taxanalysts special report

Tax Classification of Segregated Portfolio Companies

By James M. Peaslee and Jorge G. Tenreiro

James M. Peaslee is a partner with Cleary Gottlieb Steen & Hamilton LLP in New York. Jorge G. Tenreiro was an associate with the same firm and is currently on a judicial clerkship.

Segregated portfolio companies (SPCs, also sometimes known as series or cell companies) are a relatively new type of limited liability company that allows identified groups of assets and related liabilities within a company to be walled off from one another for most commercial purposes (including in particular, the enforcement of creditors' claims). SPC statutes have been adopted in a number of states and foreign countries. For reasons of administrative convenience, SPCs are being widely used in structured finance and securitization transactions. In that setting, the segregated portfolios lack a common business purpose and do not share in profits, losses, or capital. This report argues that portfolios with this degree of separation should be treated as separate entities for tax purposes. The main support for this view comes from authorities on mutual funds divided into series. There are no authorities involving SPCs as such. While the argument for separate entity treatment on the right facts is a strong one, it would be very helpful if the government confirmed the view, given the growing commercial importance of SPC structures.

Copyright 2007 James M. Peaslee and Jorge G. Tenreiro. All rights reserved.

Table of Contents

I.	**Introduction**	43
II.	**Description of SPC Statutes**	45
III.	**Illustration**	46
IV.	**Relevant Authorities**	48
	A. Entity Classification Regulations	48
	B. Treatment of Series Funds	48
	C. Series Fund Reasoning Applied to SPCs	51
	D. Other Analogies	51
V.	**Conclusion**	52

I. Introduction

This article discusses the federal tax classification of segregated portfolio companies (SPCs), focusing on those used in securitizations or other structured finance transactions. An SPC is a type of limited liability company having separate portfolios of assets that, by statute, are treated for most significant commercial purposes as if they were held by separate companies. Under a typical statute, a creditor of one portfolio cannot reach assets of another, and one portfolio can undergo a receivership without affecting the other assets or liabilities of the SPC.

A threshold tax question in analyzing these arrangements is whether each portfolio is considered a separate "entity" (as that term is used in the entity classification regulations) or merely a part of the larger entity, the SPC. Properly identifying the relevant entity is particularly important if the entity is classified as an association, but also affects tax transparent vehicles. The identification-of-entity question has begun to loom large in practice, as SPCs are being used widely in securitizations and structured finance transactions (among others). The IRS has informally indicated some interest in addressing the treatment of SPCs in the insurance context (presumably whether insuring risks of segregated portfolios involves risk spreading and hence insurance) and more broadly, but so far nothing has emerged (not even private letter rulings or other informal guidance).[1]

---

[1]Notice 2005-49, 2005-2 C.B. 14, *Doc 2005-13279, 2005 TNT 117-3*, raises several questions about the proper classification of entities as insurance companies. One question concerns the treatment of separate "cells" (similar to segregated portfolios) within a legal entity as a separate company with its own risks. During a discussion at a seminar on June 2, 2006, on the taxation of captive insurance companies and finite risk insurance, IRS attorney John Glover remarked that the issue of whether a cell is a separate entity for tax purposes is not just an insurance-specific question. He said that "hopefully" the IRS will be able to get some guidance out on the question, although for a question to be answered there must be some call for it. *See Doc 2006-10710, 2006 TNT 107-11*. *Cf*. Rev. Rul. 2005-40, 2005-2 C.B. 4, *Doc 2005-13278, 2005 TNT 117-1* (treating a contract that "insures" the risks of 12 LLCs owned by a common parent as insurance when the LLCs are associations but not when they are disregarded entities (because insurance requires the spreading of risk among multiple insureds)). A 2004 letter from a practitioner asks the IRS to provide guidance on the treatment of a Delaware series LLC. *See* letter from Howard J. Levine to Heather C. Maloy, associate chief counsel (passthroughs and special industries), *Doc 2004-18367, 2004 TNT 181-23* (the Levine letter). In an example given in the letter, each series owns a real estate project, there is overlapping ownership of all of the series and a common purpose of the LLC (property development), and the parties hold themselves out as partners in the overall venture (real estate development). The letter argues that the

(Footnote continued on next page.)

(C) Tax Analysts 2007. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

This article focuses on SPCs in which segregated portfolios are used to hold financial assets (including derivative contracts) and interests in the portfolios are held by different classes of investors (or at least each portfolio is marketed separately and common investments are coincidental and result from separate investment decisions). To the extent the assets are managed, the management is undertaken by an investment manager hired by the portfolio. The investors are passive and do not view themselves as joining together in any enterprise that extends beyond the individual portfolio (and indeed every effort is made to reinforce the separateness of portfolios to reduce the risk of consolidation in an insolvency proceeding). Because SPC statutes are flexible and can cover many different types of arrangements, it is likely that the entity classification issue can be addressed only in a specific context. As a result, guidance from the IRS may have to take the form of a revenue ruling or ruling guidelines prescribing separate entity treatment (or joint treatment) based on an assumed set of facts.[2]

SPC legislation is of recent vintage. As far as we can tell, the first statute became effective in Delaware in August 1996.[3] Thus, the new structure came into existence just before the effective date of the most recent overhaul of the entity classification rules implementing the check-the-box regime (the beginning of 1997). The lack of current guidance reflects the relative novelty of the structure.

The statutes allowing the creation of SPCs sometimes refer to the segregated portfolios as ''series.'' However, in this article, the term ''series fund'' will be used to refer to mutual funds (technically, regulated investment companies) having separate classes of equity representing interests in distinct investment portfolios. Series funds have been around for years. Traditionally, they have been organized as trusts or conventional corporations.

This article argues that segregated portfolios used in a typical structured finance transaction should be treated as separate business entities for purposes of applying tax classification rules. This position is supported by the treatment of series funds organized as state law trusts. As discussed below, under case law and informal IRS guidance, individual series within such a fund have been treated as separate associations. By contrast, series funds organized as state law corporations were considered a single corporation. The playing field was leveled by the enactment of section 851(g) in 1986,[4] which treats series funds as multiple corporations regardless of their legal form.

