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Letter Ruling 00-9: Tax Consequences of Converting a Subsidiary Manufacturing Corporation into a Limited Liability Company

June 9, 2000

You request certain rulings on the tax consequences of a proposed transaction between ***** (the "parent") and ***** (the "subsidiary").

STATEMENT OF FACTS

The following is your representation of the facts upon which we base this letter ruling. The parent is a Georgia corporation, and is not currently a taxpayer in Massachusetts. The parent is the 100% owner of the subsidiary. The subsidiary is a Massachusetts corporation, incorporated under the provisions of G.L. c. 156B. The subsidiary has its headquarters and physical plant in Massachusetts. The subsidiary is currently classified as a domestic manufacturing corporation within the meaning of G.L. c. 63, § 38C. The parent has no manufacturing activity in Massachusetts other than the activities of the subsidiary.

The parent is considering merging the subsidiary into a single member limited liability company (the "LLC"), organized under the laws of Georgia. The parent will continue to hold a 100% interest in the LLC. The merger will take place within a single taxable year, and will be in complete cancellation or redemption of the subsidiary's stock. After its creation, the LLC will elect, for federal income tax purposes, pursuant to federal Treasury Regulations §§ 301.7701 through 301.7701-4, to be disregarded as an entity separate from its owner, and will be treated as a division of the parent for federal income tax purposes. After the transaction, the LLC will continue to perform the same activities and sell the same products to the same consumers as the subsidiary does today.

RULINGS REQUESTED

1. To the extent that the subsidiary's merger into the LLC will be treated as a tax-free liquidation and dissolution of a subsidiary for federal tax purposes under IRC §§ 332 and 337, it will also be treated as a tax-free liquidation and dissolution of a subsidiary for Massachusetts corporate excise purposes.
2. Whether the parent, as a result of the proposed transaction, will have nexus with Massachusetts for corporate excise purposes.
3. Whether, following the proposed transaction, the parent will be entitled to apportion its income to

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Massachusetts in accordance with the provisions of G.L. c. 63, § 38. In particular, you ask whether:

- a. Following the proposed transaction, any real or tangible personal property owned by the LLC will be treated as real and tangible property owned by the parent and will be included in the property factor of the parent's corporate excise apportionment formula, G.L. c. 63, § 38(d), subject to appropriate adjustments for interdivisional leases and rentals, if any, and based upon the property's original cost to the subsidiary.
 - b. Following the proposed transaction, any wages paid to the employees of the LLC will be treated as wages paid by the parent and will be included in the payroll factor of the parent's corporate excise apportionment formula, G.L. c. 63, § 38(e).
 - c. Following the proposed transaction, any sales made by the LLC will be included in the sales factor of the parent's apportionment formula, G.L. c. 63, § 38(f), subject to appropriate adjustments for interdivisional sales, if any.
4. Following the proposed transaction, whether the parent will be a manufacturing corporation within the meaning of G.L. c. 63, § 38(l), provided that the activities of the LLC continue without substantial change.
 5. Following the proposed transaction, whether the parent will be a foreign manufacturing corporation within the meaning of G.L. c. 63, § 42B, provided that the activities of the LLC continue without substantial change.
 6. Following the proposed transaction, and upon classification as a manufacturing corporation pursuant to G.L. c. 59, § 5, whether the machinery of the LLC will be eligible for the local property tax exemption provided by G.L. c. 59, § 5, clause (16)(3).

RULINGS AND DISCUSSION

Ruling 1:

To the extent that the subsidiary's merger into the LLC will be treated as a tax-free liquidation and dissolution of a subsidiary for federal tax purposes under IRC §§ 332 and 337, it will also be treated as a tax-free liquidation and dissolution of a subsidiary for Massachusetts corporate excise purposes.

Discussion:

The Internal Revenue Code (I.R.C.) provides that "no gain or loss shall be recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation." I.R.C. § 332(a). To be eligible for this tax-free liquidation, the corporation receiving the property must own at least 80% of the liquidated corporation, and the liquidation must be in complete cancellation or redemption of all its stock. I.R.C. § 332(b). The liquidation under most circumstances must occur within a taxable year. *Id.* The corporation being liquidated also recognizes no gain or loss as a result of the transaction. I.R.C. § 337(a).

