Update on Status of Series Entities

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INTRODUCTION[1]

For the past decade, the ''check-the-box'' Treasury regulations (the ''CTB Regulations'') have allowed for certainty by choice in classifying business entities (including real estate entities) for federal tax purposes.[2] The CTB Regulations generally provide a flexible framework, permitting owners and managers in most instances to choose the entity's federal tax classification. For those who do not affirmatively make that choice by election, the CTB Regulations fill the gap with default classifications for both domestic and foreign business entities.

Fundamental to the application of the CTB Regulations is that, first, there must exist a ''business entity'' to be classified. Generally, a business entity is any entity recognized for federal tax purposes.[3] Whether an organization or enterprise is recognized as an entity separate from its owner or owners for federal tax purposes (a ''separate entity'') is a matter of federal tax law.[4] Correspondingly, that determination is not dependent upon recognition of the entity as a legal entity under local law.[5] While the CTB Regulations provide that a joint venture or other contractual arrangement *may create* a separate entity for federal tax purposes if the participants carry on, *inter alia*, a business or financial operation and divide the profits therefrom,[6] in many circumstances, the question of whether an enterprise constitutes a separate entity for federal tax purposes is not one that can be answered confidently.[7]

This article addresses whether separate entities will be recognized for federal tax purposes in arrangements that dissect business and investment activities into segregated compartments. Domestically, the most prominent of these arrangements are the ''series'' entities authorized by Delaware's statutes.[8] Under Delaware law, each series of the ''umbrella'' legal entity has a distinct portfolio of assets and liabilities that are considered separate from the assets and liabilities of the other series of the same legal entity. Several other jurisdictions have also adopted similar statutes.[9] The issue presented by these ''series'' arrangements is whether each series should be cast as a separate entity for federal tax purposes even though there is a single juridical entity for state law purposes. Indeed, a recent submission by the Tax Section of the New York State Bar Association to Treasury and the Internal Revenue Service (the ''Service'') addressed this topic, proposing a safe harbor for determining whether an individual ''cell'' of a ''protected cell company'' [10] should be treated as an entity separate from any other cell of the protected cell company.[11]

The classification of series entities is not confined, however, to determinations of domestic arrangements. Many foreign jurisdictions have enacted legislation authorizing the formation of ''series'' entities.[12] In similar fashion, the European Union has adopted di-

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[1] Unless otherwise specified, all ''section'' references are to the Internal Revenue Code of 1986, as amended (the ''Code''), and the regulations promulgated thereunder.

[2] *See generally* Regs. §§301.7701-1 to 301.7701-4.

[3] *See* Regs. §301.7701-2(a).

[4] *See* Regs. §301.7701-1(a)(1).

[5] *See id.*

[6] *See* Regs. §301.7701-1(a)(2).

[7] A common setting in which the ''separate entity'' issue presents itself is in connection with an arrangement that may be viewed as a mere contractual alliance between parties, but sufficient ''partnership'' indicia are evident to deem a partnership to exist for federal tax purposes. *See, e.g., Comr. v. Culbertson*, 337 U.S. 733 (1949); *Madison Gas & Elec. Co. v. Comr.*, 72 T.C. 521 (1979), *aff'd*, 633 F.2d 512 (7th Cir. 1980).

[8] *See* DEL. CODE ANN. tit. 6, §§17-218 (limited partnerships), 18-215 (limited liability companies) (2007).

[9] *See, e.g.,* 805 ILL. COMP. STAT. 180/37-40 (2005); IOWA CODE ANN. §490A.305 (West 2006); NEV. REV. STAT. ANN. §86.296 (West 2005); OKLA. STAT. ANN. tit. 18, §2054.4 (West 2007); TENN. CODE ANN. §48-249-309 (2006); UTAH CODE ANN. §48-2c-606 (2006); P.R. LAWS ANN. tit. 14, §3426(p) (2004).

[10] In general, a ''protected cell company'' is an insurance company that holds assets in one or more segregated cells. The purpose of such a structure is to separate the assets in each cell from the assets (and liabilities) in the other cells. *See generally* Rev. Rul. 2008-8, 2008-5 I.R.B. 340 (providing a general description of what constitutes a ''protected cell company'').

[11] *See* Tax Section of the New York State Bar Association, Comment on Notice 2008-19 and Protected Cell Companies Outside of the Insurance Arena (May 2, 2008) (hereinafter, ''NYSBA Comment''); *see also* American Bar Association, Section of Taxation, Comments in Response to Notice 2008-19 (Jan. 5, 2009) (hereinafter, ''ABA Comments''), and Notice 2008-19, 2008-5 I.R.B. 366 (announcing that the Service will be proposing guidance as to the federal income taxation of protected cell companies); *cf.* Rev. Rul. 2008-8, 2008-5 I.R.B. 340 (providing guidance for determining whether a transaction between a risk protection buyer and an individual cell of a protected cell company constitutes insurance for federal tax purposes).

[12] The following list should not be considered exhaustive, but it should provide the reader with a hint as to the popularity of series entities in foreign jurisdictions.

Anguilla — Protected Cell Companies Act (2004).

