

MEMO# 8133

August 7, 1996

CALIFORNIA TREATMENT OF MASTER-FEEDER STRUCTURES

1 See Institute Memoranda to California Members, dated August 25, 1995, and to Tax Committee No. 34-93 and California Members, dated August 5, 1993. August 7, 1996 TO: CALIFORNIA MEMBERS TAX COMMITTEE No. 29-96 RE: CALIFORNIA TREATMENT OF MASTER-FEEDER STRUCTURES

_____ As we informed you previously,¹ a California Franchise Tax Board regulation required that a managed business trust be treated as a corporation for California tax purposes. In the context of "master-feeder" structures, this regulation thus characterized as a corporation for California tax purposes a "master fund" organized as a business trust. In contrast, under federal tax rules, master funds organized as business trusts normally qualify for partnership tax treatment. This divergence has caused a number of anomalies for master-feeder structures in California. Recently, the Franchise Tax Board adopted amendments to the regulation that required treatment of managed business trusts as corporations (the amended regulation is attached). Under the amended regulation, a master fund will be treated as a partnership for California tax purposes if it (i) would be characterized as a partnership under California's entity classification rules, and satisfies an asset test and a gross income test, or (ii) would be characterized as a partnership under California's entity classification rules, treating the existence of a power to vary investments as an additional corporate characteristic in applying the classification rules. The amendment is effective May 3, 1996. We will keep you informed of developments. Anne M. Barr Assistant Counsel - Tax Attachment