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Chapter 16: State and Local Taxation

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CHAPTER 16

State and Local Taxation

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A. Administration

§16.1. The State Tax Commission. The year 1955 saw the first change in the personnel of the State Tax Commission since its establishment in 1953.[1] William A. Schan, who had served as Commissioner of Corporations and Taxation and as Chairman of the State Tax Commission since its organization, resigned in October. He was succeeded by John Dane, Jr., a distinguished Boston tax lawyer.

During Commissioner Schan's tenure great strides were made in modernizing the administration of the Massachusetts tax laws. The tax department was reorganized, procedures were streamlined, accounting methods were mechanized, and improved research and statistical techniques were introduced. Enforcement laws and practices were tightened with the result that more than 100,000 new taxpayers were added to the rolls.

Substantive changes in the tax laws in 1955, while not so numerous as in 1954, were still important. They indicate a continued willingness on the part of the legislature to accept most of the recommendations for legislation by the new State Tax Commission.

Formal regulations with respect to various state taxes have not yet been promulgated by the Commission, but it is understood that complete regulations are currently being drafted.

B. The Personal Income Tax

§16.2. Persons subject to tax: Nonresidents. The Massachusetts personal income tax has traditionally applied only to income of certain specified classes received by inhabitants of the Commonwealth.[1] An inhabitant for the purpose of the income tax means one who is

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§16.1. [1] Acts of 1953, c. 654.

§16.2. [1] G.L., c. 62, §§1, 25.

domiciled here.[2] Persons domiciled outside of the state had not hitherto been subject to the personal income tax, even though their income was earned, in whole or in part, within the state.

Chapter 780 of the Acts of 1955,[3] however, has amended G.L., c. 62 by inserting a new Section 5A imposing an income tax on nonresidents. A nonresident is defined as "any natural person whose domicile is outside of the commonwealth." The new law also defines, for the purposes of G.L., c. 62, resident or inhabitant to mean "every natural person domiciled in the commonwealth," thus reaffirming earlier judicial decisions.

Because of jurisdictional limitations nonresidents are taxed only on income derived from professions, employment, trade or business, i.e. so-called business income. Specifically excluded from the tax is compensation paid to armed services personnel of the United States assigned to duty within the Commonwealth. Also excluded are all types of retirement allowances. Nonresidents are entitled to the same deductions and exemptions as are allowed to inhabitants under Chapter 62, except that allowable deductions are limited to that portion associated with the production of taxable income within the Commonwealth.

Every nonresident whose income from taxable sources within the Commonwealth exceeds $2000 is required to file. Failure to file may result in an estimate of income by the Commissioner and a computation by him of tax based on gross income without exemptions or deductions.[4]

Chapter 780 also reaches the business income derived within the Commonwealth by trustees or other fiduciaries under the will of a nonresident decedent. In this aspect the statute is very narrowly drawn to reach only such business income received by a trust established by will.[5]

The taxation of partnerships has also been changed.[6] Under G.L., c. 62, §17, before amendment, only those partnerships were taxable which had a usual place of business in the Commonwealth and at least one inhabitant partner. Chapter 780 amends Section 17 of Chapter 62, and subjects to the tax all partnerships having a usual place of business in the Commonwealth. The amendment purports to tax to such a partnership all of its business income, but presumably the intention of the statute was to tax only the business income of the nonresident partners derived from sources within the Commonwealth with the same proration of exemptions and deductions which are allowed to nonresident individuals. Otherwise the statute would present, in this aspect, a serious constitutional difficulty. In the case of

2 Ness v. Commissioner, 279 Mass. 369, 181 N.E. 178 (1932).
3 Applicable to income received during the calendar year 1955 and thereafter.
4 Acts of 1955, c. 780, §1 (d).
5 Id. §3.
6 Id. §4.

non business income an allocation to the Commonwealth is made on the basis of the aggregate interest of the inhabitant partners.