Barbados — Companies Act, Part III, Division G (as

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rectives providing for ''undertakings for collective investments in transferable securities'' (or ''UCITS'').[13] In accordance with these directives, UCITS are intended to facilitate collective investment portfolios that operate freely throughout the European Union on the basis of a single authorization from one Member State. As relevant to the question addressed in this article, the implementing regulations generally incorporate the concept of an ''umbrella fund'' that can be divided into a number of sub-funds.[14]

Series arrangements typically are premised upon a recognized effort to realize cost efficiencies by establishing an umbrella legal entity. Although the authorizing statutes in the various jurisdictions use different terminology, one common theme is present in each case: *There is an intended commercial benefit to isolating the assets and liabilities (and revenues and expenses) of the respective series of the umbrella legal entity.* In light of this common theme and those sought-after cost efficiencies, any analytic framework for determining whether each series of a series entity is a ''separate entity'' for federal tax purposes should be consistently and predictably applied. In addition, that analytic framework should apply no matter whether the series entity is domestic or foreign, or whether the activities conducted by the separate series are active operating businesses or passive investment activities.

While the CTB Regulations control once the existence of a separate business entity is established, the resolution of that base determination requires formal guidance. Treasury and the Service seemingly appreciate the need for such guidance, as (i) a number of informal private letter rulings have been issued on the subject, and (ii) a project concerning the federal tax classification of series entities has been added to the Priority Guidance Plan.[15]

This article presents an analytic framework for Treasury and the Service to consider in crafting formal guidance on the federal tax classification of series entities. The article begins with a brief primer on the general characteristics of series entities under Delaware law and the UCITS Regulations. Following that discussion, the relevant authorities are reviewed. Finally, the article suggests factors for Treasury and the Service to consider in their efforts to guide Taxpayers.

A PRIMER ON THE GENERAL CHARACTERISTICS OF SERIES ENTITIES

Series Entities Under Delaware Law

In 1996, Delaware amended its limited liability company and limited partnership statutes to permit the designation of ''series'' of ownership interests within such entities.[16] The Delaware Series Provision provides that:

amended), *available at* http://www.barbadosbusiness.gov.bb/miib/Legislation/Documents/companies_act_cap308.pdf.

Belize — Protected Cell Companies Act (2000), *available at* http://www.ifsc.gov.bz/acts/protected-cell-cap271.pdf.

Bermuda — Segregated Accounts Companies Act 2000 (as amended in 2002 and 2004).

British Virgin Islands—Segregated Portfolio Companies Regulations, 2005, *available at* http://www.bvifsc.vg/DesktopModules/Bring2mind/DMX/Download.aspx?EntryId=66&PortalId=2&DownloadMethod=attachment.

Cayman Islands — Companies Law, Part XIV — Segregated Portfolio Companies (2004), *available at* http://www.investcayman.ky/laws/companieslaw.pdf.

Gibraltar — Protected Cell Companies Act 2001.

Guernsey—Protected Cell Companies Ordinance, 1997 (as amended in 1998, 2003, 2005, and 2006), *available at* http://www.gov.gg/ccm/cms-service/download/asset/?asset_id=2126007.

Isle of Man — Companies Act 2006, Part VII, *available at* http://www.fsc.gov.im/lib/docs/fsc/companiesReg/companiesbill2006.pdf.

Jersey — Companies (Amendment No. 8) (Jersey) Law (2006).

Luxembourg — Securitisation Act (2004), *available at* http://www.securitisation.lu/securitization_securitisation/lois/.

Mauritius — Protected Cell Companies Act (1999), *available at* http://www.gov.mu/portal/sites/ncb/fsc/download/pccact.doc.

Republic of the Marshall Islands — Limited Liability Company Act 1996, §79 (as amended), *available at* http://www.paclii.org/mh/legis/consol_act/llca1996256/.

Seychelles — Protected Cell Companies Act, 2003 (as amended in 2004), *available at* http://www.sterlingoffshore.com/downloads/Protected-Cell-Company-Act-2003.pdf.

Virgin Islands — The Alternative Market and International Reinsurance Act (authorizing, *inter alia*, protected cell companies), Title 22, Chapt. 54, V.I. Code (2008).

[13] A summary of Council Directive 85/611/EEC, 1985 O.J. (L 375) 3 (as amended), can be found on the European Union's official website at http://europa.eu/scadplus/leg/en/lvb/l24036a.htm.

[14] *See, e.g.,* European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2003 (as amended) (hereinafter, ''UCITS Regulations'') (bringing into force in Ireland the measures necessary to implement the UCITS Directive), *available at* http://www.finance.gov.ie/documents/publications/legi/finregucits.rtf.

[15] *See* Office of Tax Policy and Internal Revenue Service, 2008-2009 Priority Guidance Plan, at 10 (Sept. 10, 2008), *available at* http://www.irs.gov/pub/irs-utl/2008-2009_gpl.pdf.

[16] The Delaware ''series'' began its life as a signature feature in the former Delaware Business Trust Act (now the Delaware Statutory Trust Act, DEL. CODE ANN. tit. 12, §§3801–3826 (2006)) where transactions generally involved mutual funds or highly financed asset securitizations. The Delaware Business Trust Act originally was enacted in 1988; however, the series language was not brought into that Act until July 5, 1990. *See* 67 *Del. Laws* ch. 296 (1990).