The SPCs considered in this article are similar to series funds in that they hold portfolios of financial assets and the owners of the portfolios are not substantially overlapping and lack a common business objective. However, they are not RICs and thus cannot benefit from section 851(g). They are also different from traditional series funds organized as state law corporations because the segregated portfolio legislation, unlike a traditional corporate statute, allows the legal isolation of pools of assets and related liabilities within a single company. Also, of course, an SPC is a type of LLC, and hence generally not a per se corporation for tax purposes.

The business reasons for using SPCs in structured finance transactions are humble: administrative convenience and cost savings. It often happens that an investment bank or other sponsor wishes to create, for sale to investors, debt or equity securities that are backed by identified assets. For repeat business with various asset pools and investors, it is cheaper, easier, and quicker to use as the securities issuer segregated portfolios within a single company rather than multiple companies. Companies have to be formed and cared for. They must have a board of directors or managers and have stockholder or member meetings. It is better to form a company once rather than 100 times if there is a commercial desire to create 100 series of securities backed by distinct asset pools.

Treating each segregated portfolio in a structured finance transaction as a separate tax entity would conform the tax treatment with the commercial reality and produce more accurate allocations of tax items, benefiting both taxpayers and the government. Further, melding portfolios into one larger entity for tax purposes would not raise revenue (at least going forward). If separate tax treatment of the assets and liabilities that make up each segregated portfolio were considered important for a class of issuers, and the tax law did not allow that treatment through an SPC, sponsors would use separate companies and forgo the benefits of the SPC structure. In the end, the tax result would be the same, save perhaps for higher deductions for added administrative costs (and at the margin a reduction in the volume of activity).

The consequences of properly determining if each segregated portfolio is a separate entity can range from momentous to none depending on the circumstances. One key factor is how the relevant entity (once it is identified) is classified. Not surprisingly, the consequences are likely to be greatest for entities that are

---

LLC in the example should be treated as a single partnership. As described below in the text, those facts are quite different from typical structured finance transactions. For other commentary, see Charles T. Terry and Derek D. Samz, ''An Initial Inquiry Into the Federal Tax Classification of Series Limited Liability Companies,'' *Tax Notes,* Mar. 6, 2006, p. 1093, *Doc 2006-3770, 2006 TNT 44-40* (compares Illinois SPC legislation with Delaware and notes that Illinois statute more clearly allows each series to be treated as a separate entity); Craig A. Gerson, ''Taxing Series LLCs,'' 45(4) *Tax Management Memorandum*, Feb. 23, 2004 (concludes that only Treasury guidance will resolve scope of entity issue).

[2] *Cf.* Rev. Proc. 2002-22, 2002-1 C.B. 733, *Doc 2002-6847, 2002 TNT 54-12*, which specifies the conditions under which the IRS will issue a private letter ruling that an undivided fractional interest in rental real property will be treated as a co-ownership arrangement and not as an interest in a partnership (or other business entity) among the co-owners or between the co-owners and lessees.

[3] *See* Del. Code. Ann. tit. 6, section 18-215 (2007).

[4] Section 851(q), the predecessor to the current section 851(g), was enacted as part of the Tax Reform Act of 1986. It was redesignated as section 851(h) in 1988, P.L. 100-647, section 1006(o)(1), and finally as section 851(g) in 1997 in the Taxpayer Relief Act of 1997.

(C) Tax Analysts 2007. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

associations. A tax law corporation has one set of tax attributes (such as taxable income or loss, earnings and profits, and capital gain net income or losses). A corporation makes its own tax elections. Tests to determine the tax status of a corporation (for example, whether the corporation is a related person under section 267 or a 10 percent shareholder in applying the portfolio interest exemption) can come out differently when applied at the SPC or segregated portfolio level.

If an SPC is tax transparent, the tax consequences of identifying the proper entity will depend on how the SPC is owned. If all of the segregated portfolios within the SPC have the same owner, under the disregarded entity rules, the assets, liabilities, and other tax items of the SPC would be attributed to the owner, whether there are many disregarded entities or only one. If the segregated portfolios have multiple owners, the analysis is more complex. If each portfolio were considered a separate entity, and there is no sharing of economics among portfolios, each segregated portfolio would be a disregarded entity or partnership depending on whether it has one or more than one owner. By contrast, if the SPC were considered one entity, the SPC would appear to be a single partnership that provides special allocations of the tax items of each portfolio to its owners, although depending on the facts, it could be argued that regardless of how the abstract question of entity status is resolved, there cannot be an overarching partnership that combines portfolios without some sharing of economics, control, or business objectives.[5] At any rate, allocations of income and deduction items from each portfolio to the related owner should be recognized under section 704 even if there were a single partnership covering all portfolios. Entity status still could be important in making partnership elections (for example, under section 754) or in determining tax years and other common partnership attributes.

Properly determining the relevant entities is also important in administering the check-the-box regulations, at least if there is a desire to change a default classification. For example, to classify a foreign SPC that provides limited liability to all members as a partnership or disregarded entity, an election must be filed for the relevant entity, whatever it is. An election filed for the SPC may not be effective for new portfolios if they are separate entities. Elections to change the tax status of individual portfolios could be made only if the portfolios were separate entities.

The balance of this article will first describe in more detail SPC statutes, and then discuss relevant tax authorities and their application to SPCs.

II. Description of SPC Statutes

Seven states and Puerto Rico allow the creation of segregated portfolios (often called series) within an LLC.[6] Several jurisdictions outside of the United States also have segregated portfolio statutes, including Bermuda,[7] the British Virgin Islands,[8] the Cayman Islands,[9] Guernsey,[10] Luxembourg,[11] and Mauritius.[12] (The list is not necessarily comprehensive.) It is not surprising that the foreign list includes some popular tax havens, as they are often used to create repackaging vehicles and respond quickly to market trends.

The statutes differ in some details, particularly in the way in which they characterize the segregated portfolios as separate legal entities. They have in common, however, the ability of each segregated portfolio to hold its own assets and to limit the claims against those assets to liabilities incurred by that portfolio (generally by so providing in a governing document, maintaining separate accounts, and giving notice through a filing) even if the claim does not arise out of contract or is contractual

---

[5]The tax law definition of a partnership looks to various factors, but an intention to share profits is an important one. *See* reg. section 301.7701-1(a)(2) (treats venture as separate entity if the participants carry on a venture and divide the profits therefrom). *Cf.* Rev. Rul. 55-39, 1955-1 C.B. 403 (assets held within a partnership are deemed distributed to a partner (and thus are no longer part of the partnership) when 100 percent of the profits and losses from the assets are allocated to the partner and he controls the disposition of the assets). The Levine letter, *supra* note 1, argues that there should be a single partnership even without a sharing of profits among portfolios, if there is a business purpose for an overall operation and overwhelming common ownership among portfolios and if the owners hold themselves out as partners in the overall operation.

