§ 62:1. Definitions.

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GENERAL LAWS OF MASSACHUSETTS

Part I. ADMINISTRATION OF THE GOVERNMENT

Title IX. TAXATION

Chapter 62. TAXATION OF INCOMES

Current through Chapter 101 of the 2011 Legislative Session

§ 62:1. Definitions

When used in this chapter the following words or terms shall, unless the context indicates otherwise, have the following meanings:--

(a) "Commissioner", the commissioner of revenue.

(b) [Deleted]

(c) Code, the Internal Revenue Code of the United States, as amended on January 1, 2005 and in effect for the taxable year; but Code shall mean the Code as amended and in effect for the taxable year for sections 62(a)(1), 72, 105, 106, 139C, 223, 274(m), 274(n), 401 through 420, inclusive, 457, 529, 530, 3401 and 3405 but excluding sections 402A and 408(q).

(d) "Federal gross income", gross income as defined under the Code.

(e) "Dividend", any item of federal gross income which is treated as a dividend under the provisions of the Code.

(f) "Resident" or "inhabitant",

(1) any natural person domiciled in the commonwealth, or

(2) any natural person who is not domiciled in the commonwealth but who maintains a permanent place of abode in the commonwealth and spends in the aggregate more than one hundred eighty-three days of the taxable year in the commonwealth, including days spent partially in and partially out of the commonwealth. For purposes of clause (2), a day spent in the commonwealth while on active duty in the armed forces of the United States shall not be counted as a day in the commonwealth. The word "non-resident" shall mean any natural person who is not a resident or inhabitant.

(g) The determination of whether the taxpayer is married shall be made as of the close of his taxable year, except that if his spouse dies during his taxable year such determination shall be made as of the time of such death. An individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married.

(h) "Taxable year" shall have the same meaning as in the Code, except as otherwise provided in section sixty-two of this chapter.

§ 62:6F. Gross income; determination of capital gains; basis of property.

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§ 62:6F. Gross income; determination of capital gains; basis of property

(a) In determining Massachusetts gross income, if the federal gross income includes any item of gain or has been reduced by any item of loss, with respect to property, then the federal gross income shall be increased by the excess of the federal adjusted basis of such property over the Massachusetts adjusted basis thereof, and shall be decreased by the excess of the Massachusetts adjusted basis of such property over the federal adjusted basis thereof.

(b) (1) The Massachusetts initial basis of property held on December thirty-first, nineteen hundred and seventy shall be determined as follows:--

(A) In the case of property as to which, if it had been sold on December thirty-first, nineteen hundred and seventy in the course of business, a gain realized on such sale would have been taxable under this chapter to its then owner:

(i) The Massachusetts initial basis shall, for purposes of computing gain, be its adjusted basis as computed under this chapter as in effect on December thirty-first, nineteen hundred and seventy, and

(ii) The Massachusetts initial basis shall, for the purpose of computing loss, be the lower of the basis computed under clause (i) of this subparagraph or the federal adjusted basis for the determination of loss as of such date.

(B) In the case of any other property the Massachusetts initial basis shall be its federal adjusted basis on such date, determined without regard to any federal adjustment made under section one thousand and fifteen (d) of the Code.

(2) The Massachusetts initial basis of property acquired after December thirty-first, nineteen hundred and seventy shall be determined as follows:--

(A) If the taxpayer's federal basis of the property at acquisition is determined without regard to the basis of such property in the hands of the transferor or of other property in the hands of the transferee, hereinafter called the "basis of prior property", the Massachusetts initial basis shall be the federal basis, determined without regard to any federal adjustment made under section one thousand and fifteen (d) of the Code.

(B) If such federal basis is determined in whole or in part by application of the basis of prior property, and

(i) if no item of gain is includible in federal gross income and federal gross income has not been reduced by any item of loss, with respect to the transaction, the Massachusetts initial basis shall be the initial federal basis, increased by the excess of the Massachusetts adjusted basis over the federal adjusted basis of prior property, or decreased by the excess of the federal adjusted basis over the Massachusetts adjusted basis of prior property, or

(ii) otherwise, the Massachusetts initial basis shall be the initial federal basis of the acquired property.

