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Chapter 16: State and Local Taxation

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CHAPTER 16

State and Local Taxation

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§ 16.1. Personal Income Taxes — Graduated Exemptions. The Supreme Judicial Court has consistently held that article 44 of the Massachusetts Constitution[1] forbids the taxation of income from the same class of property at graduated rates.[2] During the *Survey* year, however, the Court retreated somewhat from its previously uniform stand against legislative imposition of graduated income taxation. In an advisory opinion responding to a question posed by the Taxation Committee of the House of Representatives,[3] the Court indicated that a bill proposing a system of

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§ 16.1. [1] MASS. CONST. amend. art. 44 provides:

> ART. XLIV. Full power and authority are hereby given and granted to the general court to impose and levy a tax on income in the manner hereinafter provided. Such tax may be at different rates upon income derived from different classes of property, but shall be levied at a uniform rate throughout the commonwealth upon incomes derived from the same class of property. The general court may tax income not derived from property at a lower rate than income derived from property, and may grant reasonable exemptions and abatements. Any class of property the income from which is taxed under the provisions of this article may be exempted from the imposition and levying of proportional and reasonable assessments, rates and taxes as at present authorized by the constitution. This article shall not be construed to limit the power of the general court to impose and levy reasonable duties and excises.

[2] *See, e.g.*, Opinion of the Justices to the House of Representatives, 1981 Mass. Adv. Sh. 1433, 1434, 423 N.E.2d 751, 752 (holding proposed state income tax based on flat rate percentage of taxpayer's federal income tax violative of uniforming requirements under article 44); Opinion of the Justices, 266 Mass. 583, 585, 165 N.E. 900, 901-02 (1929) (holding proposed state income tax "graded as to rate according to the amount of income received by the taxpayer" constitutionally infirm, because such a tax would not be proportional as required under article 44).

[3] Opinion of the Justices, 386 Mass. 1223, 437 N.E.2d 194 (1982). The question posed to the Court was phrased as follows:

graduated exemptions from state income tax would be constitutional under article 44.

The proposed legislation, House Bill No. 5528, sets forth a schedule of so-called "vanishing" exemptions from state income tax.[4] Under present law, single individuals with income not exceeding $3,000 and married individuals with income not exceeding $5,000 in the aggregate are entitled to a complete exemption from Massachusetts income tax.[5] In contrast to the current total exemption with a ceiling, the bill submitted to the Court proposed a new schedule of exemptions which progressively decrease as the total income of the individual increases.[6] For instance, individuals with income not exceeding $3,000 would continue to be entitled to total exemption, as under current law.[7] Individuals with income exceeding $3,000, however, would also be eligible for an exemption; the amount of their exemption would decrease by $300 from the original $3,000 exemption for each incremental increase of $3,000 in income.[8] Consequently,

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Is it constitutionally competent for the General Court to enact House Bill No. 5528 which would provide for a system of low income vanishing exemptions from the state income tax under the provisions of Article XLIV of the Amendments to the Constitution of the Commonwealth of Massachusetts?

Id. at 1223, 437 N.E.2d at 195.

Four of the seven Justices considering the bill found the exemption scheme proposed therein to be consistent with the uniformity requirements of article 44. *Id.* at 1223-30, 437 N.E.2d at 194-98. The remaining three justices would have answered the question propounded by the House in the negative; that is, they viewed the majority opinion as a misconstruction of prior precedent regarding the scope of the "reasonable exemption" exception in article 44, and thus thought the proposed bill an impermissible, *de facto*, graduated income tax. *Id.* at 1230-34, 437 N.E.2d at 198-200.

[4] *Id.* at 1224, 437 N.E.2d at 195. House Bill No. 5528 would amend G.L. c. 62, § 5(a), as appearing in Acts of 1973, c. 723, § 2, by substituting a new section 5(a). *See infra* notes 5-9 and accompanying text for discussion and relevant text of the current and proposed section 5(a).

[5] G.L. c. 62, § 5(a), amended by Acts of 1973, c. 723, § 2, provides in relevant part:

Taxable income shall be exempt from all taxes imposed by this chapter if the total income of the taxable year does not exceed three thousand dollars for a single individual or five thousand dollars in the aggregate for a husband and wife. No tax shall be imposed under this chapter which shall reduce such taxable income below three thousand dollars and five thousand dollars respectively.

[6] 386 Mass. at 1224, 437 N.E.2d at 195.

[7] *Id.* at 1225, 437 N.E.2d at 195 (proposed schedule of exemptions for individual taxpayers reproduced in text of the Court's opinion). Married taxpayers filing jointly would continue to be entitled to total exemption, as under current law, so long as their total joint income does not exceed $5,000. *Id.* at 1225 n.2, 437 N.E.2d at 195 n.2.

[8] *Id.* at 1225, 437 N.E.2d at 195 (proposed schedule of exemptions for individual taxpayers reproduced in text of the Court's opinion). For married taxpayers filing jointly, the proposed reduction is $500 from the original $5,000 exemption for every incremental increase of $5,000 in joint income. The exemption phases out at $50,000 of joint income. The House bill also provides a schedule of exemptions for married taxpayers filing separately,

the entitlement to an exemption under the proposed bill would completely phase out, or "vanish," when an individual's income for the taxable year exceeds $30,000.[9]

In sanctioning this scheme, the Supreme Judicial Court emphasized that article 44 authorizes the General Court to " 'grant reasonable exemptions and abatements.' "[10] The Court reasoned that, because of the authorization for exemptions, "the constitutional requirement of a uniform rate of taxation cannot be absolute."[11] Relying primarily on an earlier opinion of the Court, sanctioning the legislature's broad discretion in granting reasonable exemptions,[12] the Court concluded that the exemption scheme proposed in the House Bill No. 5528 satisfied the "reasonableness" requirement.[13] The Court viewed the amounts of the varying income class exemptions as not sufficiently large to produce unequal treatment of taxpayers.[14] It tested the proposed scheme against one which it had previously approved in the 1930s,[15] making appropriate adjust-

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calling for a maximum exemption of $2,500 which, after gradual reduction with increased income, phases out when total income is greater than $25,000. *Id.* at 1225 n.2, 437 N.E.2d at 195 n.2.

[9] *Id.* at 1229 n.5, 437 N.E.2d at 198 n.5. *See supra* note 8 for discussion of separate schedules for married taxpayers filing jointly and married taxpayers filing separately.

[10] *Id.* at 1226, 437 N.E.2d at 196. *See supra* note 1.

[11] *Id.* at 1226, 437 N.E.2d at 196.

[12] Opinion of the Justices, 270 Mass. 593, 599-600, 170 N.E. 800, 804 (1930) (with regard to the provision for "reasonable exemptions" in article 44 the Court stated: "Those words were designed to vest a considerable discretion in the General Court in determining how [income taxes] ought to be apportioned among all the people to the end that the burdens for the support of government may rest as nearly equally as possible among those able to bear them."), *cited in* Opinions of the Justices, 386 Mass. 1223, 1226, 437 N.E.2d 194, 196 (1982); *see* Daley v. State Tax Comm'n, 376 Mass. 861, 865-66, 383 N.E.2d 1140, 1143 (1978) (Court stating that with respect to exemptions, "[t]he Legislature surely has a considerable range of discretion within the bounds of reason."), *cited in* Opinion of the Justices, 386 Mass. 1223, 1226, 437 N.E.2d 194, 196 (1982).

[13] 386 Mass. at 1227-28, 437 N.E.2d at 197.

[14] *Id.* at 1229, 437 N.E.2d at 197.

[15] *See* Opinion of the Justices, 270 Mass. 593, 170 N.E. 800 (1930), *cited in* Opinion of the Justices, 386 Mass. 1223, 1226, 437 N.E.2d 194, 196 (1982). The 1930 decision rendered by the Justices of the Court was likewise in response to a question concerning the constitutionality, under article 44, of a bill proposing a personal income tax exemption scheme. The Justices indicated their approval of the bill, proposing exemptions of $1,500 to single persons, $3,000 to married persons, and an additional exemption of $250 for each dependent other than a husband or wife. 270 Mass. at 597-98, 170 N.E. at 803. The proposed bill further provided that the available exemption would be reduced, dollar for dollar, by the amount of the taxpayer's income exceeding $10,000. 270 Mass. at 596, 170 N.E. at 802. The Justices' approval of the bill, including the reduction scheme, was interpreted by the 1982 Court as acceptance of the constitutionality of a graduated exemption scheme. 386 Mass. at 1227, 437 N.E.2d at 196-97.

ments reflecting "changes between 1930 and now in the purchasing power of the dollar and increases in per capita income."[16] In addition, the Court considered the exemption scheme reasonable as a measure for relieving those individuals least able to pay taxes.[17]

The Court voiced one reservation to its approval of the graduated exemption bill; namely, that the bill might be unconstitutional as applied to taxpayers in the lowest ranges of the various brackets.[18] While foreseeing the problem of lack of uniform treatment of borderline taxpayers, the Court intimated no solutions or "corrections" which it would consider constitutionally appropriate.[19]

While the Court's opinion may be viewed by some as a great divergence from past decisions concerning a graduated system of taxation, it must be evaluated in light of the total amounts of the proposed exemptions. The range of the exemptions authorized in House Bill No. 5528 clearly falls within the range of what has been construed as reasonable in the past.[20] The largest effective increase per taxpayer as a result of bracket jumping is at the lower end of each exemption bracket. The Court, however, in approving this proposal, considered this a modest increase when viewed in the context of total increases in purchasing power and per capita income since the Court's opinion of over fifty years ago defining what constitutes a reasonable system of exemptions.[21] In summary, the mod-

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Those Justices of the 1982 Court who declined to join in the majority opinion took issue with the majority's reading of the 1930 opinion as implying general approval of a graduated exemption scheme based on a taxpayer's income. The dissenting Justices of the 1982 Court considered the 1930 decision to be limited to approval of a bill narrowly tailored to relieve a certain class of taxpayers from state taxes "*solely on the basis of lack of ability to pay tax*." 386 Mass. at 1232-33, 437 N.E.2d at 199-200 (emphasis in original).

[16] 386 Mass. at 1228 & n.4, 1229, 437 N.E.2d at 197 & n.4, 198.