[6]*See* Del. Code Ann. tit. 6, section 18-215 (2007); 805 Ill. Comp. Stat. 180/37-40 (2005); Iowa Code Ann. section 490A.305 (2006); Nev. Rev. Stat. Ann. section 86.296 (2005); Okla. Stat. Ann. tit. 18, section 2054.4 (2007); Tenn. Code Ann. 48-249-309 (2006); Utah Code Ann. section 48-2c-606 (2006); Puerto Rico Laws Ann. tit. 14, section 3426(p) (as amended through 2004). In addition to SPC legislation (which deals with LLCs), several states provide for the creation of series within a trust. *See* Conn. Gen. Stat. Ann. section 34-517(b)(2) (2005); Del. Code Ann. tit. 12, section 3806(b)(2) (2006); Md. Code Ann. Corps & Assocs. section 12-207(b) (2007); Nev. Rev. Stat. Ann. section 88A.280 (2005); N.H. Rev. Stat. Ann. section 293-B:7, II(d) (2007); Va. Code Ann. section 13.1-1219 (2006); Wyo. Stat. Ann. section 17-23-108(b)(ii) (2007).

[7]*See* Bermuda Segregated Accounts Companies Act 2000, as amended by the Segregated Accounts Companies Amendment Act 2004.

[8]*See* British Virgin Islands, Statutory Instrument 2005 No. 96, Segregated Portfolio Company Regulations, *available at* http://www.bvifsc.vg/LegislationLibrary/tabid/211/DMXModule/626/Command/Core_Search/QuickSearch/segregated+portfolio+companies/Default.aspx.

[9]*See* Cayman Island Companies Law, Part XIV-Segregated Portfolio Companies, sections 232-248 (2004) *available at* http://www.webcom.com/offshore/solomonharris/laws/colaw.rtf.

[10]*See* Guernsey, Protected Cell Companies Ordinance, 1997, amended by the Protected Cell Companies (Amendment) Ordinance, 2006, *available at* http://www.gov.gg/ccm/general/law-officers/legislation/company-law-commercial/companies-legislation-index.en.

[11]*See* Luxembourg Securitisation Act (2004), *available at* http://www.securitisation.lu/securitization_securitisation/lois/.

[12]*See* Mauritius Protected Cell Company Act (1999), *available at* http://www.gov.mu/portal/sites/ncb/fsc/download/pccact.doc.

(C) Tax Analysts 2007. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

but lacks a limited recourse feature.[13] Typically, each portfolio may have its own management.[14] Portfolios can have their own distribution policies.[15] Some of the statutes provide expressly for separate receiverships for segregated portfolios in the case of bankruptcy.[16] Segregated portfolio companies are open-ended in that new segregated portfolios can be added and old ones wound up and terminated over time, without affecting the existence of the other portfolios. A company can have common assets and liabilities that are not allocated to segregated portfolios.[17]

The statutes differ in the degree to which they characterize segregated portfolios as separate legal entities, although as a general matter they are not described that way. In drafting the Delaware statute, a conscious choice was made not to describe portfolios as separate legal entities.[18] The Cayman Islands statute explicitly provides that each segregated portfolio is not a separate legal entity.[19] Under the Illinois statute, by contrast, each segregated portfolio may determine the degree to which it is a separate legal entity from the other portfolios (but in most respects appears to be legally similar to a separate company),[20] and the Luxembourg statute also appears to treat them as separate legal entities.[21] Some statutes are ambiguous. For example, the Tennessee statute applies several statutory provisions for LLCs to each series "as if [it] were a separate LLC."[22]

There are as yet no authorities testing whether segregated portfolios will be recognized to be separate entities in bankruptcy, although clearly that is the intent of the statutes and the hope of the users. Standard & Poor's has guidelines for rating structured finance vehicles that issue debt in series that are intended to increase the likelihood that the separateness of each series will be respected in the event of financial difficulties.[23]

III. Illustration

It may help make the discussion more concrete to give an example of a typical securities repackaging transaction involving an SPC.

> **Example.** The repackaging vehicle (the Company) is formed as a Cayman Islands segregated portfolio company. The Company has a single class of common stock with nominal value held by a charitable trust. All but a nominal amount of its assets and liabilities are allocated to segregated portfolios (that is, there are no material general assets). Each segregated portfolio (referred to as an Issuer) holds as assets an identified group of debt instruments and may enter into derivative contracts either to hedge the assets or to take on exposure to other assets. Each Issuer issues one or more classes of notes under an indenture. The note classes include one class (the Equity Class) that is entitled to all residual cash flows and is subordinated to all other classes of notes of the same Issuer. The notes are not supported by any capital taking the legal form of equity. The note indenture serves as the main document spelling out what the related Issuer can do. To the extent an Issuer is allowed to make discretionary decisions relating to its assets or liabilities, it would enter into an investment management agreement appointing a manager to make those decisions. The manager would also provide reports and perform other administrative functions. The manager's activities would be limited to investing or trading in debt instruments or derivative contracts in debt instruments (all activities that would fall within the securities trading safe harbor

---

[13]*See, e.g.*, Iowa Code Ann. section 490A.305(2) (2006) ("the debts, liabilities, and obligations incurred, contracted for, or otherwise existing with respect to a particular series shall be enforceable against the assets of that series only, and not against the assets of the limited liability company," if the governing agreement so provides, separate records are maintained for the series and its assets, and notice of such limited liability is provided in the filed articles of organization); Del. Code Ann. tit. 6, section 18-215(b) (2007); 805 Ill. Comp. Stat. 180/37-40(b) (2005); Nev. Rev. Stat. Ann. section 86.296(3) (2005); Luxembourg Securitisation Act 2004 section 62(1) (2004).

[14]*See, e.g.*, Del. Code Ann., tit. 6, section 18-215(e) (2007); 805 Ill. Comp. Stat. 180/37-40(h) (2005); Iowa Code Ann. section 490A.305(6) (2006); Okla. Stat. Ann. section 2054.4(F) (2007).