On the practical side it is apparent that even in the case of individual nonresident taxpayers there will be knotty problems in the identification of the source of income, and in the proration of exemptions and deductions. These problems would appear to be compounded in the application of the new law to large multistate partnerships with complex income derivations.

In taxing the income of nonresidents it was necessary to provide for some sort of credit for taxes paid to other states in order to avoid double taxation of the same income. The technique adopted was to add a new Section 6A to Chapter 62, providing that a resident of Massachusetts would be entitled to a credit for taxes paid to any other state on income earned in such other state. This credit, however, cannot exceed the amount of the Massachusetts tax attributable to such income.

It would appear that we might better have followed a different course. The only two states physically bordering on Massachusetts which do impose income taxes are New York and Vermont. Their geographical proximity makes it likely that these two states will be involved in most of our out-of-state income situations. Both of these states impose an income tax on nonresidents who earn income within their borders. But they allow a credit against the tax to a nonresident who is subject to tax on such income at his domicile. In short, domicile is considered the controlling factor in the determination of which state has priority. The Massachusetts theory is that the source of the income determines priority.

In the interest of uniformity we might well have accommodated ourselves to the laws already in effect in New York and Vermont. The result has been threatened reprisals against Massachusetts residents earning income in these states. Until all three states have an integrated method for dealing with this problem, inequities in individual cases are likely to occur.

Chapter 592 of the Acts of 1955 changed the law with respect to trusts which are subject to the income tax.[7] Under prior law the income of a testamentary trust was taxable in Massachusetts, subject to the requirements of allocation, if the testator died an inhabitant of the Commonwealth, and any of the trustees or other fiduciaries was an inhabitant of Massachusetts, or derived his appointment from a Massachusetts court. Chapter 592 has eliminated jurisdiction to tax testamentary trusts based on the inhabitancy of the trustees. In practically every case where a testator dies domiciled in Massachusetts, his testamentary trustees, if any, will derive their appointment through a Massachusetts court. It is conceivable, however, that a Massachusetts decedent might leave as his sole asset taxable income-producing prop-

[7] By amending G.L., c. 62, §10.

erty in another state, and that his will might be admitted to probate in the other state. In such case it would seem that the 1955 amendment has narrowed the basis for taxing testamentary trusts.

The basis for taxing inter vivos trusts was broadened by Chapter 592. Trusts with more than one settlor are now taxable if any one of the settlors was a resident[8] of Massachusetts. Also taxable is an inter vivos trust established, either alone or with others, by a person who dies an inhabitant of the Commonwealth. It may be questioned whether it is fair to tax such a trust in a case, for example, where the settlor at the time of its creation was a nonresident and made a relatively small contribution to the total trust property.

Also broadened is the taxation of Massachusetts beneficiaries of trusts which are not subject to our state income tax.[9] Under prior law,[10] the Massachusetts beneficiary was taxed only if he received income from an out-of-state trust. Now he is taxed if he is an "inhabitant of the commonwealth who receives, is entitled to, or to whom income is available . . ." from such trusts. Actual receipt is no longer necessary.

Another important change made by Chapter 592 concerns the taxation of estates of decedents. Under G.L., c. 62, §9, before the amendment, interest and dividends accrued prior to the decedent's death were taxable to the estate. Now taxable income from all sources which would have been taxable to the decedent if he had survived to receive it are taxed to the estate.

§16.3. Taxable income: Corporate distributions in liquidation. In 1954 the legislature closed an often-used avenue of tax avoidance by providing that accumulated profits capitalized within two years of liquidation would still be treated as accumulated profits under G.L., c. 62, §1(g).[1] Nothing was done, however, to change the traditional Massachusetts rule that corporate distributions in liquidation in excess of the legal capital attributable to the shares are taxable as ordinary dividends. Also left untouched are the extremely inflexible provisions of the Massachusetts tax laws with respect to consolidations, mergers, reorganizations, and recapitalizations. Chapter 635 of the Acts of 1955 attacked the first of these problems by providing that distributions in connection with the redemption or cancellation of stock are not taxable under Section 1(g) of Chapter 62, i.e., as ordinary dividends.[2] Instead such distributions are held to be sales or exchanges and taxable, if at all, under Section 5(c) of Chapter 62. Gain or loss is to

[8] The word "resident" was introduced into G.L., c. 62, §10 by the 1955 amendment. Previously the word "inhabitant" was used uniformly. In view of Acts of 1955, c. 780, both words now have the same meaning in Chapter 62.
[9] Acts of 1955, c. 592, §3.
[10] G.L., c. 62, §11.