[17] *Id.* at 1228-29, 437 N.E.2d at 197-98. The dissenting Justices considered the majority opinion incorrect insofar as it read into the bill a purpose to provide relief to low income taxpayers when no such purpose was expressed in the bill itself. *Id.* at 1232-33, 437 N.E.2d at 199-200.

[18] *Id.* at 1229, 437 N.E.2d at 198. With respect to the uniformity problem posed by the House bill, the Court stated:

> [T]here appears to be a significant question about the constitutionality of the proposed bill as it applies to taxpayers whose total income falls in the lowest ranges of the various brackets. For example, by earning one more dollar of income a taxpayer may move into the next higher bracket and thus be granted a lower exemption. The additional income tax resulting from earning that additional dollar would substantially exceed one dollar. Some appropriate correction might be considered in order to avoid situations of this character, which present a special problem of lack of uniformity.

Id. at 1229-30, 437 N.E.2d at 198.

[19] *Id.* at 1229-30, 437 N.E.2d at 198.

[20] Compare the exemption scheme approved in Opinion of the Justices, 270 Mass. 593, 594-97, 170 N.E. 800, 802-03 (1930), discussed *supra* at note 15.

[21] 386 Mass. at 1227-28, 437 N.E.2d at 197 (citing Opinion of the Justices, 270 Mass. 593, 600-01, 170 N.E. 800, 805 (1930)).

ification which would be achieved by this proposed legislation is not significant enough to be considered a back door effort at introducing a graduated income tax in the Commonwealth.

§ 16.2. Real Estate Taxation — Foreclosure — Low Value Land Sales — Notice Requirement. There are two procedures under Massachusetts law for sale of land as a consequence of nonpayment of taxes, one for the sale of land of low value[1] and the other more formal procedure of judicial foreclosure.[2] In contrast to the judicial foreclosure procedure, sales of low value land under chapter 60, section 79 of the General Laws may be made without judicial supervision. Section 79 is designed to provide a "more economical and more expeditious" means of collecting taxes on land of low value.[3]

The validity of the statute governing tax sales of low value land was addressed by the Supreme Judicial Court during the *Survey* year in *Guaranty Mortgage Corp. v. Burlington*.[4] In keeping with the design of section 79 as a "more economical and more expeditious" procedure for a tax sale,[5] the Court in *Guaranty Mortgage* held that a mortgagee of land which the tax collector intends to sell pursuant to section 79 is neither entitled to actual notice of the low value determination[6] nor actual notice of the proposed sale under the statute.[7] More importantly, the Court held that the notice provisions of the low value land sale statute satisfy the requirements of due process under both the fourteenth amendment of the United States Constitution and article ten of the Massachusetts Declaration of Rights.[8]

The plaintiff, Guaranty Mortgage Corporation, held a first mortgage on certain parcels of land in the town of Burlington.[9] The entities owning

§ 16.2. [1] G.L. c. 60, § 79. "Low value" land is defined under the statute as land which, in the opinion of the Commissioner of Revenue, is "of insufficient value to meet the taxes, interest and charges including the payment of fifty dollars . . . as the legal fee for proceedings under this section . . . " assessed on the land, as well as any parcel the value of which is not considered to exceed "two thousand five hundred dollars."

[2] G.L. c. 60, §§ 16, 40, 42, 43, 52, 65.

[3] Johnson v. McMahon, 344 Mass. 348, 353-54, 182 N.E.2d 507, 511 (1962).

[4] 385 Mass. 411, 432 N.E.2d 480 (1982).

[5] *See supra* note 3 and accompanying text.

[6] 385 Mass. at 415-16, 432 N.E.2d at 484.

[7] *Id.* at 416-17, 432 N.E.2d at 484-85.

[8] *Id.* at 420, 432 N.E.2d at 486.

[9] *Id.* at 413, 432 N.E.2d at 483. The mortgages were given to Guaranty by Hart Properties, Inc., owning one grouping of the parcels, and by McLaughlin Realty Trust, owning the remaining parcels at issue. The mortgages on these properties had been assigned by Guaranty to State Street Bank and Trust Co. The assignments were not recorded, however, prior to the tax sale of the properties. Consequently, Guaranty, as mortgagee of record prior to the tax sale, was a necessary party to the maintenance of the suit against the town of Burlington. *Id.*

these parcels had failed, after several written demands by the town tax collector, to pay taxes on the properties for three successive years.[10] Consequently, the tax collector, following the publication of notice, took the properties to satisfy the tax claim.[11] The Commissioner of Revenue (the "Commissioner") subsequently made and recorded an affidavit pursuant to chapter 60, section 79 stating that the land fell within the definition of low value land under the statute.[12] The town of Burlington sent written notice of the proposed sale of the properties to the owners of record of the lots and, in addition, notice was published in a local newspaper and posted in a public place in Burlington.[13] The treasurer of the town did not, however, send written notice of the Commissioner's low value determination, or of the proposed sale of the parcels, to Guaranty.[14] After a public auction in which the properties were sold, Guaranty made an offer to redeem the lots.[15] The treasurer of Burlington refused the offer, prompting Guaranty to bring suit challenging the legality of the sales.[16]

Guaranty's suit rested on principally three arguments[17] referable to the notice requirements under chapter 60, section 79: first, Guaranty con-

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[10] *Id.* at 414, 432 N.E.2d at 483.

[11] *Id.* The Court stated that the notice of intention to take the lots was "posted in two or more convenient and public places in Burlington." *Id.*; *see* G.L. c. 60, § 53 (requiring that notice be posted "in two or more convenient and public places" fourteen days prior to the taking). In addition, the takings were recorded.

[12] 385 Mass. at 415, 432 N.E.2d at 483-84.

[13] *Id.* at 412-13, 432 N.E.2d at 482-83. The notice, both published and sent to the owners of record, read as follows:

> NOTICE IS HEREBY GIVEN THAT on January 14, 1974, at 9:30 A.M., at Town Treasurer's Office, pursuant to the provisions of General Laws, Chapter 60, Sections 79 to 80B, inclusive, and by virtue of the recording on November 26, 1973, of an affidavit of a finding by the Commissioner of Corporations and Taxation, with Middlesex South District Registry of Deeds, as Instrument No. 221, I SHALL OFFER FOR SALE AT PUBLIC AUCTION, severally or together, certain parcels of land of low value listed in said affidavit, said parcels having been taken or purchased by the Town of Burlington for nonpayment of the taxes due thereon.

Id. at 413 n.4, 432 N.E.2d at 482-83 n.4; *see* G.L. c. 60, § 79 (requiring that notice of time and place of the sale be published at least 14 days prior to the sale in a town newspaper or, if there is no town newspaper, the notice must be posted in a convenient public place).

[14] 385 Mass. at 415, 432 N.E.2d at 484.

[15] *Id.* Guaranty tendered a check for $12, 426.39, to the treasurer of Burlington for the purpose of redeeming the lots.

[16] *Id.*

[17] In addition to the three principal arguments discussed in the text, Guaranty argued that the published notice respecting the land sales did not contain an adequate description of the land. *Id.* at 418, 432 N.E.2d at 485. Because the Court summarily rejected this argument by reference to the required description under section 79, and, further, because this argument is incidental to Guaranty's general claim of a right to personal notice, this argument is not treated in the text of this section.

tended that it was entitled to actual notice of the low value determination;[18] second, Guaranty contended that it was entitled to prior actual notice of the Public Sale of the lots;[19] finally, Guaranty urged that the limited notice obligations under G.L. c. 60, § 79 violated the due process clause of the fourteenth amendment of the United States Constitution.[20] With respect to Guaranty's first claim, concerning notice of the low value determination, the Court held that the words of the low value sale statute did not provide Guaranty the right to personal notice of the Commissioner's affidavit.[21] The Court construed the statute as follows:

> The Legislature imposed only three conditions for the effective termination of the right to redeem under the low-value procedure: "(1) the issuance of the affidavit by the Commissioner, (2) the proper recording of the affidavit, and (3) the posting of fourteen days' notice of the intended sale."[22]

Noting that these conditions had been met, the Court rejected Guaranty's demand for personal notice.[23] The Court concluded that "to impose the burden of [personal] notice would destroy the purpose of the low-value procedure," reasoning that the statute was aimed at providing an expeditious alternative to judicial foreclosure.[24]

Responding to Guaranty's second claim of entitlement to notice of the proposed land sales, the Court again stressed that no such entitlement to personal notice could be found in the language of section 79.[25] Guaranty pointed out, however, that instructions in a state tax form, prescribed by the Commissioner,[26] provided that notice be sent by registered mail to any person having a right of redemption or any other interest in the land.[27] The Court deemed the town's noncompliance with this directive immaterial to the issue of whether a legal duty to give notice was violated.[28] The Commissioner's directive did not have the effect of law and could not bind the township, according to the Court.[29]

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[18] *Id.* at 415, 432 N.E.2d at 484.

[19] *Id.* at 416, 432 N.E.2d at 484.

[20] *Id.* at 418, 432 N.E.2d at 485-86.

[21] *Id.* at 415, 432 N.E.2d at 484.

[22] *Id.* at 415-16, 432 N.E.2d at 484.

[23] *Id.* at 416, 432 N.E.2d at 484.

[24] *Id.* at 415, 432 N.E.2d at 484.

[25] *Id.* at 416, 432 N.E.2d at 484.

[26] *See* Form 470A (notice of sale of low value land) prescribed by the Commissioner pursuant to G.L. c. 60, § 105 which provides: "Forms to be used in proceedings for the collection of taxes under this chapter and chapter fifty-nine and of all assessments which the collector is authorized or required by law to collect shall be as prescribed or approved by the commissioner."

[27] 385 Mass. at 416, 432 N.E.2d at 484.

[28] *Id.* at 416-17, 432 N.E.2d at 484-85.