[15]Thus, one series may make distributions even if another series is insolvent. *See, e.g.*, Del. Code Ann. tit. 6, section 18-215(h) (2007); Iowa Code Ann. section 490A.305(8) (2006); Okla. Stat. Ann. section 2054.4 (H) (2007). *See also* Cayman Islands Companies Law section 237(3) and (4) (2004) (separate dividend policies allowed; segregated portfolio distributions made by reference only to portfolio accounts).

[16]*See, e.g.*, Cayman Islands Companies Law section 244 (2004).

[17]*See, e.g.*, Cayman Islands Companies Law section 236(1) (2004).

[18]The authors understand from a conversation with one of the drafters of the statute that this was done to avoid a concern that each series would be analyzed as a separate entity for nontax purposes unrelated to creditor rights (for example, in applying the Investment Company Act of 1940).

[19]Cayman Islands Companies Law section 236(2) (2004). ("A segregated portfolio company shall be a single legal entity and any segregated portfolio of or within a segregated portfolio company shall not constitute a legal entity separate from the company.")

[20]*See* 805 Ill. Comp. Stat. 180/37-40(b) (2005). ("A series with limited liability shall be treated as a separate entity to the extent set forth in the articles of organization. Each series with limited liability may, in its own name, contract, hold title to assets, grant security interests, sue and be sued and otherwise conduct **(Footnote continued in next column.)** business and exercise the powers of a limited liability company under this Act.") One commentator (who helped develop the Illinois legislation) argued that the Illinois statute is preferable to the Delaware statute in terms of treating each series as a separate entity. *See* Terry and Samz, *supra* note 1.

[21]*See* Luxembourg Securitisation Act 2004 section 62(3) (2004). ("As between investors, each compartment shall be treated as a separate entity, except as provided for in the constitutional documents.")

[22]*See, e.g.,* Tenn. Code Ann. section 48-249-309(d) and (e) (2006).

[23]*See* Standard & Poor's, *Structured Finance: Legal Criteria for U.S. Structured Finance Transactions* 41-43 (2006); *see also* Standard & Poor's, *Legal Criteria for European Structured Finance Transactions* (2005) (tests for European vehicles).

(C) Tax Analysts 2007. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

in section 864(b)(2)(A)(ii)). The indenture prohibits the Company from earning U.S.-source income unless it is free of withholding tax.[24] The Company has a board of directors elected by the common shareholder, consisting of personnel from a services company. However, the board will not make any discretionary decisions relating to assets or liabilities of the Issuers, and payments on the notes (as debt service payments) do not require board action. Administrative expenses incurred by the Company as a whole are charged against the individual portfolios and treated as portfolio expenses. They are not material in amount. Aside from the allocation of those expenses, the segregated portfolios do not share any income or expenses. The Company will hold shareholder and board meetings at least annually. The Company and Issuers do not elect to change their U.S. tax status.

In the typical case, the parties would take the position that each Issuer is a separate entity for U.S. tax purposes. Under that characterization, each Issuer would be an eligible entity under the entity classification regulations that could choose to be an association or not (specifically, it would not be a per se corporation).[25] It is assumed in the example that no elections are made to change the tax status of the Issuers. Absent an election, the default classification for each Issuer would be an association, because the owners of the Issuers have limited liability.[26]

Each Issuer's activities are limited so that it will not be subject to U.S. net income tax at the entity level (specifically, it will not engage in a trade or business within the United States) and will not derive any U.S.-source fixed, determinable, annual, or periodical income that is subject to withholding tax.[27] Under those circumstances, the taxpayers most affected by the U.S. tax classification of the Issuers would be U.S. taxpayers holding directly or indirectly an Equity Class.

Assuming first that each Issuer is a separate corporation, the Issuer generally would be a passive foreign investment corporation.[28] U.S. owners of the Equity Class typically would make a qualified electing fund (QEF) election under section 1295(b), with the result that they would be taxed currently on the earnings of the Issuer under section 1293.[29]

If the Issuers were not treated as separate entities, then the holders of the Equity Classes of the various Issuers likely would be treated as owners of equity in the Company as a whole.[30] As a result of the QEF election, they would be taxed under section 1293(a) on their pro rata shares of the ordinary earnings and net capital gains of the Company.[31] The definition of pro rata in section 1293(b) would not necessarily allocate the income from each Issuer to the holders of the related Equity Class. At the least, treating the Company as one entity would have the effect of reducing income (ordinary income or net capital gains) allocated to holders of Equity Shares in profitable Issuers by losses attributable to Issuers with losses, even though the former holders would not ever bear any of those losses economically.[32]

---

[24]U.S.-source interest generally would be exempt from tax under the portfolio interest exemption or the exemption for short-term original issue discount obligations. Income from a notional principal contract would be sourced outside of the United States under reg. section 1.863-7.

[25]The list of per se corporations in reg. section 301.7701-2(b)(8) does not include any Cayman Islands entities. The discussion assumes that no other rule requiring classification as an association applies (Issuer is not a taxable mortgage pool, an insurance company, or a publicly traded partnership engaged in any active business).

[26]*See* reg. section 301.7701-3(b)(2).

[27]The application of U.S. tax rules to the Issuers as taxpayers could at least incidentally be affected by whether the Issuers are separate entities. For example, in determining if any Issuer were engaged in a U.S. trade or business, only the activities of the Issuer would be relevant if it were a separate tax entity. If it were part of a larger corporation, the overall activities of the corporation would have to be considered. Also, the portfolio interest exemption does not apply to 10 percent shareholders (see section 871(h)(3)), and that test could produce different results depending on whether the Issuers are separate corporations. A foreign corporation must file a U.S. tax return if it is engaged in a U.S. trade or business or has U.S.-source income subject to withholding tax that was not withheld. *See* reg. section 1.6012-2(g). Return filing requirements could differ for each Issuer if it were a separate corporation, although based on the facts of the example, no returns would be required in any event.