§16.3. [1] Acts of 1954, c. 545.
[2] Id. §1.

be determined by comparing the fair value of the property received with the basis of the stock canceled or redeemed. A pro rata formula is provided for partial liquidations.[3]

Thus another forward step has been taken to bring Massachusetts in line with existing federal law. It is unfortunate that this course has not been followed with greater purpose. Nothing has yet been done to liberalize the Massachusetts rules on tax-free exchanges in connection with mergers, consolidations, reorganizations, and recapitalizations. Several bills dealing with these matters were before the 1955 General Court, but no action was taken, presumably because of uncertainty as to the potential revenue loss.

In the course of rewriting Section 5(c) of Chapter 62, gains from "sales or exchanges" were made taxable. The earlier version applied only to gains from "sales" of intangibles, but by judicial construction had been held to apply to exchanges as well.[4]

§16.4. Basis for determining gain or loss. Section 5(c) of Chapter 62, as amended by Chapter 635 of the Acts of 1955, remains the basic taxing section for capital gains, but now contains no rules for determining the basis for gain or loss other than in the case of total or partial corporate liquidations. The rules for determining basis are consolidated in the new Section 7 of Chapter 62. The basis of property acquired in liquidation or in a taxable exchange is established as the fair market value at the time the property was acquired or the exchange made.[1]

Under the earlier version of Section 7 of Chapter 62,[2] the cost basis of real or tangible personal property for the determination of gain or loss was to be diminished by the amount of depreciation "allowable" to the taxpayer. Since rental income as such is not taxable, it became apparent that no depreciation was "allowable" on such property. As to such property the provisions for reducion in basis were inoperative. The taxpayer was entitled to his full cost basis in computing gain or loss. Chapter 635, however, added a sentence to the last paragraph of Section 7 of Chapter 62 to the effect that in determining loss in the case of real property the rental income from which is exempt under Chapter 62, the basis is to be reduced by the depreciation sustained during the period the property was rented even though such depreciation was not "allowable" for tax purposes. In the case of gain, however, the taxpayer is still entitled to use for his basis the full cost of rented real estate.

Chapter 635 makes further changes in Section 7 of Chapter 62 by rewriting the provisions for reducing the basis of intangible personal

[3] Id. §2. The new law applies to liquidating dividends received on and after November 2, 1955.

[4] Acts of 1955, c. 635, §3.

§16.4. [1] Acts of 1955, c. 635, §3.

[2] Amended by Acts of 1954, c. 599.

property in the case of nontaxable stock dividends, distributions of capital, and partial liquidations.[3]

§16.5. Exemptions and deductions. No changes in exemptions were made in 1955, but two deductions were added. Acts of 1955, c. 717 amended G.L., c. 62, §6 by adding subsection (i) permitting a deduction from business income on account of medical expenses paid within the year to the extent such expenses are deductible for federal tax purposes. It should be noted that a literal reading of the statute would make the deduction available only to taxpayers reporting on a cash basis. It is likely, however, that the deduction will also be allowed to those using the accrual method, if such expenses are accrued during the taxable year.

The effective date of Chapter 717 is January 1, 1957. It applies to returns filed on account of income received during 1956 and thereafter. Although the merits of this particular deduction may not be open to serious question, it should be noted that the basic exemption for business income is $2000, whereas the basic federal exemption is $600. In view of the much larger state exemption and the comparatively low rate of the tax on business income, it seems unwise as a matter of general policy to make available under the Massachusetts income tax the same nonbusiness deductions permitted by the federal law. It should also be noted that the allowance of the medical deduction only from business income continues the questionable practice of discriminating against taxpayers whose income is derived from other sources.