[29] *Id.* The Court stated that section 79 had fully regulated the subject of notice obligations attendant on low-value land sales and, consequently, the Commissioner "cannot further regulate it by the adoption of a regulation which is repugnant to the statute." *Id.* at 417, 432

In connection with Guaranty's claim to right of notice as to the land sales, the Supreme Judicial Court also noted that, even if it were to take an equitable view of Guaranty's position, its conclusion would be no different.[30] The Court mentioned several measures available to Guaranty that would have created a right to notice, but which Guaranty failed to undertake.[31] Specifically, the Court stated that Guaranty could have taken advantage of the statutory option to be notified of the demand for payment of taxes on the land provided in chapter 60, sections 38, 39.[32] In addition, Guaranty could have protected its interest in the land by requiring a tax escrow clause in its mortgage, according to the Court.[33] Taking into account Guaranty's failure to pursue these measures, the Court emphasized that it would be inequitable to now disturb the title vested in the good faith purchasers of the lots.[34]

Guaranty's final argument challenged the constitutional adequacy of the notice provisions under chapter 60, section 79, as construed by the Court.[35] Guaranty relied principally upon the Supreme Court's decision in *Mullane v. Central Hanover Bank & Trust Co.*[36] in alleging that notice of the sales, by publication only, violated the fourteenth amendment's requirement of due process.[37] In *Mullane*, the Supreme Court held that notice of a final judicial settlement of trust accounts by publication rather than by mail violated due process as to those beneficiaries whose addresses were known.[38] The *Guaranty Mortgage* Court considered *Mullane* distinguishable from the instant case on three grounds: first, *Mullane* involved a judicially administrated procedure more like judicial foreclosure than the low-value land sales procedure;[39] second, in *Mullane*, the

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N.E.2d at 485 (quoting Commonwealth v. Johnson Wholesale Perfume Co., 304 Mass. 452, 457, 24 N.E.2d 8, 10 (1939)).

[30] 385 Mass. at 417, 432 N.E.2d at 485.

[31] *Id.*

[32] *Id.* at 414, 417, 432 N.E. 2d at 483, 485. Under G.L. c. 60, § 38, a mortgagee may give written notice of its mortgage to the tax Commissioner, prior to July of the year of the assessment, and thereby obligate the Commissioner to make any demand for payment of taxes on the mortgagee instead of the mortgagor.

Similarly, G.L. c. 60, § 39 provides that if notice designating an address where papers with respect to mortgaged land are to be served is filed in the office of the town clerk and sent to the town tax collector by the mortgagee, the collector shall be obligated to serve any demand for taxes at such address and, further, is forbidden to advertise any sale of such land for two months after the demand has been made.

[33] 385 Mass. at 417, 432 N.E.2d at 485.

[34] *Id.*

[35] *Id.* at 418-19, 432 N.E.2d at 485-86.

[36] 339 U.S. 306 (1950).

[37] 385 Mass. at 418-19, 432 N.E.2d at 486.

[38] 339 U.S. at 319-20.

[39] 385 Mass. at 419, 432 N.E.2d at 486.

beneficiaries had no reason to know that their property interests were being affected, while every taxpayer should be on notice that if taxes on property are not paid, the city or town will eventually seize and sell the property;[40] and third, *Mullane* recognized the need for dispensation from notice by mail when it would impose "impossible or impractical obstacles,"[41] such as the obstacle presented in this case, according to the Court, of an onerous title search which would be necessitated if notice by mail were required under section 79.[42] In view of these distinguishing factors, the Supreme Judicial Court concluded that "nothing in *Mullane* . . . signals a constitutional deficiency in our statute."[43]

The *Guaranty Mortgage* Court thus took the view that, because the mortgagee claiming rights to personal notice in connection with a low-value tax sale had failed to avail itself of statutory[44] and contractual protections,[45] no rights to personal notice would be read into chapter 60, section 79 which were not present in the language of the statute. Further, given the expeditious, nonjudicial procedure for low-value land sales which the legislature intended to make available under section 79, the Court considered the statutory publication notice requirements consistent with due process. The Court emphasized throughout its analysis that section 79, by its terms, provides that any sale made pursuant to the statute "shall be absolute upon the recording of such deed of the treasurer."[46] In view of this legislative mandate, the Court intimated that it was without authority to rescind the sale in the case before it on the basis of an implied condition of notice not being satisfied.[47]

§ 16.3. Income Taxation — Loss Deduction. In *Green v. Commissioner of Revenue*,[1] decided during the *Survey* year, the Supreme Judicial Court held that a taxpayer, in computing his personal tax liability, could offset a bad debt loss incurred in one business against a capital gain realized from a completely unrelated business.[2] The significance of the *Green* decision lies in its further illumination of the interrelationship between "Part A" and "Part B" income/loss items under the general income tax computation provision, chapter 62, section 2 of the General Laws.[3]

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[40] *Id.*

[41] *Id.* at 419-20, 432 N.E.2d at 486 (quoting Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 313-14 (1950)).

[42] *Id.* at 419, 432 N.E.2d at 486.

[43] *Id.*

[44] *See supra* note 32 and accompanying text.

[45] *See supra* note 33 and accompanying text.

[46] 385 Mass. 416, 417, 432 N.E.2d at 484, 485 (quoting G.L. c. 60, § 79).

[47] *Id.* at 417, 432 N.E.2d at 485.

§ 16.3. [1] 386 Mass. 351, 436 N.E.2d 134 (1982).

[2] *Id.* at 353, 436 N.E.2d at 135.

[3] G.L. c. 62, § 2(b), divides gross income into two categories: "Part A" income includes

The taxpayer in *Green* was in the business of owning and operating commercial real estate.[4] The taxpayer was also the sole shareholder in an unrelated mail order business.[5] In 1975, the taxpayer's mail order business became insolvent and he was required to pay a debt of the corporation pursuant to his personal guaranty.[6] In the course of his commercial real estate business, the taxpayer sold a parcel of realty in 1975 yielding a substantial capital gain.[7] In his 1975 state income tax return, the taxpayer deducted the guaranty payment as a business bad debt loss from his Part B income.[8] To the extent that this loss exceeded his Part B income, the taxpayer offset the excess against his Part A income,[9] comprised entirely of the capital gain realized from his real estate business.[10]

The Commissioner of Revenue (the "Commissioner") initially took the position that the bad debt guaranty payment, while deductible from Part B income, could not be used to offset the Part A capital gain income.[11] The Commissioner appeared to have concluded that the capital gain income realized from the real estate transaction was not "effectively connected with the active conduct of a trade or business of the taxpayer."[12] The taxpayer's application for an abatement of the additional tax imposed was thus denied.[13]

The taxpayer petitioned the Appellate Tax Board (the "Board") for review of the Commissioner's decision.[14] Before the Board, the Commissioner changed her initial position and argued that the guaranty payment was neither deductible from Part B income nor from Part A income.[15] The

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most dividends, interest and net capital gains; "Part B" income includes all other gross income. Part A income is taxed at a rate of 10% while Part B income is taxed at a rate of 5%. G.L. c. 62, § 4. Specified deductions are permitted from each type of income. G.L. c. 62, § 2(c) and (d). Items deductible from Part B income, to the extent they exceed Part B income, may be deducted from Part A income that is effectively connected with the taxpayer's trade or business. G.L. c. 62, § 2(c)(1).

[4] 386 Mass. at 351, 436 N.E.2d at 134.

[5] *Id.*

[6] *Id.*

[7] *Id.* at 351-52, 436 N.E.2d at 134.

[8] *Id.* at 352, 436 N.E.2d at 134. G.L. c. 62, § 2(d) provides that deductions permitted under section 62 of the federal Internal Revenue Code may be deducted from Part B income. Business bad debt losses are deductible under section 166(a) of the Code and thus reduce federal gross income under section 62(1) as a trade or business deduction.

[9] 386 Mass. at 352, 436 N.E.2d at 134. G.L. c. 62, § 2(c)(1) provides that excess deductions from Part B income may be deducted from Part A income that is "effectively connected with the active conduct of a trade or business of the taxpayer."

[10] *See* 386 Mass. at 352-53, 436 N.E.2d at 135.

[11] 386 Mass. at 352, 436 N.E.2d at 134.

[12] *Id.* at 352, 436 N.E.2d at 134-35.

[13] *Id.* at 352, 436 N.E.2d at 134.

[14] *Id.*

[15] *Id.* at 352-53, 436 N.E.2d at 135.

Commissioner reasoned that the guaranty payment was a non-business capital loss which could only be deducted to the extent of capital gain.[16] The Commissioner further concluded that the taxpayer had no capital gain for 1975 against which he could offset the capital loss.[17] The Board, without a written opinion, affirmed the Commissioner's prior determination.[18]

The Supreme Judicial Court in *Green* reversed the Board.[19] The Court, at the outset, accepted the Commissioner's characterization of the guaranty payment as a *non-business* bad debt loss.[20] Noting that for most purposes the deductions allowable from Part B income are those allowed under section 62 of the federal Internal Revenue Code,[21] the Court adopted the Commissioner's later position that the bad debt loss was a short term capital loss under the code,[22] deductible[23] only to the extent of capital gains.[24] The Commissioner's view that the taxpayer had no offsetting capital gains, however, was rejected by the Court.[25] The taxpayer, according to the Court, realized a capital gain in excess of the bad debt loss from the sale of business realty.[26] The Court noted that the Commissioner had admitted before the Board that the realty had been held as part of the taxpayer's business and that the amount realized from its sale constituted a capital gain.[27] The Court therefore concluded that the taxpayer not only permissibly deducted the loss from his Part B income, but was entitled to offset the excess deduction against his business-connected Part A income.[28]

The Court intimated in a brief epilogue to its decision that the taxpayer could have *directly* offset the short term capital loss represented by the guaranty payment against the Part A capital gain.[29] This would have

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[16] *Id.* at 353, 436 N.E.2d at 135. *See* I.R.C. § 166(d) and § 165(f), applicable to the adjusted gross income computation under I.R.C. § 62(4) and thus to the computation of Part B adjusted gross income under G.L. c. 62, § 2(d). *See also supra* note 8.

[17] 386 Mass. at 353, 436 N.E.2d at 135.

[18] *Id.* at 352, 436 N.E.2d at 134.

[19] *Id.* at 353, 436 N.E.2d at 135.

[20] *Id.*

[21] *Id. See* G.L. c. 62, § 2(d) and *supra* note 8.

[22] *See* I.R.C. § 166(d) (1976).

[23] *See* I.R.C. § 165(f) (1976).

[24] 386 Mass. at 353, 436 N.E.2d at 135. *See supra* notes 8 and 16.

[25] 386 Mass. at 353, 436 N.E.2d at 135.

[26] *Id.*

[27] *Id.* at 352-53, 436 N.E.2d at 135.

[28] *Id.* at 353, 436 N.E.2d at 135.