[28]*See* section 1297 for the definition of a PFIC. If the Issuer were considered a controlled foreign corporation, the CFC rules would override the PFIC rules as to any U.S. shareholder in the CFC under section 1297(e). A CFC is defined as a corporation that is more than 50 percent owned by vote or value by U.S. shareholders (U.S. persons holding at least 10 percent of the voting stock). *See* sections 951(b) and 957(a). The notes likely would not be voting stock. If they were considered voting stock, application of the CFC rules may be affected by whether each Issuer is treated as a separate corporation. In any event, U.S. owners of an Equity Class are likely to make QEF elections so they would be taxed on the earnings of the Issuer whether or not it is a CFC.

[29]Making a QEF election requires that the PFIC provide an annual statement to the electing shareholders. Reg. section 1.1295-1(g). The statement would look quite different for the Company or the Issuer.

[30]The Equity Classes would represent a residual class of stock as to the related Issuer but would have no claim on other assets. In the case of a series fund treated as a single corporation, the IRS has recognized that stock that is payable out of the assets of a series is stock of the issuing corporation (although neither common stock nor preferred but ''special stock'' for purposes of applying the predecessor of section 1036). *See* Rev. Rul. 54-65, 1954-1 C.B. 101. *See also* the other series fund authorities discussed below.

[31]One question is whether the validity of an election would be affected if it were made on the assumption that the Issuer is the relevant PFIC, but the IRS successfully asserted that it was instead the Company.

[32]Section 1293(b) defines pro rata share as the amount that would have been distributed with respect to the shareholder's stock if on each day during the tax year the corporation had distributed to each shareholder a pro rata share of that day's ratable share of the ordinary earnings and net capital gain for the year. It is not clear how this pro rata rule would be applied to the Company as a whole when the notes of each Issuer require payments to be made based on the cash flows (principal

(Footnote continued on next page.)

(C) Tax Analysts 2007. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

Section 1298(b)(4) authorizes the issuance of regulations, necessary to carry out the purposes of the PFIC rules, that would treat separate classes of stock (or other interests) in a corporation as interests in separate corporations. This section would presumably authorize regulations treating each Issuer as a separate corporation for purposes of applying the PFIC rules (including allocating income), but no regulations have been issued.

IV. Relevant Authorities

A. Entity Classification Regulations

The starting point for any analysis of entity classification is the regulations under section 7701.[33] The check-the-box entity rules have been with us for just over a decade. In most common settings, at least, they have made the process of classifying business entities mundane, even boring.

One area in which the regulations offer little help, however, concerns the definition of "entity." The regulations provide classification standards for a "business entity." A business entity is basically any "entity" recognized for federal tax purposes that is not a classified as a trust (or otherwise subject to special treatment under the code).[34]

The regulations say little about what an entity is. They start out by saying that whether an organization is an entity separate from its owners for federal tax purposes is a matter of federal tax law and does not depend on whether the organization is recognized as an entity under local law.[35] A joint venture or other contractual arrangement may create a separate entity for tax purposes (a partnership if it is not an association) if the participants carry on a trade, business, financial operation, or venture and divide the profits therefrom. The regulations distinguish such a venture from a mere co-ownership arrangement, which is not an entity.[36] However, an entity formed under local law is not always recognized to be a separate entity for federal tax purposes. Examples given in the regulations are an organization wholly owned by a state that is an integral part of the state, some Indian tribes, and disregarded entities.[37]

The lack of a precise federal tax definition of entity does not ordinarily pose much of a problem. Most business enterprises are conducted through a juridical entity (corporation, LLC, partnership, or local law trust). When there is such an entity, both the existence of an entity and its scope are often answered in practice without a second's thought.[38] The area that has been perhaps most controversial concerns tax law partnerships. As indicated above, the tax law definition of partnership is expansive, and issues often arise in distinguishing a tax partnership from some other type of economic arrangement (for example, a lease or services contract or the co-ownership of particular property).

The tax issue raised by SPCs is not the usual one of whether an entity exists at all. Putting disregarded entities to one side, an SPC is a type of LLC and clearly an entity; the issue is one of delineation — whether the relevant entity is the SPC or the individual portfolio. The same question was presented in analyzing series funds, and that is the best place to look for guidance in analyzing SPCs.

B. Treatment of Series Funds

As noted above, series funds hold different portfolios of securities as investment or trading assets and issue shares in series that track the portfolios. Series funds are now treated as separate corporations under section

---

and interest) of each related Issuer. One question is whether notes receiving distributions in excess of the income from the related Issuer would be allocated an additional share of income of the Company based on the additional distributions. There is a similar concept of pro rata share in section 951(a)(2). Regulations under that section traditionally allocated subpart F income among multiple classes based on the amount each class would receive if all E&P for the year were distributed. That rule led to some anomalies (including potential abuses arising out of allocations of extra income to classes receiving distributions in redemption of shares and reduced allocations to classes that could not receive distributions in a year because of contractual restrictions). In response, the regulations were overhauled in 2005. *See* reg. section 1.951-1(e), as amended by T.D. 9222, *Doc 2005-17748*, *2005 TNT 164-4*. There are no comparable regulations or other guidance under section 1293. Moreover, ordinary earnings and net capital gains (as separate items) would be determined at the level of the relevant corporation, resulting in the offsetting of losses from one portfolio against gains from another.

[33]For business entities, reg. sections 301.7701-1 through 301.7701-3.

[34]*See* reg. section 301.7701-2(a).

[35]*See* reg. section 301.7701-1(a)(1). Presumably, federal law also would determine whether an organization that clearly is separate from its owners is one entity or several (the issue presented by SPCs).

[36]*See* reg. section 301.7701-1(a)(2).

[37]Reg. section 301.7701-1(a)(3) and (4).

[38]Sometimes it takes a little more time, particularly when dealing with trusts. A state law trust may turn out to be a mere agency relationship and not a real trust. *See, e.g.*, Rev. Rul. 92-105, 1992-2 C.B. 204 (Illinois land trust deemed not an entity, so interests in the trust were not "trust certificates" that were ineligible for like-kind exchange treatment under section 1031, when the beneficiary had the right to direct the trustee in dealing with the property, was entitled to all income or proceeds from the property, and was liable to pay any taxes and liabilities relating to the property). Compare that ruling with Rev. Rul. 2004-86, 2004-2 C.B. 191, *Doc 2004-14855*, *2004 TNT 140-13*, which treated a Delaware business trust holding land and incurring debt as a real entity and not an agency relationship, in light of the rights and obligations created under the Delaware statute, but still allowed trust interests to qualify for section 1031 exchange treatment. For a more general discussion of when an entity exists for federal tax purposes, see James M. Peaslee and David Z. Nirenberg, *Federal Income Taxation of Securitization Transactions,* Chapter 4, Part C (3d Ed., Frank J. Fabozzi Associates 2001) (with supplements at http://www.securitizationtax.com).