Chapter 527 of the Acts of 1955 allows a guardian or conservator to deduct from taxable income the amounts paid for premiums on his surety bonds. Previously this deduction was permitted only to trustees.

§16.6. Administrative provisions. The most important administrative change enacted by the 1955 General Court was embodied in Chapter 692 of the Acts of 1955. This act, which inserted a new Chapter 62A into the General Laws, authorized the filing of a simplified income tax return form by certain individual taxpayers. To be eligible to file under Chapter 62A a taxpayer must derive all of his taxable income in the form of compensation for personal income from one or more employers, and the total amount of such gross taxable income must not exceed $8000.

Chapter 62A establishes an optional tax table listing gross taxable income (i.e., without any of the deductions allowed under Chapter 62) with $50 increments, between $2400 and $8000. The tax to the nearest dollar is calculated in the table according to the number of the taxpayer's dependents.

The tax table makes allowance for deductions much after the man-

[3] Acts of 1955, c. 635, §3.

ner of the federal tax table. In Massachusetts, since taxable salaries and wages under Chapter 62 tend to be about the same for all taxpayers with the same income, it is expected that wide use will be made of the optional tax table. Only where the taxpayer has a deduction for large medical expenses in 1956 and thereafter will it be substantially to an eligible taxpayer's advantage to use the long form and itemize his deductions.

Chapter 62A promises greater convenience to thousands of taxpayers, and real savings to the tax department in the cost of processing returns.

Accounting methods required under the income tax law were changed by Chapter 618 of the Acts of 1955.[1] The new law follows closely the federal rules on accounting methods and periods. Taxable income is to be determined in accordance with the method of accounting regularly used in keeping the taxpayer's books unless the method does not clearly reflect income. The cash basis is to be used if the taxpayer does not keep books of account. Once an accounting method is adopted by the taxpayer it cannot be changed for tax purposes without the consent of the Commissioner. Income is to be computed on a calendar year basis, unless the taxpayer's books are kept on a fiscal year basis and he has obtained permission from the Commissioner to report his income on such basis.

General Laws, c. 62, §43[2] sets the time for filing an application for abatement of income tax as three years from the last day for filing the return or one year from the date of overpayment of the tax. No provision was made for contesting an overassessment without payment of the tax. Chapter 545 of the Acts of 1955 corrects this situation. The taxpayer may apply for an abatement of an overassessment if he applies within three years from the last day for filing the return or within one year after the overassessment, whichever occurs later. There is no necessity that the tax be paid before filing for the abatement. If the overassessment has been paid, the taxpayer receives a refund with interest at 3 percent from the date of payment.

Chapter 243 of the Acts of 1955 carries the 3 percent interest rate on abatements over to refunds paid after decision by the Appellate Tax Board. Under prior law[3] such refunds were made with interest at 6 percent. It is still difficult to justify the 3 percent rate on abatement of taxes which have been paid when the Commonwealth imposes interest at the rate of 6 percent on overdue and unpaid taxes.[4]

The State Tax Commission was given an important assist in its

§16.6. [1] This amends G.L., c. 62 by adding a new Section 62 at the end of the chapter. Provisions in Chapter 62, Section 7 dealing with accounting methods were deleted.

[2] As amended by Acts of 1954, c. 269.

[3] G.L., c. 62, §46.

[4] Id., §§37A, 41.

enforcement program by Chapter 539 of the Acts of 1955. Under prior law[5] a delinquent taxpayer, whether he filed a fraudulent return or no return at all, or he filed an incorrect or insufficient return, was subjected to the same sanctions and penalties. In each case the Commissioner was permitted to assess a tax on belief only after giving ten days' notice to the taxpayer, so that the taxpayer, whatever the nature of the delinquency, would have an opportunity to confer with the Commissioner or his representative. Criminal penalties could be imposed only if the taxpayer failed to file a proper return within twenty days after the notice was given. It is obvious that under prior law there was an open invitation to fraud and evasion.