Massachusetts bases its definitions of gross income, net income, and capital gains, in part on the federal definitions of those terms. G.L. c. 63, §§ 30.3, 30.4, 38(a)(2). If the parent and the subsidiary recognize no gain or loss as a result of the proposed transaction in calculating their gross income, net income, or capital gains at the federal level, then there is likewise no gain or loss to be included in the Massachusetts corporate excise calculations. See G.L. c. 63, §§ 30.3, 30.4, 38(a)(2). Thus, to the extent that the merger is recognized to be a tax-free distribution in complete liquidation of the subsidiary at the federal level, it is also a tax-free transaction at the state level.

Ruling 2:

As a result of the proposed transaction, the parent will have nexus with Massachusetts for corporate excise purposes.

Discussion:

The federal entity classification rules are used to determine the tax filing status of various business entities. Treas. Reg. § 301.7701-1, 2. Known as the “check the box rules,” they allow an unincorporated business entity, such as the LLC, to elect to be treated either as an entity separate from its owners for tax filing purposes, or as a “disregarded entity,” and thus treated as a sole proprietorship, branch, or division of the owner. Treas. Reg. § 301.7701-1. Massachusetts has adopted the federal check-the-box rules for LLCs, and recognizes the federal entity classification for state income tax and corporate excise purposes. See TIR 97-8, DD 00-4.

Under Massachusetts law, a foreign corporation that is doing business in the Commonwealth, or owns or uses any part of its capital, plant, or any other property in the Commonwealth, has nexus and is required to pay the corporate excise. G.L. c. 63, § 39. See 830 CMR 63.39.1. For purposes of the statute, “doing business” includes every act, power, right, privilege, or immunity exercised or enjoyed in the Commonwealth. *Id.* The treatment of the LLC as a division of the parent in Massachusetts for corporate excise purposes, along with the intangible rights and powers granted to the parent, such as access to the court system and the state’s infrastructure, create nexus.

Ruling 3:

Following the proposed transaction, the parent will be entitled to apportion its income to Massachusetts in accordance with the provisions of G.L. c. 63, § 38. In particular:

- a. Following the proposed transaction, any real or tangible personal property owned by the LLC will be treated as real and tangible property owned by the parent for property factor purposes and will be included in the property factor of the parent’s corporate excise apportionment formula, G.L. c. 63, § 38(d), subject to appropriate adjustments for interdivisional leases and rentals, if any, and based upon the property’s original cost to the subsidiary.
- b. Following the proposed transaction, any wages paid to the employees of the LLC will be treated as wages paid by the parent and will be included in the payroll factor of the parent’s corporate excise apportionment formula, G.L. c. 63, § 38(e).
- c. Following the proposed transaction, any sales made by the LLC will be included in the sales factor of the parent’s apportionment formula, G.L. c. 63, § 38(f), subject to appropriate adjustments for interdivisional sales, if any.

The parent will also use the apportionment formula in calculating the non-income measure of the corporate excise. G.L. c. 30 §§ 39(a), 30.7-30.11.

Discussion:

The parent, after the proposed transaction, will have income from activity that is taxable both inside and outside Massachusetts, and for property factor purposes will be considered to have property both inside and outside Massachusetts. It must apportion its taxable net income to determine which portion of its business is derived from activity in Massachusetts. G.L. c. 63, § 38. It must also use the apportionment formula in calculating the non-income measure of the excise. G.L. c. 30 §§ 39(a),

30.7-30.11.

a. Property factor issues.

(1) Interdivisional leases and rentals.

The parent must calculate its property factor by including the average value of the real and tangible personal property owned or rented and used by the parent and the LLC in Massachusetts during the taxable year in the numerator of the fraction. 830 CMR 63.38.1(7). The parent includes the average value of all its real and tangible personal property owned or rented and used everywhere during the taxable year in the denominator of the fraction. *Id.* In order to avoid duplication, however, certain adjustments must be made to the value of any property leased or rented by the parent to the LLC or vice versa. *Cf.* 830 CMR 63.38.1(13)(d)(1). *See also* LR 99-13.

Because the parent is 100% owner of the LLC, the following rules apply. Where the parent rents property to the LLC, or the LLC rents property to the parent, the parent must include the original cost of the property in its property factor. No portion of the value of this property as leased between the parent or the LLC is included in the numerator or the denominator of the property factor.

(2) Basis of the property.