(C) Notwithstanding subparagraphs (A) and (B), in the case of property acquired from a decedent within the meaning of section one thousand and fourteen (b) of the Code, the initial basis of such property shall be determined under section one thousand and fourteen of the Code, without reference to section one thousand and fourteen (d) of the Code; except that in the case of an election under section five of chapter sixty-five C, the initial basis shall be its value determined under the provisions of such section on the applicable valuation date.

(c) (1) The Massachusetts adjusted basis of property shall be the Massachusetts initial basis of property adjusted by applying the same adjustments as are made to the federal basis for periods after determination of the initial basis, except as hereinafter provided.

(2) There shall be disregarded any federal adjustment resulting from provisions of the Code that were not applicable in determining Massachusetts gross income at the time such federal adjustments were made, and

(3) Adjustments shall be made for any item which was applicable in determining Massachusetts gross income but which was not so applicable in determining federal gross income and for which a federal adjustment would be allowed under the provisions of the Code if the item had been applicable in determining federal gross income.

(4) There shall be disregarded, and the federal basis shall be modified to the extent necessary to disregard, any federal adjustment under section one thousand and fifteen (d) of the Code.

(d) The rules prescribed in this section shall apply to non-residents; except that if any non-resident has owned any items of property during a period when the income or gains from such items were not subject to taxation under this chapter, and if the income or gains from such items subsequently became or become subject to taxation under this chapter, then the special limitations of subparagraphs (2) to (4), inclusive, of paragraph (c) of this section shall not apply as to such period.

Archive

OPINION

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A solution to the Massachusetts basis puzzle?

By Kenneth P. Brier

The correct determination of Massachusetts basis for property acquired from decedents after 2009 — and of the resultant gain or loss — continues to be a puzzle, though perhaps now there is a practical solution.

Origins of basis problem

I suggested last year in a piece titled "State, federal estate tax planning in a world reshaped" (Feb. 22, 2010) that the repeal of the federal estate tax had created a thorny Massachusetts capital gains problem.

In doing away with the estate tax, Uncle Sam also eliminated the so-called "step-up" in basis, which results in a reset of basis for all inherited assets at their date-of-death (or six-month alternate) valuations.

I suggested that Massachusetts law, as it interacted with federal law, then provided for a purely carryover basis. That meant that *all* gains, whether accrued during the decedent's life or after his death, were subject to the state's 5.3 percent capital gains tax.

Moreover, I suggested that the problem would not be cured by any return to the federal basis step-up rules when the repeal of the federal estate tax itself "sunsetted" in 2011.

The federal estate tax repeal has not "sunsetted." That federal tax has instead been affirmatively reinstated, for now, in a modified form, under legislation enacted last December, and the old basis step-up rules have been reinstated with it.

The Massachusetts problem, however, is the same as before. The problem continues to lie in the interweaving of the Massachusetts tax statute with the Internal Revenue Code.

Massachusetts has its own tax basis rules set forth in G.L.c. 62, §6F, which generally applies the basis step-up rules of Code §1014 to property acquired from a decedent:

"(C) Notwithstanding subparagraphs (A) and (B) [the general rules for initial Massachusetts basis], in the case of property acquired from a decedent with the meaning of section one thousand and fourteen (b) of the Code, the initial basis of such property shall be determined under section one thousand and fourteen of the Code, ..."

Section 6F needs to be read in conjunction with the definition of "Code" for purposes of Chapter 62, as set forth in §1(c). That definition refers to the Internal Revenue Code, as amended on Jan. 1, 2005, and in effect for the taxable year.

"Code" therefore has included §1014(f), enacted in 2001 under EGTRRA, which provides that §1014 shall not apply to decedents dying after Dec. 31, 2009.

The "sunset" provisions of EGTRRA were never part of the Code and therefore were never incorporated into the Massachusetts statute.

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The basis step-up rules of §1014, incorporated into §6F, would seem to have self-destructed, leaving us with a purely carryover basis regime for Massachusetts purposes.

