Chapter 27: State Taxation

David Flower Jr.
CHAPTER 27

State Taxation

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A. Administration

§27.1. State Tax Commission. Joseph P. Healey, Boston tax attorney and author of the chapter on state and local taxation in the first volumes of the Annual Survey, became Commissioner of Corporations and Taxation during the year. John Dane, Jr., became an Associate Commissioner. New regulations continued to make their appearance and a Procedural Manual on the inheritance and estate tax was also issued. Technical discussion of the year's tax legislation was again published at the close of the legislative year. Emphasis turned to collection of delinquent personal income taxes. The reorganization of the Department of Corporations and Taxation was well described by Commissioner Dane in a recent article.\(^1\)

B. Personal Income Tax

§27.2. Taxable income: Business income. Final regulations on business income were promulgated during the 1957 Survey year.\(^1\) Every form of compensation paid by an employer to an employee is includable in the business income of the employee. This includes sick benefits in lieu of wages, vacation pay, employee contest prizes, and compensation paid in services or property. The "convenience of the employer" rule of federal law is, however, adopted. Thus room and board furnished an employee for the convenience of his employer is not taxable business income to the employee. It is only when living or eating at the employer's home or place of business is a condition of the employment that the rule applies. A hotel manager required to live on the premises does not include in his business income the value of his suite or meals, while a groundkeeper permitted but not required to eat at the hotel restaurant must include the fair market value of meals so furnished in his business income.

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\(^1\) Dane, Developments in the Administration of the Massachusetts Tax System, 9 Tax Executive 441 (1957).

Pension and retirement allowances paid directly or through a trust or insured plan are taxable as business income as are payments to a retired employee from an annuity purchased by his employer. Not includable in taxable income are employer's contributions to qualified pension plans. Excluded also from income are contributory pensions or retirement allowances paid by the Commonwealth or its subdivisions to retired employees and those paid by private associations which qualify under G.L., c. 32, §§39-41. Also excluded are social security payments to surviving relatives after the death of a retired employee.

While the amount of an employee's expense allowances is required to be included in business income and a deduction taken for itemized expenses actually incurred, there need not be included in income the amount of advances for specific business trips when the employee is required to account for expenditures upon his return and pay back the unexpended balance. If the employee claims deductions in excess of the advance, the advance must be reported as income and all expenses itemized as deductions.

The rule adopted with respect to scholarships and fellowships follows the federal rule. Such awards to candidates for a degree at an educational institution are not includable in business income. That part of a scholarship or fellowship that represents payment for teaching, research, or other service in the nature of part-time employment is business income, except where the teaching, research, or other service is required of all candidates for the degree whether or not recipients of these grants.

While rental income from real estate is not taxable in Massachusetts, the landlord-tenant relationship is usually not present in the operation of hotels, motels, and rooming houses, and income derived therefrom is includable in gross business income. The landlord-tenant relationship requires the occupant to have the right to exclusive possession and control of the premises occupied; the usual hotel, motel, or rooming house occupant is a mere licensee.

In Gordon v. State Tax Commission income from the purchase and collection of automobile installment sales obligations was held taxable as income from a trade or business and not taxable at higher rates as income from interest. In so holding the Supreme Judicial Court found Hayes v. Commissioner of Corporations and Taxation to be controlling in view of the refusal of the General Court to enact legislation changing the result.

§27.3. Nontaxable income. Gain from the sale of real estate and tangible personal property is no longer taxable and loss thereon is no

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2 Plans or trusts qualified under G.L., c. 62, §§8(i), 8(j).
3 The only currently qualified private associations are those of the American Mutual Life Insurance Co., Monarch Mutual Life Insurance Co., and Massachusetts Institute of Technology.
5 261 Mass. 154, 158 N.E. 539 (1927) (involving credit clothing sales).

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longer deductible, except on transactions entered into for profit or connected with the taxpayer's trade or business.\(^1\) The General Court has thus eliminated the distinction it created in 1954 between sales of the taxpayer's principal residence and sales of his other non-business real estate.\(^2\) While the nondeductibility of loss from such transactions now conforms to the federal law, the nontaxability of gain does not.