The cost of property to be included in the property factor of the parent is valued at its original cost. 830 CMR 63.38.1(7)(e). "Original cost" means the basis of the property for federal income tax purposes (prior to any federal adjustments) at the time of acquisition by the taxpayer. 830 CMR 63.38.1(7)(e)(1). This amount is adjusted by subsequent capital additions and improvements to the property, and by partial disposition of the property, as by reason of sale, exchange or abandonment. *Id.* Property counted in the property factor is not adjusted for subsequent depreciation. *Id.* The basis of property received by the parent for federal income tax purposes, and thus for Massachusetts property factor purposes, is the same as it was in the hands of the subsidiary. *See* I.R.C. § 334(b)(1).

b. Sales factor issue, adjustments for interdivisional sales.

The parent must calculate its sales factor by including its total sales in Massachusetts, including the sales of the LLC, in the numerator of the fraction. 830 CMR 63.38.1(9). It must include its total sales everywhere in the denominator of the fraction. *Id.* In order to avoid duplication, however, sales by the parent to the LLC and sales by the LLC to the parent must be eliminated from both the numerator and the denominator of the sales factor. *Cf.* 830 CFR 63.38.1(13)(d)(3); *cf.* LR 99-13.

Rulings 4 and 5:

Following the proposed transaction, the parent may qualify for manufacturing corporation status and be a manufacturing corporation within the meaning of G.L. c. 63, § 38(l).

Following the proposed transaction, the parent may qualify for foreign manufacturing corporation status or foreign manufacturing corporation classification within the meaning of G.L. c. 63, § 42B and 830 CMR 58.2.1.

Discussion:

Because of the fact intensive nature of determining a corporation's classification as a manufacturing corporation, the Department of Revenue normally does not issue letter rulings regarding a corporation's classification. LR 90-5. *See* 830 CMR 62C.3.2(3)(f). Rather, a corporation that seeks classification as a manufacturing corporation must usually apply for the classification using the procedure set out in 830 CMR 58.2.1(7), (8). *See also* AP 303.1 *et seq.* Based on DD 00-4, "Manufacturing Corporation Status of LLCs, Partnerships, and Corporate Members and Partners," however, we rule that the parent, as sole member of an LLC that is treated as a disregarded entity

for corporate excise purposes, may be considered for manufacturing corporation status or classification based on the activities of the LLC. Under DD 00-4, in determining whether a corporation is a manufacturing corporation under 830 CMR 58.2.1, the corporation may take into account its pro rata share, as that term is defined in 830 CMR 63.38.1(13)(f), of the manufacturing activities a single member LLC that elects to be disregarded as an entity separate from its owner. See also G.L. c. 63, §§ 38(l), 42B.

Ruling 6:

Following the proposed transaction, and upon classification of the parent as a manufacturing corporation pursuant to G.L. c. 59, § 5, the machinery of the LLC will not be eligible for the local property tax exemption provided by G.L. c. 59, § 5, clause (16)(3).

Discussion:

A manufacturing corporation that is so classified based on the manufacturing activities of an LLC in which it is a member is allowed the local property tax exemption on machinery that the corporation itself owns, but not on machinery owned by the LLC. DD 00-4, Directive 4(d). [\[1\]](#) The fact that the subsidiary is treated as a division of the parent for federal income and excise tax purposes has no bearing on its treatment for the imposition of other taxes, including local property taxes. Cf. TIR 97-8. The entities continue to remain distinct for all other purposes, enjoying separate rights and duties, conferred under different statutes. Compare G.L. c. 155 ("General Provisions Relative to Corporations," which describes the powers and duties of both domestic and foreign corporations) with G.L. c. 156C ("Limited Liability Company Act," which describes the powers and duties of both domestic and foreign LLCs). See generally *Nashoba Communications Limited Partnership v. Board of Assessors of Danvers*, 429 Mass. 126 (1999).

Very truly yours,

/s/Frederick A. Laskey

Frederick A. Laskey
Commissioner of Revenue

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[\[1\]](#) Directive 00-4 also considers whether a disregarded LLC engaged in manufacturing can enjoy, in its own right, a local property tax exemption for its machinery. Property owned by an LLC that does not elect to be taxed as a corporation for corporate excise purposes, even if the LLC has a manufacturing corporate member, is not eligible for the local property tax exemption for manufacturing corporations at G.L. c. 59, § 6, cl. (16). DD 00-4. A limited statutory exception to this rule exists for certain LLCs that are engaged in manufacturing. G.L. c. 59, § 5, cl. (16A). This exemption applies to a domestic or foreign LLC that (a) is wholly owned by members which are corporations, (b) is engaged in manufacturing in the Commonwealth, and (c) was in existence and conducting business in the Commonwealth on or before January 15, 1996. *Id.* Since the subsidiary does not meet these requirements, the property of the LLC is not eligible for this limited local property tax exemption.