Where are we now?

Neither the Legislature, nor the Department of Revenue nor any court has addressed the Massachusetts basis issue to date. So where does that now leave us?

At least one commentator has suggested that the federal 2010 Tax Act has cured the Massachusetts basis problem, except for estates that elect the modified carryover basis regime offered for 2010 decedents.

That is not the case. The monkey wrench here is that the 2010 Tax Act is not incorporated into Massachusetts income tax law. Nothing that Congress does now affects the Code as it existed in 2005.

Alternate arguments to sidestep basis problem

One might be tempted to argue that §1014(f) is no longer "in effect for the taxable year," thus reading it out of the incorporation of the 2005 Code.

Though facially attractive, that reading, in my view, does violence to the more basic idea of referring to the Code as amended on Jan. 1, 2005. Otherwise we would have to incorporate *all* amendments put into effect after Jan. 1, 2005, thus negating any effect of the Jan. 1, 2005 reference date.

The concept of "in effect for the taxable year" must instead relate to later effective dates of federal provisions *already* enacted into the Code as of Jan. 1, 2005.

My former colleague George Mair has suggested on the ACTEC listserv an alternate argument to read §1014(f) out of the Massachusetts law. He pointed out that §6F, under its terms, requires the initial Massachusetts basis to be *determined* under Code §1014, and he then suggested that §1014(f) says nothing about determining basis. He thought it made more sense to read the Massachusetts statute as incorporating only the rules in §1014 that actually speak to determining basis.

I initially thought that Mair's argument was somewhat strained. Ordinarily, when reference is made to a specified statute, the reference is to the statute as a whole. You do not get to pick and choose the provisions that suit your purposes. However, I have since warmed up to his line of thought.

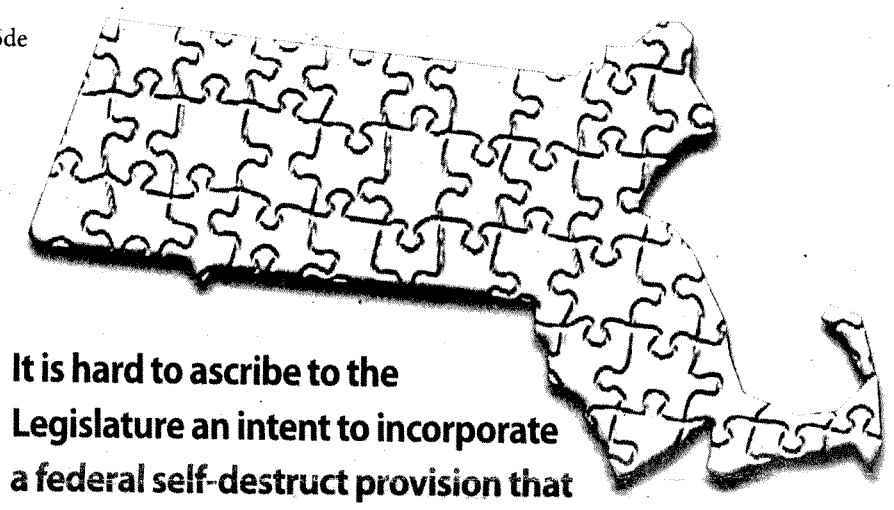
Mair correctly observed that §1014(f) is not a basis determination rule *per se*. Instead, it is a rule about the rules — a meta-rule. It certainly does affect the determination of basis, but only indirectly.

To the extent that we might ascribe an intent to the Legislature, did it intend to incorporate only the direct basis determination rules, or did it intend to incorporate the indirect rule of §1014(f) as well?

Focus

Either conclusion is plausible. Given such alternate plausible interpretations, it seems reasonable to think that the Legislature would intend the alternative that yields the more reasonable result. The more reasonable result would be to continue basis step-up, rather than to institute a carryover basis regime now at odds with the federal scheme.

That result would mesh with the implicit policy of mitigating double taxation of property already included in the gross estate for Massachusetts estate tax purposes.



