



MASSACHUSETTS PROVIDES CLARITY REGARDING MILLIONAIRES TAX

December 13, 2023

Starting with the 2023 tax year, certain Massachusetts taxpayers are required to pay a 4% surtax on taxable income in excess of \$1 million. This so-called “Millionaires Tax” is imposed on top of the state’s current 5% flat income tax.

On December 1, 2023, the Massachusetts Department of Revenue (DOR) issued a set of FAQs to address a number of questions regarding the Millionaires Tax that were not addressed in the enacting legislation. The following is a summary of the DOR guidance on some of the key questions:

■ **Gain from Sale of Primary Personal Residence or Installment Sale**

The Millionaires Tax applies to gain from the sale of a primary personal residence to the same extent the gain is subject to U.S. federal income tax. This means that the first \$250,000/\$500,000 of gain from the sale is excluded from Massachusetts taxable income for purposes of calculating the Millionaires Tax calculation because the gain is excluded from taxable income for purposes of calculating U.S. federal income tax.

Gain from installment sales is taken into account when determining the 4% surtax to the extent the gain is included in Massachusetts income under the installment sale rules. An installment sale provides an opportunity to avoid the Millionaires Tax because the gain is spread over multiple years (potentially allowing the taxpayer to remain under the annual \$1 million surtax threshold).

■ **Application of Millionaires Tax to Trusts and Estates**

The enacting legislation was unclear as to whether the Millionaires Tax would apply to Massachusetts resident trusts and estates. The FAQs make it clear that the tax applies to these trusts and estates if they have taxable income exceeding the 4% surtax threshold in a taxable year.

■ **Reporting of Millionaires Tax on Composite Return Not Permitted**

Massachusetts allows a partnership or S corporation to file a composite tax return to report the Massachusetts income and pay the Massachusetts income tax of electing nonresident owners. The FAQs state that nonresident taxpayers with Massachusetts taxable income exceeding the 4% surtax threshold cannot pay the tax with the composite return even if they participate in a composite return.

■ **Pass-Through Entities Cannot Pay Millionaires Tax on Behalf of Affected Taxpayers**

Massachusetts is one of a number of states that passed a pass-through entity tax to help provide relief for taxpayers who can no longer fully deduct state and local income taxes on their U.S. federal income tax return as a

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result of the Tax Cuts and Jobs Act of 2017. However, the Massachusetts pass-through entity tax is set at the general 5% personal income tax rate applicable to most types of Massachusetts income and therefore does not take into account the fact that taxpayers subject to the Millionaires Tax pay Massachusetts income tax on some of their income at 9%. The FAQs make it clear that the pass-through entity tax is imposed at the 5% statutory rate which cannot be increased to account for the 4% surtax.

The \$1 billion tax relief package recently enacted into Massachusetts law requires the DOR to study the potential impact of implementing an additional 4% tax on the income of pass-through entities which elect to be subject to the Massachusetts pass-through entity tax. This is being considered to help Massachusetts taxpayers obtain a federal tax deduction for the payment of the Millionaires Tax.

■ Other Jurisdiction Credit Does Not Apply to Millionaires Tax

To avoid double taxation, Massachusetts residents and part-year residents, including estates and trusts, are allowed to claim a credit against Massachusetts income tax for taxes paid on the same income to another jurisdiction (referred to as the “other jurisdiction” credit). The FAQs make it clear that the “other jurisdiction” credit can be used to offset a taxpayer’s 5% Massachusetts income tax but not the 4% surtax that might also apply to the taxpayer’s income. The explanation provided in the FAQs for this position is that a taxpayer cannot assume that all the income that was taxed by another jurisdiction was included in the taxable income over the surtax threshold. Unfortunately, the result is that Massachusetts taxpayers subject to the Millionaires Tax are subject to double tax on the amount subject to the surtax.

If you have any questions regarding this alert, please contact your Cummings & Lockwood private clients attorney.