Chapter 539 proceeds on the theory that there is a logical basis for treating differently those who file an incorrect or insufficient return, and those who file a fraudulent return or file no return at all. General Laws, c. 62, §36 is amended to allow the Commissioner to assess a tax on information and belief at any time if the taxpayer fails to file a return, or files a fraudulent return. The taxpayer is given twenty days after notice to correct his return only if he has filed a return, and it is incorrect or insufficient.[6]

More importantly, criminal penalties apply forthwith in any case where there is a fraudulent return filed or a willful failure to file a return. The twenty-day grace period, during which the criminal sanctions may be avoided, now is permitted only in cases of incorrect and insufficient returns.[7] It should be noted that although mere failure to file is sufficient reason to permit assessment on information and belief by the Commissioner, the failure to file must be willful if criminal penalties are to be invoked.

Tighter enforcement is also the aim of Chapter 661 of the Acts of 1955.[8] This permits inspection of Massachusetts income tax returns by the federal tax authorities on the same basis that authority is granted by the federal government to Massachusetts tax officials to examine United States income tax returns. The change in the law is designed to encourage greater cooperation between the two tax agencies. Previously, federal officials were not allowed access to Massachusetts income tax returns.

§16.7. Miscellaneous provisions. Chapter 707 of the Acts of 1955 reimposed the so-called temporary 1 percent tax on income derived from professions, employments, trade or business.[1] This tax applies to income received in the calendar year 1955. Also continued, apparently without a time limit, is the 20 percent surtax which is applicable to both the 1½ percent permanent tax,[2] and the 1 percent tax imposed

5 Id., §§37, 56.
6 Acts of 1955, c. 539, §1.
7 Id. §2.
8 Amending G.L., c. 62, §58.

§16.7. 1 Acts of 1955, c. 707, §2.
2 G.L., c. 62, §5(b).

by Chapter 77. Also to be added is the 3 percent surtax which has been on the books since 1941.[3] The effective rate of tax on business income received in the year 1955 is thus 3.075 percent.

There was another 1955 legislative change which does not directly affect the Massachusetts income tax, but will affect some Massachusetts taxpayers in varying degrees in computing their federal income taxes. Under Chapter 421 of the Acts of 1955 Massachusetts alcoholic beverage taxes are conclusively presumed to be direct taxes on the retail consumer. Such taxes may now be taken as a nonbusiness deduction in computing the federal income tax.

C. Taxation of Corporations

§16.8. Administrative changes. Legislative activity in the corporate tax field was much less than in income tax during 1955. Chapter 549 of the Acts of 1955 amended G.L., c. 63, §44 to extend the time within which the tax department might examine the books and papers of a corporation to verify its return to "three years after the date the return was filed or the date it was due, whichever occurs later."

Section 2 of Chapter 549 amended G.L., c. 63, §45 to make a deficiency assessment within the same period where an audit shows an additional tax is due.

Chapter 549 also continues the legislative policy of cracking down on corporate tax evaders[1] by providing that in the case of a false or fraudulent return filed with intent to evade a tax or of a failure to file a return, the Commissioner may make an assessment at any time.[2]

The other changes in the corporation tax involve the problem raised by the integration of the Massachusetts tax and the federal tax. General Laws, c. 63 provides that net income for purposes of the income measure of the corporation excise, before allocation, shall be the same as net income for federal tax purposes.[3] This obviously calls for Massachusetts tax adjustments where federal adjustments are made after the original return is filed. Under G.L., c. 63, §36, before amendment, any changes in net income for federal tax purposes had to be reported within seventy days of the notice of such final determination with an assessment of additional tax to be made by the Commissioner within one year after the receipt of the report from the taxpayer or the discovery of the change, if unreported.