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1. Each Series may have a separate business purpose or investment objective;
2. Each Series may have separate members, managers and limited liability company interests;
3. Each Series may have separate rights, powers or duties with respect to specified property, obligations or profits and losses associated with specified property or obligations;
4. The debts, liabilities, obligations ad expenses of a particular Series may be enforceable only against the assets of such Series and the debts, liabilities, obligations and expenses of the LLC or any other Series may not be enforceable against the particular Series; and
5. Each Series may have the power to, in its own name, contract, hold title to assets, and grant liens and security interests.[17]

These innovations provided managers and owners the flexibility of creating membership interests having ''separate rights, powers or duties with respect to specified property or obligations of the limited liability company or profits and losses associated with specified property or obligations. . . .'' [18] In the event that one or more ''series'' is established within an umbrella legal entity, and if (i) proper records are maintained for each series that account for the assets belonging to such series separately from the assets of the umbrella legal entity or any other series and (ii) notice of the limitation on liabilities of a series is set forth in the certificate of formation, then the debts, liabilities, obligations, and expenses of a particular series will be enforceable only against the assets of that series, and *not* against the assets of the umbrella legal entity generally or of any other series.[19] In other words, the statute effectively creates separate economic compartments, with the assets and the liabilities of each series segregated from the assets and the liabilities of each other series, as well as from the assets and the liabilities (if any) of the umbrella legal entity.[20]

Umbrella Unit Trusts Under the UCITS Regulations

An umbrella unit trust established under the laws of a Member State of the European Union and authorized as an undertaking for collective investment in transferable securities pursuant to the UCITS Regulations of that Member State incorporates many of the same features as a Delaware series entity. Such a vehicle is comprised of, and offers, units of investment interests in separate sub-funds, with the units of any particular sub-fund being distinguishable from units of each other sub-fund of the umbrella unit trust and providing holders with rights and benefits attributable solely to the relevant sub-fund.[21] As with membership interests in a Delaware series entity, the units of a particular sub-fund of the umbrella unit trust constitute beneficial ownership interests in the property of that sub-fund alone, with each unit representing an undivided share in the sub-fund's property and having an issue price based on the net asset value per unit of that sub-fund.[22]

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[17] *See* Del. Code Ann. tit. 6. §18-215. A Series is not treated as a separate entity for state law purposes under the Delaware LLC Act. Appendix A to these Comments compares the characteristics of Series under the Delaware LLC Act with the characteristics of series limited liability companies in Illinois, Iowa, Nevada, Oklahoma, Tennessee and Utah. In general, series limited liability companies in Illinois, Iowa, Nevada, Oklahoma, Tennessee and Utah share the same characteristics as Series under the Delaware LLC Act, except for: (i) only Delaware and Illinois specifically permit series to contract and hold assets in the series' name; and (ii) only Illinois permits series to be treated as separate entities for state law purposes.

[18] DEL. CODE ANN. tit. 6, §18-215 (2007). Similar provisions apply to series limited partnerships.

[19] In drafting the Delaware statute, a conscious choice likely was made not to describe the series as separate legal entities in order to avoid concerns that each series would be analyzed as a separate entity for non-tax purposes unrelated to creditor rights (e.g., in applying the Investment Company Act of 1940). *See* James M. Peaslee & Jorge G. Tenreiro, ''Tax Classification of Segregated Portfolio Companies,'' 117 *Tax Notes* 43, 46 (Oct. 1, 2007).

[20] Not only is there a separation of assets and liabilities, but different series routinely have different owners, different investment managers, different contribution and distribution policies, and different borrowing policies. Parenthetically, there is no restriction under Delaware law on the types of business or investment activities undertaken by series entities.

[21] *See* UCITS Regulations, §§2(1) (defining the terms ''umbrella fund,'' ''undertaking for collective investment in transferable securities,'' ''unit,'' and ''unit trust''), 73 (''Where a UCITS is constituted as an umbrella fund, each sub-fund of the UCITS must comply with the regulations and conditions governing UCITS.'').

[22] *See* UCITS Regulations, §§3(2) (''For the purposes of these Regulations . . ., UCITS are undertakings the units of which are, at the request of holders, repurchased or redeemed, directly or indirectly, out of those undertakings' assets.''), 23(1) (''The assets of a UCITS established as either a unit trust or common contractual fund shall belong exclusively to the UCITS. The assets shall be segregated from the assets of either the trustee or its agents or both and shall not be used to discharge directly or indirectly liabilities or claims against any other undertaking or entity and shall not be available for any such purpose.''), 23(2) (''Where a UCITS established as . . . a unit trust . . . is constituted as an umbrella fund the assets shall belong exclusively to the relevant sub-fund and shall not be used to discharge directly or indirectly the liabilities of or claims against any other sub-fund and shall not be available for any such purpose.''), 60(1) (''Units shall be issued or sold

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Summary of Commercial Features of Series Entities

Both Delaware law and the UCITS Regulations contemplate that each ''series'' of the ''umbrella'' legal entity constitutes a separate pool of assets and has distinct business or investment objectives that differ from those of each other series.[23] In other words, these arrangements, as is true with the protected cell companies addressed in the NYSBA Comment, have one recurring commercial feature: *The assets and liabilities (and the income and expenditures) attributable to a particular series belong only to that series.*[24] While there may be ''common'' expenses incurred by the umbrella legal entity that are not associated with any particular series, or (less likely) common assets and/or income that are not attributable to a particular series, the series statutes (or the operative documents for the series entity) typically allow that, for any such ''common'' asset, income, liability, or expense, a trustee or other manager has the discretion to determine the basis upon which such item is to be apportioned among the series. In any event, the assets of each series ''belong'' exclusively to that series, are segregated from the assets of the other series, and cannot be used to discharge, directly or indirectly, the liabilities of or claims against the umbrella legal entity or any other series. Furthermore, distributions with respect to ownership interests of a particular series are paid out of the assets of that series. In some instances, the manager may appoint separate auditors and accountants for each series. Quite often, the manager of a series may call for the surrender and cancellation of units of a particular series without any effect on any other series of the umbrella legal entity, or may cause funds to be borrowed for the account of a particular series without any effect on any other series. Also, it is common that a manager may terminate one series without terminating the umbrella legal entity or any other series. In sum, series entities may best be described as flexible arrangements where each series is, in terms of economic substance, an island unto itself.

at a price arrived at by dividing the net asset value of the UCITS by the number of units outstanding'').