[29] *Id.* at 353 n.3, 436 N.E.2d at 135 n.3. *See* G.L. c. 62, § 2(c)(3) (permitting deduction allowed under I.R.C. § 1202 — 60% of "net capital gain" — from Part A income); I.R.C. § 1222(11) (1976) (defining "net capital gain" as the excess of net long-term capital gain over net short-term capital loss).

yielded more favorable tax consequences to the taxpayer since Part A income is taxed at a higher rate than Part B income.[30] The Court noted, however, that this direct offset treatment would be inconsistent with the position already taken by the taxpayer on both his federal and state returns and, consequently, did not deem the taxpayer entitled to such treatment.[31]

The Supreme Judicial Court's opinion in *Green* clearly expressed the view that permissible loss deductions under section 62 of the Internal Revenue Code are deductible, without regard to source, from Part B income and, to the extent the loss deductions exceed such income, may additionally offset business-connected Part A capital gains. This presumably could result in ordinary losses being used to offset capital gain income. It should be noted, however, that for tax years beginning after 1979, the deductibility of non-business bad debts is no longer a disputable entitlement since the definition of capital gains and losses excluding such debts was repealed in 1979.[32]

§ 16.4. Installment Sales Treatment — Subsequent Legislation. During the *Survey* year, the Supreme Judicial Court addressed the effect of a 1971 legislative tax enactment on a transaction consummated in a prior year, but reported on an installment method. In *Johnson v. Department of Revenue*[1] the taxpayer challenged on both statutory and constitutional grounds the determination of the Commissioner of Revenue (the "Commissioner") that a 1971 enactment, rendering taxable the gain derived from certain sales of realty, applied to the gain element of an installment payment received by the taxpayer in 1973.[2] The installment payment was referable to a land sale transaction consummated in 1970.[3] The Supreme Judicial Court, in upholding the Commissioner's determination, effectively placed all taxpayers on notice that an election to defer recognition of gain will not shield the taxpayer from changes in the tax laws unfavorably affecting the treatment of previously realized, but unrecognized, gains.

In *Johnson*, the taxpayer sold a parcel of realty in 1970, receiving cash for one-fourth of the purchase price and taking a promissory note for the remainder.[4] The promissory note was payable in three equal annual

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[30] 386 Mass. at 353 n.3, 436 N.E.2d at 135 n.3. *See* G.L. c. 62, § 4 and *supra* note 3.
[31] 386 Mass. at 353 n.3, 436 N.E.2d at 135 n.3.
[32] Acts of 1979, c. 409, § 1, *repealing* G.L. c. 62, § 1(k) (defining "net capital gain").
§ 16.4. [1] 387 Mass. 59, 438 N.E.2d 1059 (1982).
[2] *Id.* at 60-61, 438 N.E.2d at 1060.
[3] *Id.* at 60, 438 N.E.2d at 1060.
[4] *Id.*

installments.[5] The taxpayer elected to report the gain on the installment method for federal income tax purposes.[6] He did not report the gain as income on his 1970 state tax return since the gain from sales of realty was not taxable under the Massachusetts income tax law then in effect.[7] Further, the taxpayer did not report gain from the sale as income on his state tax returns for subsequent years through 1973, the year in which the final installment payment was received.[8]

Several legislative amendments to the state tax laws adopted between 1970 and 1973 prompted the controversy in *Johnson*. First, in 1971 the legislature substantially revised the methodology for determining individual income tax liability with one result being that gains from sales of realty were no longer exempt from state tax.[9] Second, as part of the same 1971 enactment, the legislature provided that taxpayers electing installment treatment for federal tax purposes were entitled to corresponding installment treatment on their state tax returns.[10] Finally, in 1973 the legislature completely revised the treatment of installment sales for state tax purposes providing that only "installment transactions" would be entitled to installment treatment for purposes of deferring tax on gain.[11] An "installment transaction" was defined as one which: (1) is treated for federal income tax purposes under section 453(a) or (b) of the Internal Revenue Code; *and*, (2) but for the application of section 453(a) or (b), would result in an item of Massachusetts gross income for the taxable year of the transaction.[12]

In response to these modifications in the state tax laws, the Commissioner assessed an additional tax against the taxpayer in *Johnson* in 1973, referable to the gain from the 1970 transaction for which final payment was received in 1973.[13] The taxpayer paid the additional tax and subsequently applied for an abatement.[14] The Department of Revenue denied the application.[15] Its decision was affirmed by the Appellate Tax Board (the "Board").[16] The taxpayer appealed the Board's decision to the

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[5] *Id.*

[6] *Id.*

[7] *Id. See* Acts of 1957, c. 677, *amending* G.L. c. 62, §§ 5, 6; Flower, *State Taxation*, 1957 ANN. SURV. MASS. LAW § 27.3, at 186-87.

[8] 387 Mass. at 60, 438 N.E.2d at 1060.

[9] *See* Acts of 1971, c. 555, § 5. Prior to the 1971 amendments to the state tax laws, only gains from sales of realty connected with the taxpayer's trade or business or entered into for profit were taxable under state law. *See* Flower, *supra* note 7, at 187 & n.1.

[10] *See* Acts of 1971, c. 555, § 18, adding subsection (d) to G.L. c. 62, § 63.

[11] *See* Acts of 1973, c. 723, § 11 and G.L. c. 62, § 63(a).

[12] G.L. c. 62, § 63(a).

[13] 387 Mass. at 60, 438 N.E.2d at 1060.

[14] *Id.*

[15] *Id.*

[16] *Id.*

Supreme Judicial Court on the basis of two arguments: first, that the installment payment received in 1973 was excluded from state income tax under the amended installment sales provision, chapter 62, section 63; and second, that the Commonwealth could not constitutionally tax the 1973 receipt from the 1970 sale.[17]

Undertaking a statutory analysis, the Court first determined that the gain received by the taxpayer in 1973 was income subject to state tax "under the literal wording of [chapter] 62, [sections] 2 and 3," unless exempted by a particular provision of the state tax statute.[18] The Court, agreeing with the Board, determined that the exemption under chapter 62, section 63 urged by the taxpayer was not applicable because the 1970 sale did not qualify as an "installment transaction."[19] The Court referred to the two statutory prerequisites for an "installment transaction" under section 63(a) and found that only one of these prerequisites was satisfied.[20] Because the gain from the 1970 sale was not taxable in the year of the transaction under the state law then in effect, the Court pointed out that it could not be said that "but for" the application of section 453 of the Internal Revenue Code, the transaction would result in an item of Massachusetts gross income "*for the taxable year of the transaction*."[21] Because one of the prerequisites to the definition of "installment transaction" was not met by the 1970 sale, the Court held that the exemption under chapter 62, section 63 was not available.[22]

After reviewing the transaction within the current statutory framework under Massachusetts law, the Court then addressed the taxpayer's constitutional arguments against the additional assessment.[23] The taxpayer

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[17] *Id.* at 60-61, 438 N.E.2d at 1060. *See infra* note 22.

[18] 387 Mass. at 61, 438 N.E.2d at 1060.

[19] *Id. See* Dogon v. State Tax Comm'n, 370 Mass. 699, 702 n.6, 351 N.E.2d 854, 856 n.6 (1976).

[20] 387 Mass. at 61, 438 N.E.2d at 1060-61.

[21] *Id.* at 61-62, 438 N.E.2d at 1061. *See* G.L. c. 62, § 63(a).

[22] 387 Mass. at 62, 438 N.E.2d at 1061. The taxpayer made two additional statutory arguments before the Court which the Court refused to consider because they were neither raised in the proceedings before the Appellate Tax Board nor addressed in the Board's opinion. The first of these two arguments was that the 1973 amended version of G.L. c. 62, § 63 was not intended to apply to pre-1973 sales. *Id.* Presumably in an effort to have a portion of the 1973 payment treated as the basis for state tax purposes, the taxpayer urged that former G.L. c. 62, § 63(d), as inserted by Acts of 1971, c. 555, § 18, should be construed as remaining in effect. Adoption of this interpretation would result in the taxpayer's basis in each payment for federal tax purposes being the measure of his basis for state tax purposes. The second argument was likewise aimed at attaining a favorable basis adjustment for state tax purposes, in this case, under the revised basis rules of former G.L. c. 62, § 7, as appearing in Acts of 1973, c. 723, § 2. 387 Mass. at 62 & n.3, 438 N.E.2d at 1061 & n.3.

[23] *Id.* at 63, 438 N.E.2d at 1061.

contended that the new tax enactments were being applied retroactively to his transaction in violation of constitutional due process and in violation of article 44 of the state constitution, insofar as the new legislation taxed previously accrued capital.[24] In addition, the taxpayer urged that the tax laws as applied to him were discriminatory and in violation of equal protection because he had previously elected installment treatment for federal tax purposes as opposed to recognizing all gain in the year of the transaction when such gain was not taxable.[25]

The Court rejected the basic premise underlying the taxpayer's due process and article 44 arguments. The taxpayer advanced the view that because the gain from the 1970 transaction was fully realized in the year of the transaction, subsequent changes in the state tax laws could not be applied to the prior transaction requiring recognition of any part of such gain not subject to tax in the year of the transaction.[26] Noting that federal gross income provides the measure for calculating Massachusetts gross income,[27] the Court found that the taxpayer's installment treatment election for federal tax purposes had the consequence of making the receipt of each installment payment, rather than the transaction itself, the "taxable event."[28] Because the assessment applied only to the payment received in 1973, there was no retroactive application of the tax laws according to the Court.[29] Likewise, the Court deemed it irrelevant that the new enactment, taxing gains from realty sales, had the effect of taxing capital accruing prior to the adoption of the legislation.[30] The Court reasoned:

> The fact that a part of the taxed gain, represented increase in value . . . before the present taxing act, is without significance. [The Legislature], having constitutional power to tax the gain, and having established a policy of taxing it, . . . may choose the moment of its realization [and recognition] and the amount realized [and recognized], for the incidence and the measurement of the tax. Its failure to impose a tax upon the increase in the value in the earlier years . . . cannot preclude it from taxing the gain in the year when realized [and recognized].[31]

Accordingly, with respect to both the taxpayer's due process and article 44 arguments, the Court concluded that the additional assessment was not constitutionally infirm since the 1973 payment had not been previously recognized for either state or federal tax purposes.[32] Moreover, the Legis-

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[24] *Id.* at 63, 66-67, 438 N.E.2d at 1061-62, 1063.