The tax exemption for interest paid on savings bank deposits is extended to interest paid on deposits in other banking or Morris Plan companies.\(^3\)

§27.4. Basis for determining gain or loss. When a corporation has neither earnings and profits of the current year nor accumulated earnings and profits, a dividend paid to its stockholders is a nontaxable distribution of capital. Such a distribution, when no stock is surrendered, reduces the stockholders' basis in their stock by the amount of the distribution. Any such distribution after the basis has been reduced to zero is treated as an amount received from sale of the stock. These obvious results of a capital distribution have now been added to the tax statutes.\(^1\)

Income tax is not imposed on gain attributable to appreciation in value of property before January 1, 1916, the date of inception of the Massachusetts income tax. This is accomplished by an exception to the normal basis rule. Property acquired by purchase is given the alternative basis of fair market value on January 1, 1916, or purchase price, whichever was higher. Property acquired by other means, such as inheritance, was given only its January 1, 1916, value. While pre-1916 gain was not taxed in either situation, purchased property had the advantage of using its normal basis when its January 1, 1916, value was lower. This benefit has now been extended to all pre-1916 property, whether acquired by purchase or otherwise.\(^2\)

§27.5. Stock dividends. In order to be nontaxable, stock dividends have hitherto been required to be paid in "new," i.e. newly issued, stock of the declaring corporation, association or trust with transferable shares. This created a trap for those who were unaware of the requirement and made taxable distributions with treasury stock. The requirement that the stock dividend be in "new" stock to avoid taxability has now been eliminated.\(^1\)

When originally promulgated, the regulations provided that a dividend paid in the payor's newly issued stock was taxable if the stockholder had an election or other right to receive payment in money or

\(^1\) Acts of 1957, c. 677, amending G.L., c. 62, §§5, 6. All legislation enacted during the 1957 Survey year applies to taxable years commencing after December 31, 1956, unless otherwise stated.

\(^2\) Acts of 1954, c. 611.


§27.4. 1 Acts of 1957, c. 540, amending G.L., c. 62, §5.


§27.5. 1 Acts of 1957, c. 445, amending G.L., c. 62, §§1(b), 1(c).
property. This constructive receipt rule was changed by retroactive amendment to the regulations so that an election or other right to have a dividend paid in money or property does not make the stock dividend taxable if the stockholder actually receives the dividend in stock. The rule thus adopted is contrary to the federal rule.

§27.6. Deductions and credits. Final regulations on deductions and credits were promulgated during the Survey year. Enumeration is made of the expenses which are deductible provided they are directly connected with the taxpayer's profession, employment, trade or business. While the regulations state that payments made by a "taxpayer" to a qualified pension or profit sharing plan or trust are deductible, the author is advised by the draftsman that no change in law is intended and that the employee is given no deduction with respect to his contribution withheld from his wages. That this is the intention is further indicated by the later section dealing with payments to the Commonwealth's retirement or pension funds and those of certain private associations approved by the Commissioner of Insurance under G.L., c. 32, §§39-41. Payments made to or withheld by these associations are deductible.

While a cash basis taxpayer may deduct the entire rental in the year paid when he makes advance payment of rent under a lease extending beyond a year on property used in his profession or business, the federal rule is applied to payment of business insurance in advance. Thus, when the taxpayer pays in the first year the entire premium on a three-year fire insurance policy on his business property, the cost must be deducted ratably over the three-year period both by a cash- and an accrual-basis taxpayer.

In setting out rules with respect to business expense, the regulations follow the federal rule that when the taxpayer entertains a business client or customer, he may not deduct the cost of his own meals or entertainment except to the extent that the cost exceeds the amount he would otherwise have spent on himself. In general the deductible business expenses of employees, salesmen and professional men correspond to those deductible for the federal return. In addition to memberships in professional societies and subscriptions to professional journals for physicians, accountants, lawyers and engineers, the cost of attending institutes and seminars is deductible when the sole purpose is to maintain or advance the taxpayer's standing in his profession. A rule is adopted with respect to research and development expenditures that approximates the federal rule; these expenditures if

3Amendment No. 1 of the State Tax Commission, December 19, 1956, revoking the former rule as of September 28, 1956 (the effective date of the original regulation) and making the new rule effective from and after January 1, 1957.

§27.6. 1 Adopted by the State Tax Commission on February 7, 1957, pursuant to G.L., c. 62; Acts of 1954, c. 681; Acts of 1953, c. 654.
2See §27.2 supra, note 3. The regulations point out that only these three associations are qualified.
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regularly incurred to produce business income may be deducted as a current expense, except in the case of capital items.

The rules with respect to depreciation also follow closely the rules under the Internal Revenue Code of 1954, even to the allowance of the Declining Balance and the Sum of the Years Digits Methods of computing depreciation. These methods are applicable only to property having a service life to the taxpayer of three or more years and which is new equipment purchased by or erected by the taxpayer. As under the present federal rule, the rate for the declining balance method may be double the rate that would be used under the straight-line method. The Bureau will not interfere with a reasonable service life adopted by the taxpayer and consistently followed. Percentage depletion is allowed for wasting assets at the same rates allowed by the Internal Revenue Code. Unlike the federal rule, however, no deduction for percentage depletion is permitted after the taxpayer has recovered his cost or other basis.

