Letter Ruling 95-7: Tax Classification of Joint Trading Account Established by a Group of Mutual Funds

May 9, 1995

You have requested a ruling on behalf of ********** (collectively, the "Advisers"). The request is also on behalf of a specified group of mutual funds to which the Advisers provide counsel, and any additional mutual funds which subsequently become a part of this group (collectively, the "Funds"). Your question is whether a joint trading account (the "Joint Account") established by the Funds is a separate entity for Massachusetts tax purposes, and whether Massachusetts requires any income tax or corporate excise returns to be filed with respect to the Joint Account.

I. FACTS

The Joint Account was established to allow the Funds to manage their uninvested cash balances more efficiently and more profitably. Previously, each Fund invested its daily cash balances separately in Short Term Investments (as defined below). The custodian bank would charge a separate processing fee for each transaction in a Short Term Investment. The purchase and maturity of a Short Term Investment would be separate transactions, each subject to a separate processing fee.

By using the Joint Account to pool their cash balances available for such investments, the Funds are able to purchase a smaller number of Short Term Investments in larger denominations. It is anticipated that the pooling of the Funds' cash balances will significantly reduce the number of transactions, and hence the aggregate processing fees, for such investments. It is also anticipated that the larger denomination Short Term Investments held through the Joint Account may carry a higher rate of return than the Funds could obtain if each Fund were to invest separately in smaller denomination Short Term Investments of the same aggregate amount. For these reasons, the Funds have decided to utilize the Joint Account, in the manner described below, to take advantage of the reduced transaction costs and higher rates of return potentially available.

On a daily basis, each Fund transfers into the Joint Account the cash it wishes to invest through the Joint Account. Cash transferred into the Joint Account is invested on the same day in one or more of the following types of investments ("Short Term Investments"), as specifically directed by the contributing Fund: (1) interest bearing or discounted commercial paper with a remaining maturity not to exceed thirty days issued by persons on the Advisers' Commercial Paper Approved List ("ACPAL"); (2) securities issued or guaranteed by the United States government or its agencies, authorities or instrumentalities with remaining maturities not to exceed thirty days ("U.S. Government Securities"); or (3) repurchase agreements, with maturities not to exceed seven days, purchased

from issuers on ACPAL. Repurchase agreements must be collateralized by U.S. Government Securities.

Short Term Investments are purchased through the Joint Account in accordance with predetermined procedures similar to those previously employed by the Advisers on behalf of the Funds. The Advisers administer the Joint Account as part of their duties under their investment advisory contracts with each Fund and do not collect any additional fee for such services. You represent that the Advisers' activities with respect to the Joint Account are purely ministerial.

Cash contributed by a Fund into the Joint Account is commingled with cash contributed by other Funds designated for the same type of Short Term Investment solely for the purpose of reducing transaction costs and achieving economies of scale in the purchase of investments. The books and records of the Funds and of the Joint Account are updated on a daily basis to reflect each Fund's pro rata share of each such investment as a separate asset of such Fund. Short Term Investments within each of the three categories listed above are not treated as fungible; each Short Term Investment is separately identified as belonging to a specific Fund or Funds. Except for the pooling of moneys to purchase an investment, the Joint Account is not distinguishable from any other account maintained by a Fund with its custodian bank. The sole function of the Joint Account is to provide a convenient procedure for the Funds to participate in transactions which would otherwise require individual management by each Fund.

Each Fund retains all beneficial ownership rights with respect to its pro rata share of each investment held through the Joint Account, including interest and principal payable thereon. A Fund may sell its fractional portion of a Short Term Investment if the cost of such transaction is borne solely by the selling Fund and the transaction does not adversely affect the other Funds participating in the Short Term Investment. It has been represented that, upon the maturity of a Short Term Investment, the proceeds will be automatically distributed by the administrator of the Joint Account to the Funds in accordance with their respective interests in such Investment unless a Fund directs at that time that its share of the proceeds be reinvested in a specified type of Short Term Investment. In the latter case, the proceeds belonging to the directing Fund will be commingled with and invested in the same manner as other cash transfers to the Joint Account for investment on that day.

If a Fund wishes to withdraw its share of a Short Term Investment from the Joint Account prior to the maturity of such Investment, the administrator of the Joint Account will liquidate only the pro rata portion of the Investment attributable to the withdrawing Fund for the purpose of distributing cash to the withdrawing Fund, leaving the interests of other Funds in such Investment unaffected by such withdrawal.

You represent that: (1) a Fund that acquires an interest in a Short Term Investment with a maturity longer than one day through the Joint Account will withdraw its interest in such investment only for the purpose of meeting ordinary cash needs, such as funding net share redemptions, paying expenses, or settling securities purchases, and (2) a Fund will not withdraw its interest in a Short Term Investment for the purpose of reinvesting in a higher yielding Short Term Investment that becomes available after the purchase of such Investment (i.e., to attempt to profit from short term swings in market interest rates).

The Funds will be the only entities investing through the Joint Account. The interest of a Fund in a Short Term Investment held through the Joint Account is not transferable to any other party, including another Fund. No Fund will be allowed to create a negative balance in the Joint Account; accordingly, the Joint Account could not be used as a mechanism for one Fund to borrow from another Fund. No Fund is obligated to invest through the Joint Account or maintain any minimum balance therein.