[23] The same generally is true of the statutes of each of the domestic and foreign jurisdictions mentioned above. *See* fns. 9 and 12, above.

[24] Furthermore, as exemplified by the UCITS Regulations, where an asset is derived from any other asset (whether cash or otherwise) of a particular series, such derivative asset must be accounted for in the records of the same series as the asset from which it was derived.

REVIEW OF THE AUTHORITIES RELEVANT TO THE ANALYSIS OF THE CLASSIFICATION OF SERIES ENTITIES

Historic Caselaw

The issue of whether each series of an umbrella legal entity should be considered a separate entity for federal tax purposes has a long history. In the first case on this issue, *Union Trusteed Funds, Inc. v. Comr.*,[25] the Tax Court considered whether a domestic multi-fund investment company (incorporated under state law) that made an election to be treated as a regulated investment company (a ''RIC'') should be treated as a single RIC, or whether each fund of the investment company should be treated as a separate RIC. The Service argued that each fund of the investment company should be treated as a separate RIC — a theory that the Tax Court considered (at the time) to be novel and unsupported by law. Thus, the Tax Court concluded that the multi-fund investment company should be treated as a single taxable entity, i.e., as a single RIC, for federal tax purposes. The Service later reached the same conclusion in Rev. Rul. 56-246,[26] in which it concluded that a multi-fund RIC constitutes ''one taxpayer'' for federal tax purposes.

However, after *Union Trusteed Funds* (but before the issuance of Rev. Rul. 56-246), the Tax Court implicitly reached a contrary conclusion in *National Securities Series — Industries Stocks Series v. Comr.*[27] The taxpayers in *National Securities* were unincorporated investment trusts that were created under a single trust agreement and differed only in the nature of the assets. Each trust regularly issued certificates representing shares in the property held in the trust and regularly redeemed such certificates pursuant to the terms of the trust agreement. During the relevant period, each taxpayer made distribution of net earnings to its shareholders incident to the redemption of such shares. The principal issue in the case was whether such distributions in redemption of shares by different series of an investment trust (an unincorporated entity, organized as a trust under state law) that elected to be taxed as a RIC for federal tax purposes were preferential dividends.[28] The facts indicated that each redemption distribution by a series of the invest-

[25] 8 T.C. 1133 (1947), *acq.*, 1947-2 C.B. 4.

[26] 1956-1 C.B. 316, *obsoleted by* Rev. Rul. 88-14, 1988-1 C.B. 405.

[27] 13 T.C. 884 (1949), *acq.*, 1950-1 C.B. 4.

[28] In calculating its federal income tax liability, a RIC generally is entitled to a deduction for dividends paid to its shareholders. *See* §§562 and 852. However, in determining the amount of the deduction for dividends paid, a RIC is not allowed a deduction for

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ment trust reflected the earnings of that series alone. Although the Tax Court concluded that the distributions of a particular series' earnings in redemption of shares were not preferential dividends, it did not directly address whether each series of the investment trust was a separate entity for federal tax purposes. Nonetheless, recognition of each series of the investment trust as a separate RIC was implicit in (and a necessary premise for) the Tax Court's conclusion.[29]

Early IRS Guidance

The Service applied the principles set forth in *National Securities* in Rev. Rul. 55-416.[30] Rev. Rul. 55-416 also dealt with unincorporated investment trusts created under a single trust agreement. Like *National Securities*, Rev. Rul. 55-416 treated each trust as a separate regulated investment company. The ruling has also been cited in support of the proposition that each series of a limited liability company should be treated as a separate entity for federal tax purposes.[31]

Rev. Rul. 55-39 [32] has also been cited as precedent for how series of a limited liability company should be classified for federal tax purposes.[33] The taxpayer in Rev. Rul. 55-39 was a general partner of a partnership comprised of both limited and general partners. Under the partnership agreement, the taxpayer was permitted to direct that the amount in his capital account be invested, in whole or in part, in securities selected and controlled by the taxpayer and held by the partnership for the taxpayer's account. Rev. Rul. 55-39 holds that securities purchased at the taxpayer's direction become the taxpayer's property at the time the securities were acquired by the partnership. Rev. Rul. 55-39 also concludes that treating the securities as the taxpayer's property at the time the securities are acquired by the partnership is not affected by the fact that the securities would be treated as partnership property with respect to the claims of partnership creditors. Commentators have asserted that the principles of Rev. Rul. 55-39 support treating each series of a limited liability company as a separate entity for federal tax purposes.[34]

The Service's Reconciliation of the Historic Caselaw: The Private Letter Rulings of the Mid-1980s

Thus, a seeming inconsistency in the treatment of multi-fund investment companies remained for the next 30 years, based on the holdings of *Union Trusteed Funds* and *National Securities Series*. Then, in the mid-1980s, the Service issued a handful of private letter rulings addressing whether the series of an unincorporated business trust should be treated as separate entities for federal tax purposes.[35] For example, in PLR 8419017 (Feb. 2, 1984), an unincorporated business trust that was registered as an investment company under the Investment Company Act of 1940 (the ''1940 Act'') and was comprised of separate investment funds, each represented by a separate series of beneficial interests. The economic interest of a shareholder in a particular investment fund was limited to the net assets of that fund, and the liabilities of each fund also were so restricted. Procedural and administrative matters were handled on a fund-by-fund basis (except for matters required to be handled otherwise by the 1940 Act). Each fund had a different investment objective, a different composition of assets, a different management fee arrangement, and different shareholders. Based on these facts, the Service, citing *National Securities Series*, ruled that each series of the business trust was a separate and distinct economic entity consisting of a ''separate pool of assets and stream of earnings'' and, accordingly, should be classified as a separate entity for federal tax purposes.

