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## *Massachusetts letter ruling: Security corporations must purchase credits at full face value or lose classification status*

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The Massachusetts Department of Revenue held that a security corporation must purchase at full face value transferable Massachusetts credits to offset its corporate excise or it will lose its classification status under Massachusetts law. [[Mass. Dept. of Rev. LR 11-6; Security Corporation, Purchase of Tax Credits](#), issued 5/16/11]

### Background

A corporation classified as a security corporation under Mass. Gen. Laws ch. 63, Sec. 38B is subject to a lower tax rate than general business corporations on its gross income. To qualify for this preferential tax rate, the activities of such corporations are limited by statute to "buying, selling, dealing in, or holding securities on its own behalf and not as a broker..." [Mass. Gen. Laws ch. 63, Sec. 38B](#). In general, "securities" includes equity or debt instruments, but does not include tax credits, *Id.* Security corporations are permitted to engage in necessary "ancillary activities" including engaging a payroll services company for payment of its staff, or sponsoring employee benefits programs. [830 CMR 63.38B.1\(3\)\(c\)](#). Ancillary activities do not include enriching security corporations in a manner not specifically allowed by statute.



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## Letter Ruling 11-6

The Department ruled on the following issues:

1. Whether acquisition of transferrable tax credits is an ancillary activity, participation in which will not cause a security corporation to lose its classification status;
2. Whether a security corporation may purchase transferrable tax credits from a third party and use them to reduce its tax liability without losing classification status; and
3. Whether a security corporation may acquire transferrable tax credits from an affiliate at an arm's length price or as a transfer or contribution to capital and use them to reduce its tax liability without losing its classification status.

*Purchase at Full Face Value Required.* In general, a tax credit is transferred for less than full face value. The buyer of the credit is enriched to the extent that the face value of the credit exceeds the purchase price. This potential enrichment, not sanctioned under the security corporation statute, may cause such corporation to lose its classification status.

The Department ruled that the purchase of a credit from a third party or an affiliate may be deemed a valid ancillary activity if the security corporation pays full face value for the credit. The Department explained that this ensures that there is no issue of built-in gain (the difference between the purchase price and the face value of the credit used against the security corporation's tax liability) and thus, no monetary enrichment to the security corporation buyer. If the credit passes as a transfer for less than full consideration, a security corporation may not retain its classification status.

Further, the Department held that a security corporation is permitted to reduce its corporate tax liability by the use of credits as an allowable ancillary activity, but is not allowed to sell the credit.

*Contribution to Capital.* Regardless of the federal treatment of affiliates contributing to capital a tax credit to a security corporation, the Department ruled that such a contribution contradicts Massachusetts law and thus invalidates security corporation classification.

The Department explained that, while affiliates are permitted to contribute qualifying securities to a security corporation, a tax credit is not a security. Permitting a security corporation to receive a tax credit as contribution to capital would allow the corporation a tax reduction for the full face value of the credit. The tax reduction would be a source of enrichment in violation of the statute.

*Gain Recognition.* The Department held that the transferor of a tax credit is subject to tax on the income incurred on the sale or transfer of the credit.

## PwC Observes

"This is the first instance in which the Department has explicitly stated that the seller of a tax credit has gain," observes David Sheehan, State and Local Tax Managing

Director with PwC in Boston. "While this tax treatment corresponds to federal tax law, it also serves as a disincentive to the seller of tax credits and underscores the need for legislation exempting the income arising from the sale of state tax credits."

"The letter ruling provides no incentive for a security corporation to purchase a tax credit because such purchase must be at face value to avoid the security corporation from losing its classification status," explains Sheehan.

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