[25] *Id.* at 63, 65, 438 N.E.2d at 1061, 1063.

[26] *Id.* at 63, 438 N.E.2d at 1062.

[27] *Id.* at 64, 66, 438 N.E.2d at 1062-63. *See* G.L. c. 62, § 2(a).

[28] 387 Mass. at 64, 438 N.E.2d at 1062.

[29] *Id.*

[30] *Id.* at 67-68, 438 N.E.2d at 1063-64.

[31] *Id.* at 67, 438 N.E.2d at 1063 (quoting McLaughlin v. Alliance Ins. Co., 286 U.S. 244, (1932)).

[32] *See id.* at 64-65, 67-68, 438 N.E.2d at 1062, 1064.

lature had the authority to amend the laws to require recognition of gain applicable to any "taxable event," for either state or federal purposes, occurring after adoption of any such amendment.[33]

The Court likewise rejected the taxpayer's claim of an equal protection violation based on his view that he was, in effect, being penalized for having elected federal installment treatment.[34] The Court noted that "[a]ny distinction in a tax statute that has a rational basis will survive a challenge under the equal protection clause."[35] The disparate treatment under state tax laws of the taxpayer and one who did not elect installment treatment for a transaction entered into in the same year was an incidental consequence, according to the Court, of the legislative choice to adopt federal gross income as a measure of Massachusetts gross income.[36] Because taxation of installment recipients is not "a specific goal" of the choice to use the federal gross income figure for state tax purposes, and because the adoption of this standard "seems justified in the interests of simplicity," the Court reasoned that the tax laws did not work a denial of equal protection.[37] The Court added that the possibility of a change in the tax laws "was a risk the taxpayer took in deferring the recognition of [his] gains."[38]

The Supreme Judicial Court in *Johnson* thus adopted a literal approach to interpreting the new tax enactments and permitted the taxation of gains *upon receipt*, under these enactments, of previously realized and previously non-taxable income. Because the receipt of the gain was the "taxable event" triggering recognition for federal income tax purposes, the Court apparently concluded that this characterization was likewise controlling for purposes of permitting the application of the new state tax laws to the gains from the prior transaction.

§ 16.5. Tax Exempt Institutions — Constitutional Challenges. In *Trustees of Smith College v. Board of Assessors of Whately*,[1] decided during the *Survey* year, the Supreme Judicial Court considered a challenge raised by local tax assessors to an educational institution's claim to an exemption from state real estate taxes.[2] The local assessors, while conceding that the educational institution in question was a "charitable organization" within

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[33] *Id.*

[34] *Id.* at 65, 438 N.E.2d at 1063.

[35] *Id.* (quoting Smith v. Commissioner of Revenue, 1981 Mass. Adv. Sh. 677, 679, 417 N.E.2d 967, 969).

[36] *Id.* at 66, 438 N.E.2d at 1063.

[37] *Id.*

[38] *Id.*

§ 16.5. [1] 385 Mass. 767, 434 N.E.2d 182 (1982).

[2] *Id.* at 767, 434 N.E.2d at 182-83.

the meaning of the statutory exemption provision,[3] claimed that the exemption was unavailable because the policies of the institution, in their view, violated the equal rights amendment to the state constitution.[4] The Court, in an opinion further clarifying the powers and duties of local assessors, held that the assessors were without authority to challenge the exemption claim on the basis of the institution's policy of admitting only students of one sex to its degree programs.[5]

The realty at issue in the *Trustees of Smith College* case consisted of two unimproved parcels of land which were part of a larger tract of land surrounding the school's astronomical observatory.[6] The realty was owned and retained in an unimproved state in order to protect against "development and consequent interference from lights."[7]

In 1979 the local assessors assessed the land and sent tax bills to the college.[8] Smith College paid the assessed taxes and timely filed its application for abatement on the basis that the realty was exempt from taxation pursuant to chapter 59, section 5, clause third of the General Laws.[9] Upon denial of its application for abatement Smith College appealed to the Appellate Tax Board (the "Board").[10]

Before the Board, the assessors argued that the land in question was precluded from qualifying for the exemption allowed by section 5, clause third because: 1) the land in question surrounding the observatory was not occupied for the educational purposes of Smith College; and 2) even if the use of the land did so qualify, Smith College was not entitled to the exemption because it engaged in sex discrimination in violation of federal and state law.[11] Smith College, in response, argued that the land was occupied for educational purposes, that the policies of the school were not in violation of the law, because no state action was involved, and finally, that the assessors had no standing to raise the sex discrimination issue.[12]

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[3] *See id.* at 770, 434 N.E.2d at 184. The relevant statutory provision, G.L. c. 59, § 5, clause third, as amended by Acts of 1977, c. 992, § 2, provides a tax exemption for "real estate owned by or held in trust for a charitable organization and occupied by it or its officers for the purposes for which it is organized." The statute defines "charitable organization" as either: "(1) a literary, benevolent, charitable or scientific institution or temperance society incorporated in the commonwealth," or "(2) a trust for literary, benevolent, charitable, scientific or temperance purposes if it is established by a declaration of trust executed in the commonwealth."

[4] 385 Mass. at 768, 434 N.E.2d at 183.

[5] *Id.* at 771, 434 N.E.2d at 184.

[6] *Id.* at 768, 434 N.E.2d at 183.

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] *Id.*

The Board concluded that the land was exempted from taxation under section 5, clause third without reaching the question of the assessors' standing.[13]

On appeal to the Supreme Judicial Court, the only issue presented by the assessors was whether the equal rights amendment to the Massachusetts Constitution precluded a private educational institution, admitting only students of one sex to its degree programs, from receiving a tax exemption under state law.[14] Smith College raised the additional issue before the Court of the assessors' standing to raise the discrimination issue.[15]

Justice Liacos, writing for the Court, ruled that a "literal reading" of the exemption granting statute, defining charitable organizations, limited the potential for inquiries into an institution's charitable status in the course of abatement proceedings.[16] The Board, the Court noted, had found that Smith College met the requirements of a charitable organization under the statute.[17] The Court observed that the assessors had not disputed this finding, which the Court itself found to be "clearly warranted."[18] The Court went on to state that the assessors and the Board were foreclosed from taking any further action regarding an exemption claim other than requiring certification from the appropriate state body regarding the organization in question.[19] Finding "no authority vested in the assessors, by the statutes defining their powers and duties, to raise a constitutional challenge of the kind they [sought] to assert by [their] appeal," the Court concluded that Smith College was entitled to the abatement requested and, thus, affirmed the Board's decision.[20] The Court noted that the Attorney General alone was imbued with the statutory authority to challenge the grant of a tax exemption on the basis of violations of the constitution or state law.[21] The *Trustees of Smith College*

[13] *Id.*

[14] *Id.* at 769, 434 N.E.2d at 183. The notice of appeal filed by the assessors set forth the additional issue of whether the Board's finding that the property was occupied by the taxpayer for the charitable purpose for which it is organized was in error. Because the assessors neither briefed nor argued this issue for the appeal, the Court refused to consider it. *See id.* at 768-69, 434 N.E.2d at 183.

[15] *Id.* at 769, 434 N.E.2d at 183.

[16] *Id.* at 770, 434 N.E.2d at 184. *See supra* note 3 for the statutory definition of "charitable organization."

[17] 385 Mass. at 769, 434 N.E.2d at 184.

[18] *Id.* at 770, 434 N.E.2d at 184.

[19] *Id. See* DeCenzo v. Assessors of Framingham, 372 Mass. 523, 362 N.E.2d 913 (1977) (assessors found to have no discretion as to blind person exemption under G.L. c. 59, § 5 clause thirty-seventh, or as to veterans' exemption under § 5, clause twenty-second). *Cf.* Assessors of Saugus v. Baumann, 370 Mass. 36, 345 N.E.2d 360 (1976) (hardship exemption under G.L. c. 59, § 5, clause eighteenth solely within discretion of assessors).

[20] 385 Mass. at 770-71, 434 N.E.2d at 184.

[21] *Id.* at 771, 434 N.E.2d at 184.

case thus clarifies the limited avenues open to local tax assessors in taking action to deny tax exempt status to statutorily qualified institutions.

§ 16.6. Business Trusts — Consolidated Returns. During the *Survey* year in *Marco Realty Trust v. Commissioner of Revenue*[1] the Supreme Judicial Court ruled that the filing of consolidated state income tax returns by business trusts is unauthorized and warrants the assessment of additional taxes and interest based on the filing of separate returns.[2] The Court emphasized in its opinion that the adoption of federal gross income as the measure of Massachusetts gross income does not imply that the federal consolidated return rules likewise govern the availability of consolidated filing for state purposes.[3]

The taxpayer in *Marco Realty Trust* was a Massachusetts business trust with transferable shares.[4] The taxpayer owned all the shares in a similar business trust with which it filed consolidated returns for both federal and state income tax purposes in the years 1971, 1972, and 1973.[5] The consolidation of income and expenses from the two business trusts inured to the benefit of the taxpayer.[6] The State Tax Commission (the "Commission"), for each of the years in question, determined that the filing of consolidated state income tax returns was unauthorized and thus assessed additional taxes and interest.[7] The taxpayer paid the additional tax and filed for an abatement which was denied by the Commission.[8] The Appellate Tax Board (the "Board") affirmed the Commission's decision on appeal.[9] The taxpayer subsequently appealed the Board's decision to the Supreme Judicial Court.[10]

The taxpayer's principal argument before the Court was premised on the treatment of business trusts with transferable shares as corporations for federal tax purposes.[11] The taxpayer reasoned that because the Massachusetts definition of gross income incorporates the Internal Revenue Code definition of gross income,[12] the federal treatment of business trusts as corporations [13] and the authorization of affiliated corporations to file

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§ 16.6. [1] 385 Mass. 798, 434 N.E.2d 200 (1982).
[2] *Id.* at 798, 434 N.E.2d at 201.
[3] *See id.* at 799, 434 N.E.2d at 202.
[4] *Id.* at 798, 434 N.E.2d at 201.
[5] *Id.*
[6] *Id.*
[7] *Id.*
[8] *Id.*
[9] *Id.*
[10] *Id.*
[11] *See id.* at 799, 434 N.E.2d at 202; I.R.C. § 7701(a) (1976).
[12] *See* G.L. c. 62, § 2, as appearing in Acts of 1971, c. 555, § 5.
[13] *See* I.R.C. § 7701(a) (1976).

consolidated returns under federal tax law [14] should likewise be considered incorporated into Massachusetts tax law.[15]

In rejecting this argument, the Court stated that "[t]he [Internal Revenue] Code definition of gross income speaks only to what is includable in gross income. It says nothing about how income is to be reported or whether several taxpayers may report their separate incomes and expenses on one return."[16] The Court, consequently, found that the adoption of federal gross income for state tax purposes did not carry with it the authorization to file consolidated state tax returns;[17] rather, the Court deemed pertinent provisions of state tax law controlling on this issue.[18]

Turning to the state statutory provisions governing taxation, the Court ruled that for each of the three years at issue the completion and filing of tax returns in Massachusetts was governed by sections 22, 23, and 24 of chapter 62 of the General Laws.[19] Section 22, the Court noted, provided that every individual, partnership, association or *trust*, receiving a specified minimum of income subject to taxation, was required to "make a return of such income."[20] Only husbands and wives, according to the Court, were given express authority under section 22 to file joint returns.[21] The Court concluded that "[t]he clear intent of the Legislature was that every taxpayer subject to taxation under chapter 62, except husbands and wives, was required to file a separate return."[22] In further support of its view that separate returns were mandated for each of the three years in the case before it, the Court noted that other definitional sections of chapter 62 had consistently indicated that business trusts were to be taxed as individuals rather than corporations.[23] This statutory

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[14] *See* I.R.C. § 1501 (1976).