Detailed rules are provided for the deduction of federal income tax, other taxes, and interest. Since a tax is not a debt under Massachusetts law, there is no deduction for interest on overdue taxes either as a business expense or otherwise. A taxpayer engaged in two or more businesses as an individual proprietor may deduct the losses of one business from the profits of another. Since a partnership with a principal place of business in Massachusetts is a separate taxable entity, a taxpayer may not deduct his share of losses of such a partnership from profits earned as a sole proprietor. Casualty losses are defined as in the federal law and are deductible in the same manner except that they must be sustained in a profession, trade or business to be deductible in the Massachusetts tax. The medical expense deduction is keyed into and follows the federal rules. The deduction is not permitted where the taxpayer elects the "standard deduction" on his federal return or files the federal short form. Nor can it be claimed if the taxpayer uses the Massachusetts short form 1A or 1A-NR.

The deduction against earned income for taxes paid thereon to other jurisdictions is extended to include taxes paid to United States dependencies and to Canadian provinces. The credit formerly allowed to Massachusetts residents for taxes paid to other states is extended to include taxes paid to United States dependencies, to the Dominion of Canada and to the Canadian provinces.

Deductions for bond premium amortization, safe deposit rentals and for compensation on income collected, formerly allowed to trustees, were extended to other fiduciaries as was the deduction for premium on security bonds, formerly available only to trustees, guardians and conservators. The maximum rate of deductible compensation of the fiduciary was increased to 7 percent of income taxable in Massachusetts from the 6 percent formerly allowed.

3 Acts of 1957, c. 448, §1, amending G.L., c. 62, §6(c).
4 Id. §2, amending G.L., c. 62, §6A.
§27.7. Exemptions. The $2000 earned income exemption, extended to unearned income and then granted to beneficiaries of trusts, is now granted to beneficiaries of estates where there is no trust.\(^1\)

An individual whose income from all sources does not exceed $2000 and whose income combined with that of his wife does not exceed $2500 is given an exemption of $2000 against income from interest, dividends, annuities and gains from the sale of intangibles. The Commissioner has ruled that in the case of an individual resident in Massachusetts for only a part of the year, the reference to income from all sources in this exemption refers to income received during the entire calendar year and not just to the taxpayer's income received while a resident of Massachusetts.\(^2\) A similar interpretation is applied to the $1000 exemption against annuity income for an individual whose income from all sources does not exceed $5000 and whose income combined with that of his wife does not exceed $7500.

§27.8. Nonresident income tax. The legislature extended the nonresident income tax to gains from the sale of Massachusetts real estate and tangible personal property on transactions entered into for profit or connected with the taxpayer's trade or business.\(^1\)

Omissions in the nonresident income tax were corrected by making income from a trade or business carried on in Massachusetts taxable in the following situations: income earned in the year of the nonresident's death; income earned by executors and administrators of estates of nonresidents; income earned by trustees of trusts established by nonresidents during their lifetime; income earned by the estate of a deceased resident or by a trustee under his will and payable to a nonresident.\(^2\)

The right of nonresidents to file joint returns was made clear.\(^3\)

§27.9. Miscellaneous provisions. The federal rule has been adopted so as to permit the filing of a joint income tax return for the year of death of either husband or wife, or both.\(^1\)

The General Court has closed a loophole which permitted the avoidance of tax on income of a trust accumulated for unborn or unascertained persons or persons with uncertain interests.\(^2\) By appointing nonresident individuals as trustees, a Massachusetts resident was able formerly to create a trust under which income accumulated for unascertained persons, such as his surviving children, was taxable only in the proportion that the number of Massachusetts resident trustees

\(^1\) Acts of 1957, c. 457, amending G.L., c. 62, §12A.
\(^3\) Id., c. 644, amending G.L., c. 62, §§9, 10.
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The entire income is now taxable if there is one Massachusetts resident trustee.

Final regulations on the use of the whole dollar method on tax returns were adopted by the State Tax Commission on December 26, 1956, effective for taxable years commencing after December 31, 1955. This method permits the rounding off to even dollars of all amounts appearing on the return or a schedule required to be submitted with the return. Fractional parts of a dollar are omitted unless the fraction amounts to a half-dollar or more, in which event the amount is increased to an even dollar. Subsidiary figures not on the return or schedule may not be rounded off. Election is made by using the method on a return. It is then irrevocable for that return but there is a new election with each return.