The taxpayer, by Acts of 1955, Chapter 613,[4] is now given a year within which to report the final federal determination. However, the additional tax has been made self-assessing so that the payment of any additional amount due must accompany the report.

[3] Acts of 1941, c. 729, §9.

§16.8. [1] See Acts of 1954, c. 193.
[2] Acts of 1955, c. 549, §3, amending G.L., c. 63, §46.
[3] See G.L., c. 63, §§30, 32, 39.
[4] Amending G.L., c. 63, §36.

If the taxpayer fails to report a final determination by the federal authorities of a difference in net income, the Commissioner has three years[5] after receipt of information from the federal government within which to assess a deficiency.

If it turns out as a result of a downward adjustment in federal net income that the taxpayer has overpaid its Massachusetts tax the corporation is entitled to a refund if it applies to the State Tax Commission within sixty days of the filing of the report provided that the report was filed on time. Under prior law there was no requirement for timely filing of the report as a requirement of eligibility for abatement.

D. Inheritance Taxation

§16.9. Charitable bequests. Legislative changes in the taxation of legacies and successions, as in 1954, were not numerous. Chapter 596 of the Acts of 1955 liberalized the exemptions under the inheritance tax law on account of gifts for charitable, educational, and religious purposes.[1] Under prior law a bequest to a charitable, educational, or religious society or institution, not organized under the laws of Massachusetts, was exempt only if its principal objects were carried out within the Commonwealth, or the society or institution was organized under the laws of, or its principal objects were carried out within, some state allowing an exemption for gifts to Massachusetts organizations on a reciprocal basis.

The words "whose principal objects are carried on" within the Commonwealth were construed somewhat narrowly in *MacGregor v. Commissioner*[2] to exclude from the scope of the exemption gifts to charities not organized in Massachusetts if any substantial part of the principal objects of such charities are carried on outside of the Commonwealth. The Court intimated that a different result might have followed if the language of the exemption read "objects principally carried out within the Commonwealth."[3]

Chapter 596 adopts the Court's suggestion and amends G.L., c. 65, §1 to provide that the exemption applies to property passing to non-Massachusetts charitable, educational or religious societies or institutions "whose charitable, educational or religious objects are principally and usually carried out within, or whose charitable, educational or religious activities are principally and usually carried out within the commonwealth . . ."

Chapter 596 also extends these exemptions to organizations whose

[5] Formerly the Commissioner was required to assess the deficiency within six months.

§16.9. [1] By amending G.L., c. 65, §1.
[2] 327 Mass. 484, 99 N.E.2d 468 (1951).
[3] 327 Mass. at 489, 99 N.E.2d at 471.

principal charitable, educational, or religious objects are carried out in one or more states whose laws provide for exemptions to Massachusetts organizations on a reciprocal basis. Previously the reciprocal exemption was available only for objects carried on within "some other state of the United States . . ."

E. Property Taxes

§16.10. Abatements; Flood disaster. The most important legislative change in this field was Chapter 699 of the Acts of 1955. This authorized the assessors in cities and towns affected by the disastrous floods of August, 1955, to grant abatements of taxes on real estate and personal property for the year 1955 in cases where such property was wholly or partially destroyed by the floods. These abatements followed the recent legislative policies in connection with the Worcester tornado and the hurricanes of 1954. Applications for abatement under the 1955 law had to be filed before October 1, 1955.

§16.11. State assessing system. A development of much potential long-range value is found in Chapter 649 of the Acts of 1955,[1] providing for the installation of a state assessing system in the cities and towns. The legislation is merely permissive, but it does allow any city or town, by proper authority, to petition the State Tax Commission to install an assessment system in such city or town. The assessment systems would provide maps, forms, instructions, and accurate record techniques for each parcel of property assessed. The stated objective is the production of uniform and equitable valuations and assessments throughout the city or town.

§16.11. [1] Inserting §§7A-7E in G.L., c. 58.