This string of informal guidance from the Service rested relied on the views expressed in General Counsel Memorandum 32911 (Jan. 13, 1984). In that GCM, the Service distinguished its position in those private letter rulings from its conclusion in Rev. Rul. 56-246 and the Tax Court's holding in *Union Trusteed Funds*. In so doing, the Service suggested that there was an inherent difference between an incorporated business entity and an unincorporated business entity,[36] reasoning as follows:

> In the present case, each fund is a separate and distinct economic entity consisting of separate pools of assets and streams of earnings. The ownership of beneficial interests in each fund is different, and the beneficial owners of each fund may look only to its assets in redemption, liquidation, or termination. The

''preferential dividends.'' *See* §562(c).

[29] The Service cited *National Securities Series* with approval in Rev. Rul. 55-416, 1955-1 C.B. 416, although this revenue ruling concerned only the effect of distributions in redemption of shares of a RIC and did not involve a multi-fund investment company.

[30] Rev. Rul. 55-416, 1955-1 C.B. 416.

[31] *See, e.g.,* Mass. Ltr. Rul. 08-2: *Separate Entity Status and Federal Classification for Each Series of an LLC* (Feb. 15, 2008).

[32] Rev. Rul. 55-39, 1955-1 C.B. 403.

[33] *See, e.g.,* Donn, *supra*, §IX.A.1.c.; Bishop, *supra*, ¶2.11[4].

[34] See ABA comments at p. 8.

[35] *See, e.g.,* PLR 8419017 (Feb. 2, 1984) (discussed below); *see also* PLR 8510013 (Dec. 5, 1984); PLR 8507013 (Nov. 16, 1984); PLR 8453058 (Oct. 1, 1984); PLR 8451029 (Sept. 14, 1984).

[36] This observation seemingly foresaw the distinction to be drawn between ''per se'' corporate entities and ''eligible entities'' under the CTB Regulations.

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> shareholders and creditors of each fund are limited to the assets of that fund for recovery of expenses, charges, and liabilities. Each fund has different arrangements with the management advisors. Votes of shareholders are conducted by each series individually, except to the extent the . . . Investment Company Act [of 1940] requires shares to be voted in the aggregate without regard to series. Joint activities of the funds are extremely limited. Under these circumstances, we believe that the funds should be classified as separate taxable entities.
>
> This case is distinguishable from *Union Trusteed Funds, Inc. v. Comr.*, 8 T.C. 1133 (1947), *acq.*, 1947-2 C.B. 4, and Rev. Rul. 56-246, 1956-1 C.B. 316, considered in * * * GCM 28629, A-612906 (Jan. 25, 1955), both concluding that a multifund investment company incorporated under state law is to be classified as a single taxable entity. Incorporated entities are characterized for [federal] tax purposes as corporations without regard to the rules for classifying unincorporated entities. *Cf.* * * * GCM 34376, I-3933 (Nov. 13, 1970), concluding that the entity in that case is a corporation 'per se.' Therefore, we do not believe that the classification of an incorporated entity [as in *Union Trusteed Funds*] controls the classification of unincorporated entities [as in *National Securities Series*].[37]

Thus, under the Service's analysis at the time, a series of a business entity organized as a corporation could not be treated as a separate entity for federal tax purposes, but a series of an unincorporated business entity, such as a business trust, could be so treated.[38]

Section 851(g)

Congress entered the fray in 1986 by partially modifying the federal tax treatment of separate series of a RIC.[39] Specifically, §851(g)(1) provides that, in the case of a RIC having more than one ''fund,'' [40] each fund will be considered a separate corporation for federal tax purposes.[41] This provision applies *both* to incorporated and to unincorporated entities electing to be taxed as RICs for federal tax purposes. Because the Service already had concluded that each fund of a multi-fund RIC organized as an unincorporated business trust could be recognized as a separate entity for federal tax purposes, the principal effect of the new statutory provision was to allow each fund of a multi-fund RIC organized as a corporation to be treated in a similar fashion.[42] Although by its terms §851(g)(1) applies only to an entity that elects to be taxed as a RIC for federal tax purposes, Congress clearly recognized that separate funds (or series) of a multi-fund investment entity may be treated as separate entities for federal tax purposes.

Following the addition of §851(g) to the Code, the Service continued to focus upon whether each investment fund of a multi-fund investment entity (that did not elect to be treated as a RIC and was not a ''per se'' corporation for federal tax purposes) constituted a distinct economic entity.[43] For example, in PLR 9702024 (Oct. 11, 1996), the Service, again relying upon *National Securities Series*, ruled that each series of an unincorporated trust that was registered as an open-end investment company under the 1940 Act would be respected as a separate entity for federal tax purposes. Specifically, the Service concluded that (i) each series of the trust was a ''separate taxable entity'' for federal tax purposes and (ii) because of the non-corporate characteristics of each series, each series should be classified as a partnership for federal tax purposes.

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[37] GCM 39211 (Jan. 13, 1984).

[38] Interestingly, the Service's analysis focused upon whether the umbrella entity was incorporated, not on whether the entity was taxable as a corporation. In fact, in these rulings of the mid-1980s, the separate series of unincorporated investment trusts in fact were treated as separate corporations for federal tax purposes because each series had more corporate than non-corporate characteristics under the former corporate resemblance regulations.