In order to provide more flexibility in making up the short form tax table, such as to accommodate changes in federal tax legislation after the General Court has prorogued, the task of making new tables when needed was delegated to the Commissioner with the approval of the State Tax Commission. In order to provide more flexibility in making up the short form tax table, such as to accommodate changes in federal tax legislation after the General Court has prorogued, the task of making new tables when needed was delegated to the Commissioner with the approval of the State Tax Commission. The Supreme Judicial Court held that the 1954 act providing for application for abatement within three years from the last day for filing returns in place of the prior one-year statute should be given retroactive effect. The right to file an application for abatement with respect to a return filed April 15, 1952, for the calendar year 1951, did not therefore expire until April 15, 1955. The so-called "temporary taxes," such as the 20 percent surtax, have been extended for two years.

C. TAXATION OF CORPORATIONS

§27.10. Constitutionality: Interstate sales. On the judicial scene interest was focused on the case of State Tax Commission v. John H. Breck, Inc. In question was the constitutionality of the allocation formula of the corporate excise tax when it required certain sales in interstate commerce to be included in Massachusetts taxable sales for the purpose of allocating to Massachusetts its share of the corporation's net income that would be subjected to the net income portion of the corporate excise tax. While the statute excludes from Massachusetts sales those interstate sales effected by salesmen connected with out-of-state sales offices, it requires the inclusion in Massachusetts sales of those interstate sales effected by both resident and nonresident salesmen not connected with out-of-state sales offices. In a sound opinion reversing the
Appellate Tax Board the Supreme Judicial Court held that in allocating such interstate sales to Massachusetts for application of our tax measured by net income, there was no interference with interstate commerce and, hence, no violation of the commerce clause of the United States Constitution (Art. I, §8). The Court properly distinguished the case relied on by the Appellate Tax Board, Commissioner of Corporations and Taxation v. Ford Motor Co., which had dealt with the alternative minimum tax of one-twentieth of one percent of gross receipts assignable to the Commonwealth. The gross receipts tax in the Ford case was stricken down as to these interstate sales since a tax on gross receipts taxes the sales themselves, whether they give rise to a profit or a loss, whereas the basic income portion of our corporate excise tax is a tax measured by net income and only uses sales for the purpose of apportioning the net income. While Spector Motor Service, Inc. v. O'Connor came to a different conclusion where an exclusively interstate business was concerned, it indicated the result here arrived at by the Supreme Judicial Court where the taxpayer's business was both intrastate and interstate.

§27.11. Short taxable year. In 1956 the due date for the filing of corporate excise tax returns was changed to the fifteenth day of the third month following the close of the corporation's taxable year. The definition of taxable year was also changed to that for which a federal return was required. When a corporation changed its accounting period and therefore filed a short period return, it was required to pay for the short period a full year's tax on the corporate excess, i.e. on the fair value of its capital stock or of its tangible property in Massachusetts. A full tax on the corporate excess was thus required to be paid twice within a twelve-month period. In describing this the 1956 Survey noted the need for further legislation which would provide for proration of the tax on the corporation excess measure for the short period. The General Court has now remedied this situation. When a corporation has a short taxable year, the part of the tax based on the corporate excess is prorated on a monthly basis. Where the short year is four months, the tax will be 4/12 of the corporate excess.

§27.12. Valuation of capital stock. A further step was taken during the Survey year to clarify the computation of the value of the capital stock for the corporate excess portion of the corporation excise tax. In a completely detailed ruling too lengthy to describe herein, the Commissioner sets out each step to be taken in arriving at the valua-


§27.11. 1 Acts of 1956, c. 550.
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tion of capital stock of a business or manufacturing corporation. The ruling is divided into sections dealing with corporations whose stock is and is not actively traded on a security exchange or over the counter and corporations whose officers do or do not own 50 percent or more of the voting stock. The ruling restores some of the assessing theories in effect prior to 1951. It affords some relief when the earnings capitalized indicate a depressed value.

§27.13. Miscellaneous provisions. The time for filing an application for abatement with respect to tax shown on a return was extended to three years from the last day for filing the return and the time for filing an application for abatement with respect to additional tax assessed by the Commissioner was extended to two years from the sending of the assessment notice. The periods were formerly one year and six months respectively.

A general extension of time for filing corporation excise returns due on April 10 and April 15, 1957, was granted without penalty until May 15, 1957.

All of the so-called “temporary taxes” were again extended, but this time on a two-year basis.