[15] 385 Mass. at 799, 434 N.E.2d at 202.

[16] *Id.*

[17] *Id.*

[18] *Id.*

[19] *See* G.L. c. 62, §§ 22, 23, 24, as appearing in Acts of 1916, c. 269, § 12. Acts of 1976, c. 415, § 100 repealed sections 22, 23, and 24 of chapter 62. Reference should now be made to G.L. c. 62c, §§ 5, 6, 7 added by Acts of 1976, c. 415, § 22.

[20] 385 Mass. at 799-800, 434 N.E.2d at 202. *See* former G.L. c. 62, § 22 discussed *supra* at note 19.

[21] 385 Mass. at 800, 434 N.E.2d at 202. *See* former G.L. c. 62, § 22 discussed *supra* at note 19.

[22] 385 Mass. at 800, 434 N.E.2d at 202.

[23] *See id.* at 798-99, 434 N.E.2d at 201 (quoting G.L. c. 62, § 8(a), as appearing in Acts of 1971, c. 555, § 15: "In determining the Code deductions allowable to such partnership, association or trust under this chapter [the beneficial interest in which is represented by transferable shares] it shall be considered an individual and not a corporation."); *id.* at 800, 434 N.E.2d at 202 (quoting G.L. c. 62, § 8(a), as appearing in Acts of 1973, c. 1973, § 2: "The Massachusetts adjusted gross income of [a] corporate trust shall be redetermined as if it were a resident natural person.").

treatment, in the Court's view, contravened the taxpayer's contention that it was entitled to be treated as a corporation with the corollary right of filing consolidated returns.[24] In conclusion, the Court characterized the taxpayer's further argument that it was entitled, as any individual proprietor with several businesses, to consolidate the income and expenses of its "ventures" on a single return, as "specious."[25] The Court thus affirmed the decision of the Appellate Tax Board that the taxpayer's consolidated filings were unauthorized.[26]

It is clear, then, after *Marcos Realty Trust* that the adoption of federal gross income for purposes of computing Massachusetts gross income under section 2 of chapter 62 does not imply that the federal consolidated return rules govern the manner and filing of state returns. State tax returns are instead to be made and filed only as permitted under the relevant provisions of the state tax statute. Consequently, a business trust taxpayer, filing consolidated returns for federal tax purposes with related business trusts, will be required to make multiple separate returns for each related entity under Massachusetts tax law.

§ 16.7. Sales and Use Taxes — Exemption. During the *Survey* year in *Commissioner of Revenue v. Fashion Affiliates, Inc.*[1] the Supreme Judicial Court interpreted both the scope of the exemption from use taxes contained in chapter 64H, section 6(s) of the General Laws[2] as well as the jurisdictional implications of the prerequisites to filing for an abatement under section 38 of chapter 62C.[3] The Court held, in the first instance, that leased machinery used to make paper patterns ultimately used in the process of cutting fabric for dresses is exempt from use taxes.[4] As to the second issue, the Court held that the Appellate Tax Board lacks jurisdiction to pass on abatement claims for periods where, irrespective of any use exemption dispute, taxes are owing and the petitioner has failed to file returns.[5]

Fashion Affiliates, Inc. rented certain machinery used in its business of manufacturing clothing.[6] The rented machinery, through a computerized process, traced dress pattern measurements on a long sheet of paper

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[24] 385 Mass. at 801, 434 N.E.2d at 202.

[25] *Id.* at 801, 434 N.E.2d at 202-03.

[26] *Id.* at 801, 434 N.E.2d at 203.

§ 16.7. [1] 387 Mass. 543, 441 N.E.2d 520 (1982).

[2] *See* Acts of 1971, c. 555, § 45. For the text of this provision as currently enacted see G.L. c. 64I, § 7(b) (as amended through 1983).

[3] *See* Acts of 1976, c. 415, § 22.

[4] 387 Mass. at 547, 441 N.E.2d at 523.

[5] *Id.* at 547-48, 441 N.E.2d at 523.

[6] *Id.* at 543, 441 N.E.2d at 521.

referred to as a "marker."[7] The paper printout produced by the machines was then used to guide the fabric cutting knife so as to achieve maximum use of the dress fabric.[8] In the course of this process, the paper "marker" would be destroyed.[9] The Commissioner of Revenue (the "Commissioner") assessed use taxes on the rented machinery in the hands of Fashion Affiliates, the taxpayer.[10] After paying the taxes, the taxpayer appealed the Commissioner's determination that it was not entitled to an exemption from the use taxes under chapter 64H, section 6(s) of the General Laws to the Appellate Tax Board (the "Board").[11] The Board granted the taxpayer's abatement request.[12] It also rejected the Commissioner's claim that it was without jurisdiction to pass on the taxpayer's abatement appeal since the taxpayer had failed to file timely sales and use tax returns with the state.[13] The Commissioner subsequently appealed the Board's decision to the Supreme Judicial Court.[14]

The Court noted at the outset of its opinion that the question before it was one of interpreting the scope of the statutory exemption contained in section 6(s) of chapter 64H.[15] Under section 6(s), machinery "used directly and exclusively . . . in the actual manufacture, conversion or processing of tangible personal property to be sold" is exempt from sales and use taxes.[16] Machinery will be considered as satisfying the exemption test of section 6(s) if it is "used solely during a manufacturing, conversion or processing operation to effect a direct and immediate physical change upon tangible personal property to be sold" or "to guide or measure a direct and immediate physical change upon such property where such function is an integral and essential part of tuning, verifying or aligning the component parts of such property."[17]

The Commissioner argued before the Court that the taxpayer's rented machinery did not fall within the parameters of the statutory exemption since it was neither used directly and exclusively in the actual manufacture of dresses nor did the machinery directly produce property to be sold.[18] The Court rejected the Commissioner's position that the ma-

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[7] *Id.* at 545, 441 N.E.2d at 521.

[8] *Id.*

[9] *Id.*

[10] *See id.* at 543, 441 N.E.2d at 521.

[11] *Id.*

[12] *Id.*

[13] *Id.* at 543-44, 441 N.E.2d at 521. The Court noted that the taxpayer did file returns for one three-month period, the third quarter of 1976. *See id.* at 544, 548, 441 N.E.2d at 521, 523.

[14] *Id.* at 543, 441 N.E.2d at 521.

[15] *Id.* at 544, 441 N.E.2d at 521.

[16] G.L. c. 64H, § 6(s), as appearing in Acts of 1971, c. 555, § 45. The text of this provision is reprinted in a footnote to the Court's opinion. 387 Mass. at 544 n.1, 441 N.E.2d at 521 n.1.

[17] G.L. c. 64H, § 6(s). *See supra* note 16.

[18] 387 Mass. at 545, 441 N.E.2d at 521-22.

chinery had to directly produce a sales item in order to qualify for an exemption under section 6(s).[19] It considered the test under that section satisfied in this case by the fact that the machinery was used "to guide or measure a direct and immediate change upon . . . [tangible personal] property where such function is an integral and essential part of . . . verifying or aligning the component parts of such property."[20] The statutory definition, in the Court's view, did not require that the machinery's guidance or measurement be direct or immediate in the sense of physical contact.[21]

Although the Court upheld the Board's determination that the use tax exemption was applicable with respect to the taxpayer's machinery, it nevertheless vacated the decision and remanded the case on jurisdictional grounds.[22] As previously noted, the Commissioner argued that the Board could not entertain the taxpayer's appeal due to the taxpayer's failure to file returns.[23] The Court embraced the Commissioner's position that the taxpayer, as a prerequisite to filing an application for abatement under chapter 62C, section 38 of the General Laws,[24] had to timely file a sales and use tax return.[25] This limitation on the taxpayer's relief applied only in those years where sales and use taxes were owing in addition to those assessed against the exempt machinery.[26] The Court consequently remanded the case to the Board for consideration of whether there was any relevant period during which the taxpayer owed no sales and use taxes.[27] As to any such period the Court concluded that the Board should abate the tax.[28] The Court held, however, that for those periods during which the taxpayer was otherwise liable for a sales or use tax and where no return had been filed prior to the application for abatement, the Board was without jurisdiction to hear the taxpayer's abatement appeals.[29]

§ 16.8. Corporate Excise Tax — Gross Income. Throughout the Massachusetts tax statutes there are found numerous references to the federal

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[19] *Id.* at 546, 441 N.E.2d at 522.

[20] *Id. See supra* note 16 and accompanying text.

[21] 387 Mass. at 545, 441 N.E.2d at 522.

[22] *Id.* at 548, 441 N.E.2d at 523. The Court upheld the Board's decision with respect to the three month period for which returns were filed by the taxpayer in 1976. *Id.*

[23] *Id.* at 543-44, 441 N.E.2d at 521. *See supra* note 13 and accompanying text.