[39] *See* §851(g) (originally designated as §851(h)).

[40] For purposes of §851(g), the term ''fund'' means a ''segregated portfolio of assets, the beneficial interests in which are owned by the holders of a class or series of stock of the regulated investment company that is preferred over all other classes or series in respect of such portfolio of assets.'' §851(g)(2).

[41] As a collateral consequence of this statutory change, Rev. Rul. 56-246 (discussed above) was declared obsolete. *See* Rev. Rul. 88-14, 1988-1 C.B. 405.

[42] Because §851(g) applies only to an entity (whether incorporated or unincorporated) that elects to be taxed as a RIC for federal tax purposes, an incorporated entity with multiple series that is ineligible to make such an election or otherwise does not elect to be taxed as a RIC for federal tax purposes would not be covered by §851(g).

[43] *See, e.g.,* PLR 9702024 (Oct. 11, 1996) (discussed below); *see also* PLR 9702016 (Sept. 5, 1996) (concluding that (i) each series of an unincorporated trust was a ''separate taxable entity'' for federal tax purposes and (ii) because of the non-corporate characteristics of each series, each series should be classified as a partnership for federal tax purposes); PLR 9644014 (July 15, 1996) (concluding that (i) each series of an unincorporated trust that was registered as an open-end investment company under the 1940 Act was a ''separate taxable entity'' for federal tax purposes and (ii) because of the non-corporate characteristics of each series, each series should be classified as a partnership for federal tax purposes).

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The Service's Informal Guidance Following Promulgation of the CTB Regulations

Following the promulgation of the CTB Regulations, the Service's analysis remained on course.[44] For example, in PLR 9847013 (Aug. 20, 1998), the Service determined that separate series of a trust that was registered as an open-end investment company under the 1940 Act should be recognized as separate entities for federal tax purposes. In so doing, the Service included the following observations in its analysis:

- The jurisdiction in which the trust was formed recognized sub-trusts and treated sub-trusts as ''independent legal estates or entities'';
- Each series of the trust had distinct investment objectives;
- Each series of the trust would invest in a portfolio of securities in which no other series would have an interest;
- The interest of a holder of a particular series of the trust was limited to the net assets of that series and did not extend to the assets of any other series of the trust;
- The rights of a holder of interests in a particular series of the trust were limited in redemption, liquidation or termination to the assets of that series;
- No series of the trust was liable for the debts and obligations of any other series; *and*
- The expenses, fees, charges, taxes, and liabilities incurred or arising in connection with a particular series of the trust, or in connection with the management thereof, were payable out of the assets of that series and not out of the assets of any other series.

Based on these facts, the Service concluded that each series of the trust constituted a ''separate entity'' for federal tax purposes. Consequently, the taxpayer was free to choose the federal tax classification of each series of the trust under the CTB Regulations.

More recently, in PLR 200803004 (Oct. 15, 2007),[45] the Service concluded that each series of a limited liability company constituted a separate entity for federal tax purposes where the following facts were present:

- Each series of the limited liability company consisted of a separate pool of assets and liabilities;
- The shareholders of a series of the limited liability company shared only in the income of that series;
- The shareholders of a series of the limited liability company were limited to the assets of that series upon redemption, liquidation, or termination of such series;
- The payment of the expenses, charges, and liabilities of a series of the limited liability company were limited to the assets of that series;
- The claims of creditors of a series of the limited liability company were limited to the assets of that series; and
- Each series of the limited liability company had its own investment objectives, policies, and restrictions.

Securities Law Pronouncements

The Service's approach in its private letter rulings is consistent with the analytic approach used in a different, but related, federal administrative determination. Specifically, there are occasions under the Code where the identification of an ''issuer'' is relevant.[46] For example, RIC qualification requires a degree of diversification, a determination under §851(b)(3) that involves looking to the percentage of the RIC's asset value that is invested in an ''issuer.'' While §851 uses the term ''issuer,'' it does not define it. Section 851(c)(6), however, provides that undefined terms used in §851 have the same meanings as provided under the 1940 Act. The 1940 Act defines the term ''issuer'' as ''every person who issues or proposes to issue any security or has outstanding any security which it has issued.'' [47] As this definition suffers from imprecision, the Service has looked to pronouncements from the staff of the Securities and Exchange Commission (the ''SEC'') for additional guidance.[48]

As relevant here, the SEC has taken the position that, under §5(b)(1) of the 1940 Act (regarding the

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[44] *See, e.g.,* PLR 9847013 (Aug. 20, 1998) (discussed below); *see also* PLR 200303017 (Sept. 30, 2002); PLR 9837005 (June 9, 1998).

[45] For a thorough analysis of this private letter ruling, *see* Steven E. Grob & Norman J. Hannawa, ''Federal Tax Status of a Series Limited Liability Company,'' 10 *Bus. Entities* 24 (Mar./Apr. 2008).

[46] *See, e.g.,* §851(b)(3) (discussed below); *see also* §817(h) (diversification requirements for variable life and annuity contracts).

[47] 1940 Act, §2(a)(22).