(C) Tax Analysts 2007. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

851(g).[39] The section was enacted both to clarify prior law and to change it as it related to incorporated entities.[40]

Union Trusteed Funds v. Commissioner[41] involved a RIC organized as a Delaware corporation. The entity consisted of distinct funds with different investment objectives. A separate class of stock was issued for each fund. The proceeds from the sale of each class of stock funded the related assets and the income from those assets was allocated only to the related class. In the case before the court, some series recognized capital gains and some had losses. The RIC added up all long-term capital gains and losses and prorated the net amount over all distributions on all classes of stock to determine the amount of capital gain dividends for each class. The IRS took the position that each fund should be treated as if it were a separate corporation, with the result that the capital gains dividend paid on each class was limited to the excess of long-term capital gains over capital losses for the related fund.

The court rejected the IRS's argument, at least in part. Relying on the fact that the investment vehicle was recognized as a corporation for federal tax purposes, and that Congress had mandated separate entity treatment of corporations in determining net capital gains and losses (one ''taxpayer''), the Tax Court held that the only net capital gain that could support capital gains dividends (net long-term gains less short-term losses) was gain computed at the fund level. However, the court then concluded that dividends distributed on any series of stock and designated as capital gains dividends were not properly so designated to the extent the designated amount exceeded the net capital gain of the series. Effectively, that meant that to pay out the maximum permitted amount of capital gains dividends, the fund was required to allocate net capital gains among series based on how they were earned, and not pro rata among all series. Thus, the court gave some recognition to the series structure in deciding how capital gains dividends should be allocated.

In a second case decided in 1949, two years after *Union Trusteed Funds*, the Tax Court appeared to assume, without deciding, that separate series of a series fund organized as a trust could be treated as separate associations for tax purposes. In *National Securities Series v. Commissioner*,[42] the petitioners were open-end investment companies that were organized as trust series under a single trust agreement. Each series held distinct assets and issued a single class of shares that tracked the assets. Each shareholder could redeem its shares in exchange for a pro rata share of the assets of the related series, without forcing the trust to pay out profits to other holders. The IRS took the view that the redemption payments were ''preferential dividends'' and as a result were not deductible by the trust, under the predecessor to section 562(c). The court held that no preferential dividends were paid, as each class in a series had the same right to be redeemed. However, the IRS was not arguing that the preference resulted from the existence of multiple series within a single corporation, but rather that all holders of stock of the same series did not receive the same amounts as those redeemed. Thus, the tax status of the funds was not central to the case. Nevertheless, the series had filed returns as separate corporations and that approach was not challenged.

In 1956 the IRS issued a revenue ruling that states unequivocally that a ''multifund'' RIC constitutes one taxpayer for federal income tax purposes, citing *Union Trusteed Funds*.[43] However, a 1955 revenue ruling had cited *National Securities Series* with approval and repeated the Tax Court's tacit characterization of the series funds as separate taxpayers,[44] and later informal guidance made it clear that the IRS had adopted the *National Securities Series* gloss that the single-entity treatment of series funds did not extend to funds organized as trusts.

The IRS view is set out in General Counsel Memorandum 39211 from January 1984. It analyzed a request for a private letter ruling confirming that each series that was part of a series fund constituted a separate corporation. The GCM is worth describing in some detail. The trust was formed under a declaration of trust as a single Massachusetts business trust. Each series issued a class of shares and payments on the shares were limited to assets of the series. The declaration of trust provided that the liability of each fund was restricted to the assets of that fund and that expenses, fees, charges, taxes, and liabilities incurred or arising in connection with a particular fund or in connection with the management thereof were payable solely out of assets of that fund. On matters subject to a shareholder vote (including the election of trustees, the approval of management advisers selected by the trustee, the termination of the trust, the amendment of the declaration of trust, and on any matter submitted to a shareholder vote), all shares were voted by individual series, except when an aggregate vote was required by the Investment Company Act of 1940 or when the trustees had determined that the matter affected only the interests of one or more series, in which case only the shareholders of the affected series were entitled to vote. Each fund had different investment objectives and policies, was composed of different types of assets, had different management fee arrangements

---

[39]Section 851(g) provides that in the case of a RIC having more than one ''fund,'' each fund shall be treated as a separate corporation for purposes of the income tax title (except regarding the definitional requirement of section 851(a) (requires a RIC to be have a specific status under the Investment Company Act of 1940)). A fund is defined as 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.'' Section 851(g) is not elective.

[40]*See* Rev. Rul. 88-14, 1988-1 C.B. 405 (explaining that section 851(q), the predecessor to section 851(g), treats each fund of a series investment company as a separate corporation and applies to both incorporated and unincorporated companies).

[41]8 T.C. 113 (1947).

[42]13 T.C. 884 (1949).

[43]*See* Rev. Rul. 56-246, 1956-1 C.B. 316 (1956), *obsoleted by* Rev. Rul. 1988-14, 1988-1 C.B. 405, based on the enactment of section 851(q) (now 851(g)).

[44]*See* Rev. Rul. 55-416, 1955-1 C.B. 416.

(C) Tax Analysts 2007. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

with the management advisers, and had different shareholders. The funds were organized under a single trust instrument to achieve cost savings and the benefits of associating with one another. By organizing under a single trust instrument, the funds were able to achieve substantial cost savings by sharing a single prospectus, one proxy statement, one annual report, and one set of filings.