[24] *See* Acts of 1976, c. 415, § 22. G.L. c. 62C, § 38 provides, in relevant part: "No tax assessed on any person liable to taxation shall be abated unless the person assessed shall have filed, at or before the time of bringing his application for abatement, a return."

[25] 387 Mass. at 547, 441 N.E.2d at 523.

[26] *Id.* at 548, 441 N.E.2d at 523.

[27] *Id.*

[28] *Id.*

[29] *Id.*

Internal Revenue Code (the "Code").[1] An understanding of the interaction of the Massachusetts tax statutes and the Code is therefore essential for proper tax planning. In the case of *Rohrbough, Inc. v. Commissioner of Revenue*,[2] the Supreme Judicial Court addressed the implications of the statutory adoption of federal gross income for purposes of computing state tax liability where a particular transaction is reported differently on state and federal tax returns.[3] The Court emphasized that although the taxpayer's federal gross income return figure will normally be the same on his state tax returns, this is not always the case where differing elections are made with respect to tax treatment.[4] *Rohrbough, Inc.* specifically involves the consequences of electing different tax treatment on state and federal returns for an installment sales transaction.

In 1971, George Rohrbough derived a capital gain from the sale of real estate.[5] Because the purchase price was to be paid over a six year period, he elected to report the gain as an installment sale for federal income tax purposes under section 453 of the Code.[6] For Massachusetts income tax purposes, however, he reported the entire gain on his 1971 individual income tax return and paid the capital gains tax in full at that time.[7] Subsequently, Rohrbough transferred the outstanding installment notes to a corporation, the taxpayer in this case, in exchange for 100 shares of stock.[8] The taxpayer corporation received all installment payments subsequent to the transfer and included the taxable gain realized from the installment payments in gross income on its federal corporate income tax returns.[9] On its Massachusetts corporate excise tax returns, however, the taxpayer corporation excluded the capital gain reported on its federal returns from gross income.[10] The taxpayer reasoned that the entire tax on the gain from the installment notes had previously been paid by George Rohrbough, as reflected in his 1971 individual state income tax return.[11]

The Commissioner of Revenue (the "Commissioner") subsequently adjusted the taxpayer corporation's corporate excise returns to include in gross income the gain realized from the installment payments and as-

§ 16.8. [1] *See, e.g.*, G.L. c. 62, § 2 (federal gross income adopted for purposes of computing individual tax liability); G.L. c. 63, §§ 30(5)(a) and 32 (federal gross income adopted for purposes of computing corporate excise tax).

[2] 385 Mass. 830, 434 N.E.2d 211 (1982).

[3] *Id.* at 832, 434 N.E.2d at 212.

[4] *Id.*

[5] *Id.* at 830, 434 N.E.2d at 211.

[6] *Id. See* I.R.C. § 453 (1976).

[7] 385 Mass. at 830, 434 N.E.2d at 211.

[8] *Id.* at 830, 434 N.E.2d at 211-12. George Rohrbough owned all the stock in the transferee corporation. The transfer was a tax free exchange under § 351 of the Internal Revenue Code.

[9] 385 Mass. at 831, 434 N.E.2d at 212.

[10] *Id.*

[11] *Id.*

sessed additional excise taxes to the corporation.[12] The Commissioner then denied the taxpayer's request for an abatement of these additional taxes.[13] On the taxpayer corporation's appeal to the Appellate Tax Board (the "Board"), the Board ruled that the taxpayer was entitled to the abatement requested.[14] The Commissioner subsequently appealed the Board's ruling to the Supreme Judicial Court which affirmed the Board's decision.[15]

Adopting the conclusions of the Board,[16] the Court analyzed the transaction in the following manner. First, George Rohrbough's recognition of the entire gain from the installment sale on his 1971 state tax return had the effect of increasing his basis in the installment notes to their face value for state tax purposes.[17] Second, the transfer of the notes to the taxpayer corporation resulted in no gain or loss to either Mr. Rohrbough or the corporation, and the corporation succeeded to Mr. Rohrbough's tax basis in the notes.[18] Finally, since the taxpayer corporation's basis in the notes equaled their fair market value, the actual receipt of payments on the notes did not constitute taxable gain to the taxpayer corporation.[19] The Court concluded that the amounts received should not then be included in gross income for purposes of computing the Massachusetts corporate excise tax.[20]

The Court acknowledged that federal gross income provides the basis for computing a corporation's domestic corporate excise under Massachusetts' tax laws.[21] It pointed out, however, that gross income will not always be the same for federal and state tax purposes.[22] This was true, for example, in the case before the Court where the taxpayer made differing elections with respect to tax treatment of installment obligations.[23] The Court finally rejected the Commissioner's argument that the taxpayer corporation was not being subjected to income tax on the payments but to a corporate excise, in part based on the income from the payments.[24] The

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[12] *Id.*

[13] *Id.*

[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] *See id.*

[18] *See id.* at 831-32, 434 N.E.2d at 212. *See* I.R.C. § 351 (1976).

[19] *See* 385 Mass. at 831-32, 434 N.E.2d at 212. *See* I.R.C. § 1001 (1976).

[20] 385 Mass. at 832, 434 N.E.2d at 212.

[21] *Id.* at 831, 434 N.E.2d at 212. G.L. c. 63, § 32 provides that the corporate excise is to be based on "net income" which is arrived at by taking certain deductions from "gross income." Under G.L. c. 63, § 30(5)(a) "gross income" is "gross income as defined under the provisions of the federal Internal Revenue Code."

[22] 385 Mass. at 832, 434 N.E.2d at 212. *See* I.R.C. § 453 (1976); *cf.* G.L. c. 62, § 63.

[23] 385 Mass. at 832, 434 N.E.2d at 212.

[24] *Id.*

Court responded that, in "applying the definition of capital gains in the Internal Revenue Code, there is no gain" and, thus, no income to be included in gross income for state tax purposes.[25] The Court agreed with the Board's conclusion that to hold otherwise would result in double taxation of the proceeds from the same transaction.[26]

§ 16.9. Bank Excise Tax — Constitutionality. State chartered savings banks, co-operative banks and state or federal savings and loan institutions are subject to an annual excise based on both their total deposits and net operating income under chapter 63, section 11 of the General Laws.[1] During the *Survey* year, the Supreme Judicial Court considered a challenge instituted by several savings banks and co-operative banks to the constitutionality of section 11 as well as a challenge to the application of this provision by the Commissioner of Revenue (the "Commissioner"). In *Andover Savings Bank v. Commissioner of Revenue*,[2] the Court, in a declaratory proceeding,[3] rejected the arguments advanced by the banks

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[25] *Id. See* I.R.C. § 1001 (1976).

[26] 385 Mass. at 831, 434 N.E.2d at 212.

§ 16.9. [1] *See* Acts of 1975, c. 684, § 44. G.L. c. 63, § 11 provides in pertinent part:

> Every savings bank . . . , every co-operative bank . . . and every state or federal savings and loan association located in the commonwealth shall pay to the commissioner an *annual excise equal to the following*: (a) on or before the twenty-fifth day of the seventh month of the taxable year, there shall be paid (1) *six hundred twenty-seven one thousandths per cent* of a reasonable estimate *of its net operating income, as hereinafter defined*, for the taxable year, and (2) one-sixteenth of one per cent of the average amount of its deposits or of its savings accounts and share capital for the first six months of the taxable year, after deducting from such average amounts (i) its real estate used for banking purposes, valued at cost less reasonable depreciation, and (ii) the unpaid balance on its loans secured by the mortgage of real estate taxable in this commonwealth, or real estate situated in a state contiguous to the commonwealth, and within a radius of fifty miles of the main office of such bank or association, and in the case of a bank or association not previously subject to tax by the commonwealth the unpaid balances on such of its loans secured by the mortgage of real estate located outside of the commonwealth which are outstanding on March first, nineteen hundred and sixty-six, both as of the close of such six month period; and (b) [The first paragraph of subsection (b) is similar to subsection (a), except that the tax is to be paid after the close of the taxable year, and, with respect to the income-based portion of the tax, a different percentage is payable.]
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> For the purpose of this section, "*net operating income" shall mean gross income from all sources, without exclusion, for the taxable year, less (i) operating expenses, (ii) net losses upon assets sold, exchanged or charged off as uncollectible during the taxable year, and (iii) minimum additions during the taxable years to its guaranty fund or surplus required by law or the appropriate federal and state supervisory authorities* . . . (emphasis added).

[2] 387 Mass. 229, 439 N.E.2d 282 (1982).

[3] *Id.* at 232-33, 439 N.E.2d at 286. The Court noted that although ordinarily a plaintiff must exhaust his administrative remedies before he will be heard before the Supreme

and upheld section 11 as constitutional on its face and as applied by the Commissioner.[4] The Court's opinion provides a noteworthy illustration of the difficulties encountered in trying to wage a constitutional attack through the judiciary system against a taxing statute.

The alleged constitutional infirmities in the bank excise tax provision, both on its face and as applied, may be summarized in the following manner. First, the banks claimed that the portion of the excise based on net operating income was "unreasonable" as interpreted by the Commissioner because the net income tax base did not fairly measure the present existing value of the banks' franchises.[5] Second, the banks asserted that the Commissioner was incorrect in interpreting the statute so as to forbid the banks to deduct, as an "operating expense" from the net income tax base, the amounts paid as interest to depositors.[6] The banks' third claim was based on the Commissioner's application of the deposits portion of the excise only to state-chartered mutual institutions and not to federal savings and loan associations.[7] This selective application, according to the banks, violated both the Massachusetts Constitution and the equal protection clause of the fourteenth amendment to the United States Constitution.[8] Finally, the banks asserted that a statutory deduction from the deposits tax base, eligible only to the extent of unpaid balances of loans secured by realty located within certain geographical limits, impermissibly interfered with interstate commerce in violation of article I, section 8 of the United States Constitution.[9]

The Court concluded that each of the above claims raised by the banks was without merit.[10] Chief Justice Hennessey, writing for the Court, prefaced the Court's analysis of these claims with an acknowledgment of the presumption that tax legislation is valid and is not to be voided unless it is established "beyond a rational doubt" that the tax is unreasonable.[11] Adhering to this standard, the Court proceeded to address each of the banks' separate allegations respecting chapter 63, section 11. With regard to the banks' attacks on the use of "net operating income," as construed

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Judicial Court, the fact that the plaintiff-banks did not appeal to the Appellate Tax Board in this case did not preclude a declaratory proceeding where the case involved "issues of law that affect every thrift institution chartered under the laws of the Commonwealth." *Id.*

[4] *Id.* at 232, 439 N.E.2d at 286.