[48] *See, e.g.,* PLR 200526011 (Mar. 31, 2005) (''The SEC determines the issuer of a security for the purpose of administering diversification rules that are analogous to those of §851(b)(3). Section 5(b)(1) of the 1940 Act defines a ''diversified company'' as a management company that has at least 75% of its assets invested in cash and cash items (including receivables), Government securities, securities of other investment companies, and other securities that, for the purpose of this calculation, are limited in respect of any one issuer to an amount not greater in value than 5% of the value of the total assets of the management company and to not

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definition of a ''diversified company''), the ''issuer'' of a security generally is ''the person to whom the holder of the security looks for payment.'' [49] For example, in a no-action letter issued to Hyperion Capital Management Inc., the SEC agreed that an asset pool backing a specific security could be viewed as a separate ''issuer'' under §5(b)(1), notwithstanding the fact that a large number of such asset pools had a common sponsor. In so doing, the SEC observed that holders of a specific asset-backed security would look to a single pool for return of principal and interest and that, in the event of a sponsor's bankruptcy, the sponsor's creditors would have no recourse against the pool. More recently, the SEC agreed that each portfolio of a domestic master trust should be treated as a separate ''issuer'' for purposes of §3(a)(1) of the 1940 Act.[50] Similarly, the SEC agreed that each sub-fund of an umbrella unit trust authorized under the UCITS Regulations should be regarded as a separate ''issuer'' for purposes of §3(c)(1) of the 1940 Act.[51] Notably, with respect to this last determination, the SEC concluded that the umbrella unit trust was ''analogous to a domestic 'series company.' '' [52] The inference reasonably drawn from the SEC's observation is that there is a logical nexus between a separate ''issuer'' for securities law purposes and a separate ''entity'' for federal tax purposes.

State Law Determinations

The foregoing analysis, which focuses upon the commercial separateness of assets and liabilities, also would be consistent with determinations of state revenue agencies. Specifically, both the California Franchise Tax Board and the Massachusetts Department of Revenue have indicated that each series of a series limited liability company should be treated as a ''separate entity'' for purposes of those states' respective franchise and income taxes. For example, the California Franchise Tax Board has included the following discussion in FTB Publication 3556, Limited Liability Company Filing Information:[53]

> Series LLCs
>
> California recognizes Series LLCs that form in other states if the laws of the LLC's formation state provide for the designation of a series of interests and (1) the holders of the interests in each series are limited to the assets of that series upon redemption, liquidation, or termination and may share in the income only of that series, and (2) under the home state law, the payment of expenses, charges, and liabilities is limited to the assets of that series.
>
> Each series in a Series LLC is considered a separate LLC.[54]

Furthermore, in 2008, the Massachusetts Department of Revenue concluded in Letter Ruling 08-2 that each series of a yet-to-be-formed Delaware series limited liability company would be treated as a separate entity for Massachusetts income tax purposes, with the Massachusetts classification of each series following its federal tax classification under the CTB Regulations.[55] In so doing, it touched on several of the authorities discussed above and reasoned as follows:

> Although the DOR has not issued any published guidance on the issue of whether each series of a series LLC is recognized as a separate entity, there is authority that each series in a series trust is a separate entity for Massachusetts income tax purposes. In Letter Ruling 87-19, the DOR ruled that each series of investment portfolios to which a RIC has allocated its assets was a separate entity, a corporate trust, under Massachusetts law. The fund was an open-end management invest-

more than 10% of the outstanding voting securities of the issuer. . . . The SEC also interprets §3 of the 1940 Act in order to determine the identity of the issuer of a security, in the context of the registration requirement for investment companies under the 1940 Act. An ''investment company'' is defined in §3(a)(1) of the 1940 Act as an 'issuer' that meets certain requirements.'')

[49] Hyperion Capital Management Inc., SEC No-Action Letter, 1994 WL 420077 (Aug. 1, 1994); *see also* Dreyfus New York Tax Exempt Bond Fund, SEC No-Action Letter, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶81,416 (May 16, 1977) (concluding that, under §5(b)(1) of the 1940 Act, the ''issuer'' is the person against whom the holder of a security has a legal claim); Pennsylvania Tax-Free Income Trust, SEC No-Action Letter, 1977 WL 12705 (Mar. 4, 1977) (concluding that, under §5(b)(1) of the 1940 Act, the entity responsible for payment of a bond obligation is the ''issuer'').

[50] *See* Washington Capital Joint Master Trust, SEC No-Action Letter, 2006 WL 3313800 (Sept. 25, 2006).

[51] *See* Coutts Global Fund, SEC No-Action Letter, 1994 WL 731387 (Dec. 7, 1994).

[52] *Id.*

[53] Publication 3556 is available at http://www.ftb.ca.gov/forms/misc/3556.pdf.

[54] For a discussion of the California franchise tax implications of this determination, *see* Jacob Stein, ''Tilting at Windmills: Examining FTB's Treatment of Series LLCs,'' 10 *Bus. Entities* 16 (May/June 2008).

[55] In all likelihood, Letter Ruling 08-2 involves the same trust as that addressed by the Service in PLR 200803004 (Oct. 15, 2007). *See* John A. Biek, ''IRS and Massachusetts Rule on the Income Tax Classification of a Delaware Series Limited Liability Company—But Questions Still Abound,'' 11 *J. Passthrough Entities* 13 (May-June 2008). Letter Ruling 08-2 is available at http://services.taxanalysts.com/taxbase/eps_pdf2008.nsf/Go?OpenAgent&3519&Login.