A railroad corporation which leases substantially all its physical assets was relieved of its former tax and made subject to the tax imposed under G.L., c. 63, §52A on utility corporations doing business within the Commonwealth. It thus pays a tax equal to 4 percent of its net income allocable to Massachusetts.

The Commissioner has ruled that when a corporation has distributed its assets in complete liquidation within twelve months after adopting a plan of liquidation, any gain on the sale of assets not recognized for federal tax purposes by virtue of Section 337 of the Internal Revenue Code of 1954 shall likewise not be includable in “gross income from all sources” for the purpose of the corporation excise tax.

D. INHERITANCE TAXATION

§27.14. Practice. The most welcome event of the year in the inheritance tax area was the issuance by the State Tax Commission of the Procedural Manual on Massachusetts Inheritance and Estate Taxes. In conveniently brief form the manual outlines the procedure for handling the administration of an estate with respect to Massachusetts


§27.15. 1 Acts of 1957, c. 434, amending G.L., c. 63, §51.
4 Acts of 1956, c. 629, amending G.L., c. 63, §52A.
death taxes. It represents a further step in reducing the Commission's interpretations of the law to printed form.

The General Court extensively revised the law with respect to the inheritance tax lien in order to make this defect in title more readily discoverable by title examination and to afford greater protection to the real estate owner.\textsuperscript{1} The lien on real estate listed in the inventory filed with the Probate Court or in the tax inventory filed with the Commissioner expires ten years from the date of decedent's death, provided that the Commissioner has received written notice of death within five years thereof. The filing of the inventory constitutes notice. If notice is not given until later than five years after death, the lien expires five years after the notice is given. The lien on real estate not listed in the inventory terminates twenty-five years after death. With respect to future interests in the real estate, the ten-year period runs from the date the right of possession or enjoyment accrues, provided the Commissioner receives notice within five years of the accrual.

Under the 1954 legislation which had first established an expiration date for the lien, failure to give written notice of death or of probate to the Commissioner resulted in no expiration.\textsuperscript{2} If notice was given, the lien terminated on the earlier to occur of two periods: thirty years after decedent's death or ten years after the Probate Court approved the executor's or administrator's bond. If notice was given more than a year after death or probate, the period of limitation began with the receipt of notice date. The 1957 act also permits the Commissioner to discharge the lien when he is satisfied that the collection of the tax will not be jeopardized.

The General Court adopted the federal estate tax rule with respect to the time for payment of the inheritance tax, i.e., fifteen months after the decedent's death (except for that part of the tax attributable to future interests).\textsuperscript{3} By providing for payment one year after the date of the executor's or administrator's bond, the prior law resulted in delayed payment of the tax when the executor or administrator was late in securing his appointment. The new period applies to inter vivos transfers in contemplation of death or taking effect in possession or enjoyment after death and to survivorship interests as well as to property passing under the decedent's will or by intestacy.

The "temporary" 20 percent surtax was extended for two further years on all legacy and succession taxes imposed by G.L., c. 65 with respect to property or interests therein passing or accruing upon the death of persons who died during calendar years 1958 and 1959.\textsuperscript{4}

\section*{§27.15. Tenancies by the entirety.} When tenancies by the entirety were subjected to the inheritance tax in 1949 an exemption was

\begin{footnotesize}
\begin{enumerate}
\item Acts of 1957, c. 502, amending G.L., c. 65, applicable to all liens in existence on the effective date of the act, September 29, 1957. Existing liens which would terminate before January 1, 1960, under the act will continue to that date.
\item Acts of 1954, c. 595.
\item Id., c. 456, §6.
\end{enumerate}
\end{footnotesize}

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provided for a single-family residence occupied by the decedent and spouse as their domicile. An exemption of multiple-family residential property so occupied "to the extent of twenty five thousand dollars of its value" was also provided. Inheritance Tax Ruling No. 1 of the Commissioner of Corporations and Taxation applies the $25,000 exemption only to that part of the property actually occupied by the husband and wife as their residence. Thus, if the building (purchased with the husband’s funds) is valued at $100,000 and the apartment occupied by the husband and wife is valued at $10,000, the exemption allowable on the death of the husband is $10,000. This had been the original interpretation of the statute by Henry Long, but when William Schan became Commissioner he ruled that the $25,000 exemption applied to the entire building if any part of it was occupied by the husband and wife.

The Commissioner has also ruled that real property becomes subject to the inheritance tax by virtue of the gift in contemplation of death rule where a married person in contemplation of death and within two years of death transfers the property directly or indirectly to himself and his spouse as tenants by the entirety.

§27.15. 1 G.L., c. 65, §1, as amended by Acts of 1949, c. 792.