of Securities Act, which was adopted eight years before security corporation classification was first extended by the Massachusetts Legislature, <sup>2</sup> included in its definition of a security "any...certificate under a voting trust agreement" and "any certificate or instrument representing...an interest in the capital, assets or property of any...unincorporated organization, association, [or] trust..." St. 1921, c. 499, s. 1. We conclude from these precedents that the certificates representing interests in a Massachusetts business trust may also constitute securities for purposes of G.L. c. 63, § 38B(a). <sup>3</sup>

## B. Securities Held for Investment

The status of an instrument as a "security" does not end the inquiry under § 38B, however. A security corporation may acquire and hold securities only for investment purposes. *State Tax Commission v. PoGM Co.*, 369 Mass. 611 (1976); *Industrial Finance Corp. v. State Tax Commission*, 367 Mass. 360, 366 (1975); *Edgerson, Inc. v. Commissioner of Revenue*, A.T.B. No. 141859 (October 6, 1989). The Commissioner has generally presumed that marketable securities are held for investment purposes. See DOR Directive 86-34; Letter Ruling 89q-2 (status of an obligation as a marketable security or, conversely, one that is not readily marketable, reflects upon the purposes for which it is acquired and held). We must now consider whether the shares of a wholly owned subsidiary may be held for investment purposes within the requirements of section 38B(a).

The original purpose of G.L. c. 63, § 38B, was to encourage the incorporation of investment trusts in Massachusetts. *Industrial Finance Corp. v. State Tax Commission*, 367 Mass. 360, 366 (1975). These incorporated trusts provided vehicles by which individual investors could pool their assets to obtain diversification and expert management without sacrificing liquidity. *Id.* See also *Aldred Inv. Trust v. Securities & Exchange Commission*, 151 F.2d 254, 260 (1st Cir. 1945), cert. den. 326 U.S. 795 (1945). There appears to be inconsistency between this original intent and a security corporation's maintenance of wholly-owned operating subsidiaries, either in the form of corporations or business trusts. First, a business structure in which a security corporation holds all the shares of an operating company does not promote diversification of assets or liquidity in the manner of an incorporated investment trust. Second, a security corporation with an operating subsidiary holds at least the power to control the operations of its subsidiary, and thereby to engage in business activity, even if it refrains from exercising that power.

Although the original intent behind § 38B may not support the ability of a security corporation to maintain subsidiaries, "[r]ecent amendment has broadened the applicability of G.L. c. 63, § 38B." *Industrial Finance Corp. v. State Tax Commission*, 367 Mass. 360, 366 (1975). In particular, St. 1966, c. 698, § 60, extended a reduced excise under § 38B(b) to any bank holding company that engages exclusively in buying, selling, dealing in or holding securities on its own behalf, and not as a broker. In *Industrial Finance*, the Court observed that bank holding companies, which often own operating subsidiaries and which may exercise certain management and control responsibilities, do not meet the definition of investment trust, but may nevertheless be entitled to benefit from G.L. c. 63, § 38B. <sup>4</sup> The common feature shared by investment trusts and bank holding companies, the Court noted, is that both entities invest in securities. *Id.*

We do not conclude that corporations classified under G.L. c. 63, § 38B(a), may engage in the same activities that may be available to bank holding companies classified under G.L. c. 63, § 38B(b).

Nevertheless, we infer from St. 1966, c. 698, § 60, and from the interpretation of this amendment in Industrial Finance, that a security corporation may hold all the shares of a subsidiary for investment purposes, even if the corporation is classified under § 38B(a). Whether a particular corporation in fact holds shares of a subsidiary for investment purposes can be determined only on a case-by-case basis. <sup>5</sup>

#### IV. Conclusion

Based on the facts stated in your request, we rule that the Parent Company, which is currently classified as a security corporation, may maintain its current classification as a security corporation even though it acquires all the shares of a Massachusetts business trust. Should the Parent Company engage in any activity beyond exclusively buying, selling, dealing in, or holding securities on its own behalf, the impermissible activity will be the basis for revocation of security corporation status.

Very truly yours,  
/s/Mitchell Adams  
Mitchell Adams  
Commissioner of Revenue  
July 17, 1991  
LR 91-3

#### Footnotes:

1 For purposes of this ruling, we assume that the holding company will in fact be organized as a trust, rather than as a partnership, under Massachusetts law. See *Williams v. Milton*, 215 Mass. 1 (1913).

2 St. 1929, c. 359, s. 1.

3 You suggest that certificates representing beneficial interests in a business trust should be deemed to be securities because of the similarity between these interests and the shares of a corporation. While we agree that substantial similarity exists, most importantly in the constraints on the ability of certificate holders and shareholders to manage or control business operations, nevertheless the legal characteristics and tax treatment of business trusts and corporations differ under Massachusetts law. In particular, the certificate holder of a business trust has an equitable interest in the assets of the trust that is unlike any interest of a corporate shareholder. *State Tax Commission v. Colbert*, 344 Mass. 494 (1962). The securities that may be held by a security corporation are not limited to corporate shares, however. See Letter Ruling 82-8 (limited partnership interest). We conclude that the beneficial interests in a business trust may constitute securities for purposes of G.L. c. 63, § 38B, provided that they are acquired and held for investment purposes.

4 For discussion of the ability of bank holding companies to classify as security corporations under G.L. c. 63, § 38B(b), see Letter Ruling 1988-13.

5 See, e.g., Letter Ruling 85-23. Any business activity on the part of the parent corporation, including exercise of control over the operation of its subsidiary, will be sufficient to bar it from treatment as a security corporation. See *Chatham Corp. v State Tax Commission*, 362 Mass. 216, 219 (1972). In determining whether a corporation's activities cross this line, the Department will distinguish between activities in which an ordinary investor in the securities market would engage, and activities that an ordinary investor would not pursue, such as participating in the management of a business or providing capital in the form of loans.

Because the shares of wholly-owned subsidiaries will not be publicly traded, there can be no presumption that such securities are held for investment purposes. The Department will closely scrutinize any actions of a security corporation with regard to these securities. Furthermore, because the holder of a beneficial interest in a business trust has an equitable interest in the trust's assets, the Department will scrutinize the assets of a business trust whose beneficial interests are held by a security corporation to insure that the trust is not used to circumvent the restrictions on the type of assets that the security corporation may hold.