The GCM concludes that the series should be considered separate corporations based on the following reasoning:

> In *Int'l Sec. Series-Indus. Stocks Series, Nat'l Sec. & Research Corp. Empire Trust Co. v. Commissioner*, 13 T.C. 884 (1949), acq., 1960-1 C.B. 4, the Tax Court recognized that the several series of a single investment trust may be considered distinct taxable entities, each a separate regulated investment company. Although the classification of the entities in that case was not in issue, the court assumed in its opinion that each of the several series created under a single trust instrument was a separate taxpayer. Rev. Rul. 55-416, 1955-1 C.B. 416, considered in * * * A-615771, cites *Nat'l Sec. Series* with approval, echoing the Tax Court's characterization of the series funds as separate taxpayers. Thus, both the Tax Court and the Service have tacitly endorsed the position that a single trust consisting of separate series can be classified as multiple taxpayers.
>
> 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 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 1940 Act 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 entities.
>
> This case is distinguishable from *Union Trusteed Funds, Inv. v. Commissioner*, 8 T.C. 1133 (1947), acq., 1947-2 C.B. 4, and Rev. Rul. 56-246, 1956-1 C.B. 316, considered in * * * G.C.M. 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 tax purposes as corporations without regard to the rules for classifying unincorporated entities. C.f. * * * G.C.M. 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 controls the classification of unincorporated entities.

The reasoning and the holding of the GCM were adopted in a number of private letter rulings, including one from 2003.[45]

The basic rationale for separate-entity treatment of a series fund organized as a trust is straightforward. If it can be shown that the series are economically and legally separate entities except in some formalistic ways, there is good reason to treat the entities as separate if that can be achieved without bending the law too much, and *Union Trusteed Funds* can be distinguished as involving a state law corporation.

A typical series fund described in GCM 39211 achieves a high degree of economic and legal separation. It has different assets and investment objectives, different owners, and separate management. The series do not operate together as part of one business enterprise, except in the general sense that is true for a family of mutual funds with a common manager. Further, as was the case for the fund in GCM 39211, the trust form of organization can be used to separate the series legally. For the most part, the terms of a trust are determined by contract. Significantly, it is possible to shield the assets of a series held by a trust from creditors of another series. In essence, subtrusts having the status of separate trusts can be formed under a single trust agreement. Also, the voting control over a trust series can be vested largely in the owners of that series. By contrast, a conventional corporate statute would not allow assets of one series to be insulated from creditors of another series. Distributions could not be made legally on any class without considering the overall financial condition of the corporation. Statutory voting rights applicable to stockholders would be applied treating the holders of all classes of stock as stockholders of one corporation (with allowances for additional class votes).

GCM 39211 attaches some importance to the fact that the trust is an unincorporated entity that was not a per se corporation under the then-existing classification standards. That fact allowed *Union Trusteed Funds* to be distinguished. Further, the per se corporations involved in series funds were conventional domestic business corporations, and traditional state corporate statutes simply do not allow one series to be walled off legally from the others.

The status of a trust as an ''unincorporated entity'' may be significant in two other respects. First, the phrase ''unincorporated organization'' was used in the pre-1997 entity classification regulations as a term of art to refer to entities whose status was tested under the six-factor corporate resemblance test. Thus, the phrase included incorporated entities that were not automatically considered corporations for tax purposes. For example, Rev. Rul. 88-8[46] concludes that an unlimited liability company

[45]*See, e.g.*, LTR 8510013 (Dec. 5, 1984), LTR 8512056 (Dec. 27, 1984). LTR 200303018, *Doc 2003-1578, 2003 TNT 13-72*, relies on the same reasoning in concluding that a master fund that was a series within a trust that was not classified as a corporation (and thus did not qualify under section 851(g)) could be viewed as a separate business entity.

[46]1988-1 C.B. 403.

(C) Tax Analysts 2007. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

organized under English law was an ''unincorporated organization'' subject to classification under the six-factor test, even though the entity was clearly ''incorporated'' under Great Britain's ''corporation'' statute. Thus, finding that an entity was unincorporated meant that the IRS had greater freedom to determine its tax status. Under current law, the term ''eligible entity'' is used to describe a business entity that is not automatically classified as a corporation and thus can determine its tax status by election.[47]

Second, by definition, that a trust is not a per se corporation means that it could be either a corporation or a passthrough entity. Making the choice is quite easy under current law. If an SPC were not an association and each portfolio had separate owners who did not share profits, losses, or capital or have a joint business plan, there would be a strong argument that the owners of the different portfolios were not members of one umbrella partnership. But if separate treatment of portfolios makes sense when viewed through the partnership lens, the same should be true if the box is checked the other way. The current entity classification regulations apply to determine the tax status of a business entity, and there is nothing to indicate that the scope of an entity changes based on whether it is or is not checked to be an association.

C. Series Fund Reasoning Applied to SPCs

The reasoning of GCM 39211 should apply directly to an SPC used in a structured finance transaction. Such an SPC resembles a series fund organized under a trust in three key respects. First, the arrangements are economically similar. They involve separate pools of financial assets, separate owners, and potentially separate investment objectives in that each portfolio is priced and sold separately. Second, SPCs allow the assets of each portfolio to be legally segregated in a way that is similar to a trust. Third, as a type of LLC, SPCs generally are not per se corporations and thus could potentially be classified as tax transparent vehicles.[48]

For the sake of completeness, it is worth considering two factors that could potentially distinguish SPCs from entities organized as trusts: the fact that SPCs are formed under a statute and the way in which they are characterized as separate entities in the governing statute.

SPCs and corporations are both formed under statutes. A trust, by contrast, may be formed by agreement without a statutory filing. There are, however, also business trust statutes,[49] and we are not aware of an instance in which the IRS has treated statutory trusts differently from common law trusts. Statutory trusts are still trusts.[50] Further, the existence of a statutory scheme should be significant only if it changes in material ways the rights and obligations of trusts and beneficiaries as they would exist at common law. However, even without a statute, traditional series funds organized as common law trusts had all of the major characteristics of corporations. Under the six-factor corporate resemblance test in the pre-1997 entity classification regulations, all trusts were considered to have four of the major characteristics of a corporation that distinguished it from other organizations: limited liability, free transferability of interests, continuity of life, and centralized management. Trusts classified as corporations (such as series funds) also had the two remaining corporate characteristics: associates and an objective to carry on business and divide the gains therefrom. One of the most popular types of business trusts used to form series funds is a Massachusetts business trust, which is a common law trust having all six corporate factors. GCM 39211 involved such a trust. GCM 39211 does distinguish between incorporated and unincorporated entities, but it is clear that an unincorporated entity can be formed under a statute.[51]

That an SPC statute may characterize the SPC as a single legal entity is unhelpful but hardly fatal. If in fact all of the material legal rights and obligations are tied to the individual series, there would seem to be little significance to the treatment of the SPC as an entity, and the entity classification regulations are quite clear that entity status is ultimately a federal tax question. Further, series funds organized as trusts are treated as a single entity for some legal purposes. Otherwise there would be no point to the structure.

