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## Massachusetts DOR Proposes New Restrictions on Pledges of Security Corporation Stock

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Companies with Massachusetts security corporation subsidiaries are often asked by lenders to pledge as security for a loan their shares of stock in the security corporation subsidiaries. To qualify as a security corporation, a corporation must be classified as such by the Department of Revenue (DOR) and must engage exclusively in buying, selling, dealing in, or holding securities on its own behalf. The Department of Revenue, in a draft directive released on September 30, 2011, announced limitations on the ability to pledge the stock of a security corporation as security for a loan to a shareholder of the security corporation.

The draft directive states that a pledge of stock will not cause a revocation of security corporation status, provided that: (1) the stock pledged does not exceed more than 50% of the value or the total combined voting power of the security corporation and (2) there are no negative covenants or restrictions in connection with the pledge that relate to the scope of permitted assets, liabilities, or activities of the corporation.

If finalized in its present form, the directive will apply:

- (i) where there is a pledge of stock of a security corporation (whether or not previously classified as a security corporation) made after September 30, 2011;
- (ii) where there is a prior pledge of stock of the corporation filing an application after September 30, 2011 to be classified as a security corporation; and
- (iii) to taxable years beginning on or after October 1, 2012 where there was a pledge of stock of a security corporation on or before September 30, 2011.

Accordingly, if the directive is finalized in its present form, pledges of security corporation stock made after September 30, 2011 must satisfy these conditions, and no request for security corporation classification may be filed after September 30, 2011 if the corporation's stock is subject to a pledge that does not satisfy the conditions. **Perhaps more importantly, a security corporation whose stock was pledged before September 30, 2011 must take steps to satisfy the conditions**

of the directive before its taxable year beginning on or after October 1, 2012 or face revocation of security corporation status. Presumably, this will require negotiation with lenders to change the terms of loan agreements.

The Department of Revenue has requested that comments be submitted by October 14, 2011.

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