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ment company organized under the laws of Massachusetts as a corporate trust and registered under the 1940 Act. It had operated as a single RIC from 1983 until 1987. In 1987, the trust was amended to create separate series of investment portfolios, each of which was intended to be treated as a separate RIC under the Code. Each series was separate with respect to the rights of shareholders and creditors. The original trust itself had no assets, liabilities or income because everything was allocated among the series. The function of the original trust was to make it easier to file amendments and other documents with the SEC. Letter Ruling 87-19 makes a broad reference to IRS private letter rulings issued in 1984 and 1985 and cites IRC §851(g) which permits separate series of investment funds to be organized as regulated investment companies.[56]

* * *

Therefore, based on Letter Ruling 87-19, the federal guidance of *National Securities*, Rev. Rul. 55-416 and the IRS private letter ruling issued to the Taxpayers, each LLC Series should be classified as a separate entity for Massachusetts income tax purposes.

[56] Letter Ruling 08-2 further explains:

> The LLC and the LLC Series will be set up similarly to the trust and the separate series in Letter Ruling 87-19. The LLC will have no assets, liabilities or income because everything will be allocated among the series and the function of the LLC is to make it easier to file amendments and other documents with the SEC. Each series will be separate with respect to the rights of shareholders and creditors. Under Section 5.11(c) of the Operating Agreement, each LLC Series will consist of a separate pool of assets, liabilities and stream of earnings; the shareholders of an LLC Series may share in the income only of that LLC Series; the ownership interest of the shareholders in an LLC Series will be limited to the assets of that LLC Series upon redemption, liquidation, or termination of such LLC Series; the payment of the expenses, charges, and liabilities of an LLC Series is limited to that LLC Series' assets; and votes of shareholders may be conducted by each LLC Series separately with respect to matters that affect only that particular LLC Series, except to the extent the 1940 Act requires shares to be voted as a single class of shares. Under Section 4.1 of the Operating Agreement, the creditors of each LLC Series are limited to the assets of that LLC Series for recovery of expenses, charges, and liabilities. Under Section 5.11(b) of the Operating Agreement, each LLC Series will have its own investment objectives, policies and restrictions.

Summary

Based largely on the authorities discussed above, the prevailing view among practitioners (primarily with respect to funds of multi-fund investment companies) has been that, where a series of an umbrella entity (i) possesses its own economic attributes, (ii) has distinct owners, *and* (iii) achieves commercial separateness, it should be recognized as a ''separate entity'' for federal tax purposes. As we have posited above, we do not believe that view should be confined to a particular vehicle (such as an umbrella unit trust) or a particular activity (such as an investment activity). Rather, we believe that view should be extended to *any* series entity having, *inter alia*, the commercial feature of asset and liability (and profit and loss) separation. Accepting the view that each series of a series entity should be regarded as a ''separate entity'' for federal tax purposes (and, correspondingly, concluding that the umbrella legal entity does *not* constitute a ''single'' business entity for federal tax purposes), each series then would have to be classified under the CTB Regulations as a trust, a corporation (or an association taxable as a corporation), a partnership, or, if the series has a single owner, an entity disregarded as a separate from its owner.[57]

FRAMEWORK FOR THE ANALYSIS OF THE CLASSIFICATION OF SERIES ENTITIES

In our estimation, the most important criteria for determining whether each series of a series entity should be recognized as a separate entity for federal tax purposes are —

- Whether the economics associated with an owner's interests in a particular series (in terms of valuation, distribution rights, and liquidation rights) are determined solely by reference to the owner's capital investment in that series (without regard to the owner's capital investment in any other series);
- Whether the recovery rights of an owner of an interest in a particular series are limited to the net assets of that series; *and*

[57] Remaining open questions include (i) whether the ''umbrella'' entity constitutes a separate entity for federal tax purposes; and (ii) whether separate entity treatment could, or should, apply to separate series of a ''per se'' umbrella entity. The ABA Comments address the former. As to the latter, we believe that the authority relied upon by Treasury and the Service in developing the ''per se'' list in the CTB Regulations also supports their determining that separate economic compartments of a ''per se'' umbrella entity (if established under local or foreign law, with separation of assets and liabilities) should be treated as separate entities for federal tax purposes.

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- Whether the limitation on the liability of a particular series is secured under local law, i.e., whether the satisfaction of the liabilities of a particular series is limited to the assets of that series.

In issuing formal guidance, Treasury and the Service also should consider the following elements prescribed in the NYSBA Comment:

- The series entity must be formed under a statute (or the regulations) of a state or foreign jurisdiction; and
- The relevant statute (or regulations) must provide for the unambiguous separateness of the assets and liabilities of each series and must permit beneficial ownership to be held on a series-by-series basis.[58]

[58] *See also* ABA Comments. The NYSBA further proffered that the umbrella entity itself must not be a ''per se'' entity under Regs. §301.7701-2. As noted in the NYSBA Comment, however, this element is distinct from the determination that any series itself may become a ''per se'' entity as a result of its activities or other features (e.g., by reason of predominantly conducting an insurance business). As we posit, however, if there is an economic separation (authorized under local or foreign law) between separate series of a ''per se'' umbrella entity, separate entity treatment for the separate series should follow for federal tax purposes.

We believe that a safe harbor analysis based on these factors would be logical, as it relies upon the substantive economic features of series arrangements, and would provide certainty and predictability to an area in which both have been lacking for much too long.

CONCLUSION

The CTB Regulations, helpful as they are, do not provide significant guidance in determining whether a business arrangement constitutes a separate entity for federal tax purposes. This deficiency results in uncertain treatment of series entities, whether domestic or foreign, whether active or passive. A safe harbor analysis along the lines described above — based primarily upon substantive economic rights and the commercial features of asset and liability separation — would provide certainty and predictability in determining the proper federal tax classification of series entities. Accordingly, we urge Treasury and the Service to adopt such an approach in crafting the formal guidance on that topic.

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