Based on the discussion above, the traditional position of the IRS regarding series funds organized as trusts supports the view that segregated portfolios within SPCs used in structured finance transactions should be treated as separate entities.

D. Other Analogies

While series funds appear to be the closest analogy to an SPC used in structured finance transactions, two other structures that bear some similarity to SPCs are worth a brief mention. They are tracking stock and stapled stock arrangements.

Tracking stock is a class of stock of a parent corporation that ''tracks'' the performance of a subsidiary. It is typically used to separate economically the business of the subsidiary from that of the parent without causing the parent corporation to lose tax ownership of the subsidiary (which could result, among other adverse tax consequences, in the recognition of gain).[52] The concern most often expressed with tracking stock is not whether the stock would be considered to be stock of a component part of the issuing corporation but rather whether, despite the best efforts of the taxpayers, the stock would resemble the subsidiary stock so closely that it should be

---

[47]*See* reg. section 301.7701-3(a).

[48]In the case of an SPC formed under a foreign statute, the entity could potentially be on the list of per se corporations in reg. section 301.7701-2(b)(8). That is not the case for any of the jurisdictions identified above starting at note 7.

[49]For a list of trust statutes that allow segregated portfolios, see *supra* note 6.

[50]*See* Rev. Rul. 2004-86, 2004-2 C.B. 191, *Doc 2004-14855, 2004 TNT 140-13*, analyzing a Delaware statutory trust as a trust.

[51]See the discussion of Rev. Rul. 88-8, *supra* note 46.

[52]For examples of such uses, see Stuart M. Finkelstein and Benjamin Handler, ''Tracking Tracking Stock,'' 727 *PLI/TAX* 265, 272-285 (2006). *See also* LTR 8817007 (Apr. 29, 1988), allowing tracking stock to be treated as stock of the parent, *revoked by* LTR 8844038 (Nov. 1, 1988).

(C) Tax Analysts 2007. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

considered an ownership interest in the stock. The fact that the parent issuer of tracking stock is a state law corporation, so that holders of tracking stock bear the risks of ownership of the other businesses of parent, is a significant factor in concluding that tracking stock is in substance parent stock. Further, the fear of tax adversity has led taxpayers to structure tracking stock so that the connection between the tracking stock and the stock it tracks is fairly loose (certainly by the standards of stock in a series fund).[53] The IRS has a no-ruling policy on the question whether tracking stock is stock of the parent,[54] but private letter rulings normally respect a taxpayer's representations that the tracking stock is indeed stock of the parent for tax purposes.[55]

Stapled stock arrangements provide another analogy to SPCs. Stapled stock is stock of two corporations that must be transferred together. The tax question it presents is whether to recognize the two corporations as one or two. In other words, in a stapled stock structure, the issue is whether to blend together two distinct legal entities because they have common owners. The issue with an SPC is the reverse, whether assets with separate owners can be treated separately even though the issuers are bound together legally within a single legal shell. Section 269B now provides various tax consequences for stapled stock arrangements (for example, treating a foreign corporation whose stock is stapled to a domestic one as a domestic corporation). Before the enactment of section 269B, case law produced conflicting results, sometimes recognizing the separate existence of the two corporations based on their separate rights and obligations and sometimes not when the corporations were commonly owned and run as one.[56] It would seem to be easier to separate out the components of an SPC when they represent distinct economic interests and there is a significant degree of legal separation than to blend together two corporations based on common ownership even if the common ownership is required by contract.

[53]For example, the linkage of dividends to the performance of the subsidiary might be based only on a board policy, and the tracking stock may be convertible into parent stock.

[54]Rev. Proc. 2007-3, section 3.01(63), 2007-1 IRB 112, *Doc 2007-112, 2007 TNT 2-3*.

[55]*See generally* Finkelstein and Handler, *supra* note 52, at 285-286; LTR 200229015, *Doc 2002-16775, 2002 TNT 140-31* (treating exchange of tracking stock relating to a subsidiary for all of the stock of the subsidiary as a tax-free distribution for both the parent company and the tracking-stock shareholders under section 355).

[56]*Compare Lonsdale v. Commissioner*, 32 F.2d 537, 539 (8th Cir. 1929) (noting that two stapled corporations were not identical because each had "distinct legal organizations, operating under separate charters [. . .] and possessing independent powers and privileges.") (*quoting Corsicana National Bank v. Johnson*, 251 U.S. 66 (1919)), *with De Coppet v. Commissioner*, 108 F.2d 787 (2d Cir. 1940) (disallowed loss on worthlessness of stock of investment company owning a bank building when stock was inextricably linked to stock of the bank and part of one business).

V. Conclusion

Based primarily on the series fund analogy, segregated portfolios within an SPC should be treated for tax purposes as separate entities, provided the portfolios do not share in profits, losses, or capital (aside from some reasonable allocation of common expenses of the SPC); the SPC holds financial assets (including derivatives); the interests in the portfolios are priced and offered separately; and the SPC is not a foreign corporation on the list of per se corporations.[57] While the argument is a strong one, it would be helpful if the IRS would issue a ruling confirming this result. Issuing guidance would reduce the risk that investors will take differing positions on the issue depending on which approach produces the best results for them. Further, the separate-entity approach is less distortive in that it allocates income from the separate portfolios to the investors who earn it economically.

SPCs are flexible vehicles and the argument for single-entity treatment clearly would be greater if segregated portfolios within an SPC were used to operate parts of a business with a common business objective and had by design common owners.[58] Thus, any guidance is likely to be limited to a particular fact pattern. SPCs are being used and likely will continue to be used in structured finance transactions involving many investors and large amounts of money. A ruling on structured finance transactions would be very useful even if it did not provide a comprehensive framework for analyzing SPCs.

[57]It is not clear if being a per se corporation is really significant for an entity formed under an SPC statute that allows for the legal separation of portfolios, but at any rate, that case is unlikely to arise in practice often.

[58]Even then, perhaps "single partnership" treatment could be achieved by treating the portfolios as separate entities but finding that a larger partnership exists among them.

(C) Tax Analysts 2007. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.