[5] *Id.* at 232-33, 439 N.E.2d at 286-87. The banks claimed that because the net income tax base was unreasonable, the excise violated article IV, Part II, c. 1, § 1 of the Massachusetts Constitution.

[6] 387 Mass. at 232, 439 N.E.2d at 286.

[7] *Id.* at 232, 239, 439 N.E.2d at 286, 290.

[8] *Id.* at 232, 239-41, 439 N.E.2d 286, 290-91.

[9] *Id.* at 232, 245, 439 N.E.2d at 286, 293.

[10] *Id.* at 232, 439 N.E.2d at 286.

[11] *Id.* at 235, 439 N.E.2d at 287-88. *See* Eaton, Crane & Pike Co. v. Commonwealth, 237 Mass. 523, 130 N.E. 99 (1921).

by the Commissioner, in computing the excise tax, the Court initially rejected the banks' assertion that net income is not a reasonable measure of the value of the banks' franchises.[12] The Court stated that the "value" of transacting business as a mutual banking institution is not to be measured by accumulated surplus, as urged by the banks, but rather by "the benefits that are enjoyed by the depositors and borrowers."[13] Because, in the Court's view, the bank excise tax was intended to measure the value of the bank's investment function based on the benefits realized by its depositors, the Court concluded that the income-based portion of the excise was at least as reasonable as the legally tested deposits tax, which measures the bank's investment function according to the total deposits available for investment.[14] The reasonableness of the income-based excise, according to the Court, thus dervied from the fact that the depositors of a mutual banking institution are the "owners" of the institution.[15] This view of the relationship between the mutual bank and its investors likewise led the Court to uphold the Commissioner's denial of any deductions from net income for interest paid to depositors.[16] Contrary to the banks' categorization of such payments as operating costs, the Court concluded that the interest payments were, for tax purposes, more analogous to nondeductible dividends paid to persons with an equity interest.[17] In support of this view, the Court pointed out that the accumulated surplus of a mutual bank is held in reserve for the benefit of its depositors.[18] Furthermore, the Court noted, if a savings bank is voluntarily dissolved, after all debts are paid the remaining proceeds are distributed to the bank's depositors.[19] The Court extended this approach to amounts paid to holders of fixed-rate certificates of deposit, stating that the "superficial similarities to a debtor-creditor relationship" did not alter the basic relationship between mutual banks and their depositors.[20]

The Court next considered the banks' allegations premised on the disparate treatment of state-chartered mutual banks and federal savings and loan associations by the Commissioner in assessing the deposits portion of the excise.[21] The Court first rejected the argument that the

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[12] 387 Mass. at 236, 439 N.E.2d at 288. *See* G.L. c. 63, § 11(a)(1) and (b)(1) (set forth in part *supra* at note 1).

[13] 387 Mass. at 236, 439 N.E.2d at 288.

[14] *Id.*

[15] *See id.* at 235-36, 439 N.E.2d at 288.

[16] 387 Mass. at 237-38, 439 N.E.2d at 289.

[17] *Id.* at 237, 439 N.E.2d at 289.

[18] *Id.*

[19] *Id.*

[20] *Id.* at 238, 439 N.E.2d at 289.

[21] *Id.* at 239, 439 N.E.2d at 290. *See* G.L. c. 63, § 11(a)(2) and (b)(2) (set forth in part *supra* at note 1).

Commissioner's selective application of the deposits tax violated the legislative intent of equality of treatment and thus constituted an unconstitutional usurpation of the legislative function.[22] In construing the legislative intent in enacting section 11, the Court emphasized that the provision had been enacted in 1966[23] and subsequently reenacted in 1975[24] following a decision by the First Circuit Court of Appeals[25] holding that the application of the state deposits tax to federal savings and loan associations violated federal law.[26] In the Court's view, the reenactment of section 11, in light of the judicial modification dictated by constitutional law, manifested a legislative intent to continue to apply the deposits tax to state-chartered mutual banks.[27] In response to the additional contention that this selective application of the deposits tax violated the equal protection clause, the Court relied on the United States Supreme Court's decision in *Union Bank & Trust Co. v. Phelps*[28] in concluding that the classification presented "rationally further[ed] a legitimate state interest."[29] The Supreme Judicial Court adopted the view expressed in *Phelps* that because federally-chartered banks may not be subjected to state taxes absent Congressional authorization,[30] the separate classification of such banks for state tax purposes cannot be said to be arbitrary and wholly unreasonable.[31] As a consequence of its view that the separate tax classification of federal and state banks was not unreasonable, the Supreme Judicial Court found no violation of the equal protection clause.[32]

Finally, the Court addressed the banks' claim that the provision in section 11, which granted a deduction from the deposits tax base only for unpaid loan balances secured by realty located within fifty miles of the

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[22] 387 Mass. at 240, 439 N.E.2d at 290.

[23] *See* Acts of 1966, c. 14, § 11.

[24] *See* Acts of 1975, c. 684, § 44.

[25] United States v. State Tax Comm'n, 481 F.2d 963 (1st Cir. 1973).

[26] 387 Mass. at 240, 439 N.E.2d at 290-91. The First Circuit held in the *State Tax Comm'n* case that the application of the deposits tax under G.L. c. 63, § 11(a)(2) and (b)(2) to federal savings and loan associations violated 12 U.S.C. § 1464(h) (1976). 481 F.2d 963 (1st Cir. 1973).

[27] 387 Mass. at 240-41, 439 N.E.2d at 291.

[28] 288 U.S. 181 (1933).

[29] 387 Mass. at 242, 439 N.E.2d at 291-92. When economic regulation is challenged as violative of the equal protection clause, the traditional test is whether the classification presented "rationally furthers a legitimate state interest." Blue Hills Cemetery, Inc. v. Board of Registration in Embalming and Funeral Directing, 379 Mass. 368, 376, 398 N.E.2d 471, 477 (1979).

[30] *See* First Agricultural Nat'l Bank v. State Tax Comm'n, 392 U.S. 339, 340-43 (1968) (The supremacy clause of the Constitution prohibits state taxation of national banks absent Congressional authorization).

[31] 387 Mass. at 242-43, 439 N.E.2d at 292. *See* Union Bank and Trust Co. v. Phelps, 288 U.S. 181, 186-87 (1933).

[32] 387 Mass. at 243-44, 439 N.E.2d at 292.

bank's home office, impermissibly interfered with the flow of interstate commerce.[33] Specifically, the banks asserted that the fifty mile limit, conditioning the deduction under section 11, had the effect of discouraging mutual banks from investing in mortgage loans beyond the geographic limits of the deduction.[34] This effect, they claimed, violated the commerce clause of the United States Constitution.[35] In rejecting the banks' commerce clause argument, the Court emphasized that historically state banks have never had the right, unrestricted by state laws, to exercise their corporate powers beyond the borders of their home state.[36] Furthermore, the Court noted that geographical restrictions on banking transactions are commonplace in many states and are manifestly viewed with approval under various federal laws.[37] The Court analyzed the relevant case law interpreting the commerce clause and concluded that precedent did not support the position that the commerce clause precluded states from placing geographical restrictions on the activities of state-chartered banking institutions.[38] The Court reasoned that such limitations did not block the flow of natural resources or products of trade from one state to another, nor did they generally interfere with the flow of money.[39] In addition, the Court rejected the view that out-of-state borrowers would with any certainty be burdened by such restrictions.[40] The Court thus found no constitutional infirmity presented by what it deemed to be reasonable restrictions aimed at ensuring "that the citizens of the [bank's home] state will be the primary beneficiaries" of the grant of the privilege to transact business intrastate.[41]

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[33] *Id.* at 245, 439 N.E.2d at 293. *See* G.L. c. 63, § 11(b)(2)(ii) (set forth *supra* at note 1).

[34] 387 Mass. at 245, 439 N.E.2d at 293.

[35] *Id. See* U.S. CONST. art. I, § 8, cl. 3.

[36] 387 Mass. at 247, 439 N.E.2d at 294.

[37] *Id.* (citing H. BAILEY, ENCYCLOPEDIA OF BANKING LAWS (1964)). In support of its view that federal laws sanction with approval the imposition of geographical restrictions on state banking transactions, the Court cited The Home Owners' Loan Act, 12 U.S.C. §§ 1461-1468 (1976 & Supp. IV 1980) and The Community Reinvestment Act of 1977, 12 U.S.C. §§ 2901-2905 (Supp. IV 1980). 387 Mass. at 249-50, 439 N.E.2d at 295-96.

[38] 387 Mass. at 247-48, 439 N.E.2d at 294. The Court derived a two-part test from the cases cited by the banks in support of its claim of a commerce clause violation. First, the Court derived from these cases the principle that the commerce clause prohibits a state from blocking the flow of natural resources or products of trade from one state to another in order to satisfy local needs. *See, e.g.*, Hughs v. Oklahoma, 441 U.S. 322 (1979); Philadelphia v. New Jersey, 437 U.S. 617 (1978). Second, the Court proposed that other commerce clause cases stood for the position that a state may not impose a greater burden on out-of-state businesses to the direct advantage of local interests. *See, e.g.*, Maryland v. Louisiana, 451 U.S. 725 (1981); Boston Stock Exchange v. State Tax Comm'n, 429 U.S. 318 (1977).

[39] 387 Mass. at 248, 439 N.E.2d at 294-95. *See supra* note 38.

[40] 387 Mass. at 248, 439 N.E.2d at 29. The Court noted that foreign banks would certainly not be burdened by the operation of the tax. *Id. see supra* note 38.

[41] 387 Mass. at 249, 439 N.E.2d at 295.

The Court concluded its opinion with a bit of advice to the banks. Although sympathizing with the present fiscal difficulties experienced by the banks, the Court nevertheless found itself in no position to provide relief from taxing statutes which have "come to seem burdensome" in recent years.[42] Expressing the view that the banks' current ills were at least in part due to the complex regulatory framework within which banks operate, the Court directed the banks to look to the Legislature for relief rather than the judiciary.[43]

[42] *Id.* at 250, 439 N.E.2d at 296.
[43] *Id.* at 250-51, 439 N.E.2d at 296.