II. DISCUSSION

In resolving the question as to whether the Joint Account is a separate entity for Massachusetts tax purposes we look to the types of entities which the organization could possibly be. As a threshold matter, we note that the Joint Account is not a corporation or a corporate trust under Massachusetts tax law, since each of these two entities is defined by statute and the Joint Account does not meet with either definition. See c. 63, § 30(1), c. 62, § 1(j). Moreover, the Joint Account is not a trust

taxable under c. 62, § 10, because the Advisers are given only ministerial duties and the Funds retain the benefits of direct ownership. In contrast to this, a trust generally implies that the principal will act on behalf of the beneficiary, who does not share in the discharge of responsibility. See Frost v. Thompson, 219 Mass. 360, 365 (1914). See also Treas. Reg. § 301.7701 4.

The Joint Account could be a partnership under Massachusetts tax law, since the Massachusetts tax provisions do not define this term. See G.L. c. 62, § 17. The inquiry as to whether an organization is a partnership for purposes of Massachusetts tax law is fact intensive. Federal tax law is helpful to this inquiry, but it is not controlling. Under federal tax law a partnership is broadly defined as "a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on." See Internal Revenue Code ("Code") §§ 761(a), 7701(a)(2). However, under federal tax law, the mere undertaking to share expenses, or the mere co ownership of property, does not give rise to a partnership. See Regs. §§ 1.761 1(a), 301 7701 3(1). The federal regulations promulgated under Code §§ 761(a) and 7701(a)(2) indicate that in making a determination as to whether an organization is a mere expense sharing operation or co ownership of property, the two key facts are whether the members of the organization actively associate and whether the organization has a profit motive. See id.

Your ruling request states that the Funds participating in the Joint Account do not do so for purposes of business profit, but rather to diminish costs (i.e., to realize certain economies of scale).[1] Moreover, your request states that the Funds will not engage in any joint decision making or "association" in connection with the Joint Account. Finally, you note that, if the Joint Account is a partnership for purposes of federal tax law, the Funds may still be able to report their income on a co ownership basis, since they would be deemed to have elected out of partnership treatment pursuant to Code § 761(a).[2]

While the issue is a close one, we think that this particular arrangement is not a partnership for purposes of the income reporting rules set forth in c. 62, § 17, but rather constitutes the mere sharing of expenses or co ownership of property for income reporting purposes. In reaching this conclusion, we view all the pertinent facts and circumstances, including, the fact that: (1) the Funds independently determine the purchases and sales which they will make as part of the Joint Account; (2) the Funds do not actively associate through the Joint Account in any respect; (3) the activity of the Joint Account, standing alone, does not closely resemble business activity;[3] and (4) the Funds can compute their individual income without the necessity of computing the taxable income of the Joint Account.

We stress that this partnership determination is with respect to the income reporting rules set forth in c. 62, § 17, and does not necessarily apply for other purposes (for example, for purposes of nexus determinations). In addition, we reserve the right to revisit this question if for some reason the Joint Account either elects to, or is required to, report its income as a partnership for federal tax law purposes.

III. CONCLUSION

The Joint Account is not a trust, corporation or corporate trust for purposes of Massachusetts tax law. In addition, the Joint Account is not a partnership for purposes of the income reporting rules set forth in c. 62, § 17. For this reason, the Joint Account, as such, is not required to submit an income tax or a corporate excise tax filing to Massachusetts. Rather, the Funds which invest through the Joint Account should account for their income derived from their investments on an individual basis.

With respect to partnership classification, our ruling pertains only with respect to the income reporting rules set forth in c. 62, § 17. Thus, it is possible that the Joint Account could constitute a partnership for some other purpose (for example, for purposes of a nexus determination). Moreover, we reserve the right to re evaluate this question if for some reason the Joint Account either elects to, or is required to, report its income as a partnership for federal tax law purposes.

Very truly yours,

/s/Mitchell Adams

Mitchell Adams
Commissioner of Revenue

MA:HMP:mtf

LR 95 7

---

[1] See G.L. c. 62, § 17 ("Individuals carrying on business as partners shall be liable for the taxes imposed by this chapter only in their separate or individual capacities") (emphasis added).

[2] But see Madison Gas & Electric Co. v. Cmmr., 72 T.C. 521 (1979), aff'd 633 F.2d 512 (7th Cir. 1980) (collective effort to realize certain economies of scale supports determination that expense sharing activity is a partnership, since it evidences a joint profit motive) (activity was a utility operation). See also Rev. Rul. 68 344 (expense sharing organization deemed to be a partnership, even though the IRS concludes that there is no profit motive) (activity was a utility operation).

[3] This deemed election would apply because the Funds jointly purchasing the investment property would: (1) be able to compute their income without the necessity of computing the taxable income of the Joint Account; (2) own the property as co owners; (3) reserve the right to take and dispose of their shares of property separately; and (4) not actively conduct business or irrevocably authorize a representative to buy and sell property on their behalf. See Treas. Reg. §§ 1.761 2(d)(2)(ii), 1.761 2(a)(2). The Massachusetts partnership filing, Form 3, uses information taken from the federal partnership filing, Form 1065, which in this case because of the deemed election would not be required.