It is hard to ascribe to the Legislature an intent to incorporate a federal self-destruct provision that was not to take effect for several years and which no one thought would actually take effect.

Caselaw support for basis step-up

Reading §1014(f) out of the Massachusetts basis rules finds considerable, though not uniform, support in Massachusetts caselaw.

The courts have long recognized the difficulties inherent in the Massachusetts tax system, based on an interweaving of federal rules into the state's:

"We are faced with a question of statutory interpretation that arises with some frequency in the area of Massachusetts tax law, one which requires balancing the State's independent development of its individual tax code against the Legislature's consistent references to, and incorporation of, Federal tax provisions." *Commissioner of Revenue v. Franchi*, 423 Mass. 817, 821-22 (1996) (related to self-charged interest).

The court here felt bound to a strict incorporation: "This court has consistently adhered to the meaning of Federal tax language incorporated into our tax law where no contrary legislative intent is apparent." *Id.* at 823.

Similarly, the Appeals Court in *Treat v. Commissioner of Revenue*, 52 Mass. App. Ct. 208 (2001), app. den. 435 Mass. 1105 (2001), suggested that Massachusetts basis should be bound strictly by the federal results: "As G. L. c. 62, § 6F, has incorporated Federal income tax provisions, it should be interpreted as it would be interpreted for Federal income tax purposes."

Treat, however, immediately went on to do the exact opposite, holding that jointly owned property was to be accorded only a 50 percent Massachusetts step-up, consistent with the 50 percent inclusion of jointly owned property in the Massachusetts gross estate (as then provided), rather than the 100 percent step-up that followed from the federal estate rules.

Treat thus suggests a receptivity to a result-appropriate treatment, even if divergent from a strict incorporation of the federal result.

Indeed, there can be room to deviate from a strict incorporation of federal law if the construction is in doubt and a contrary legislative intent may be inferred.

The Appeals Court has stated that "[a]ny hardship or inequitable treatment caused by a statute may be considered only where the construction of the statute is in doubt." *Larkin v. Charlestown Savings Bank*, 7 Mass. App. Ct. 178 n.9.

The obverse should also be true. When the construction of the statute is in doubt, then any hardship or inequitable treatment caused by a particular construction should be taken into account.

Toward a reasoned reporting position

The *Larkin* corollary should apply for post-2009 Massachusetts basis for property acquired from a decedent. The construction is open to doubt. Moreover, no one could have predicted the untoward result on §6F that seemingly ensued from the Legislature's 2005 updating of the reference to the "Code" as the Code in effect on Jan. 1, 2005.

It is hard to ascribe to the Legislature an intent to incorporate a federal self-destruct provision that was not to take effect for several years and which no one thought would actually take effect — and which was only *part* of a scheme to replace federal basis step-up with a *modified* carryover basis regime. Those untoward results would have been even less predictable when §6F itself was enacted in 1986.

In sum, a favorable interpretation of §6F — as incorporating only the rules of §1014 that are directly implicated in determining basis and as excluding the meta-rule of §1014(f) — is textually plausible and should be favored.

While that favorable interpretation is not a foregone conclusion, it would seem to provide a reasonable reporting position for basis step-up, at least until such time as the Legislature, a court or the DOR suggests otherwise.

Reading §1014(f) out of §6F might trigger a disconnect between federal and Massachusetts basis for a 2010 estate that elects into the alternate federal carryover basis regime. Federal and Massachusetts basis for property acquired from a decedent otherwise should remain the same. MLW

HOUSE DOCKET, NO. 02801 FILED ON: 01/21/2011

HOUSE . . . . . No. 2559

The Commonwealth of Massachusetts

PRESENTED BY:

Alice Hanlon Peisch

To the Honorable Senate and House of Representatives of the Commonwealth of Massachusetts in General Court assembled:

The undersigned legislators and/or citizens respectfully petition for the passage of the accompanying bill:

An Act to continue tax basis rules for property acquired from decedents.

PETITION OF:

NAME:	DISTRICT/ADDRESS:
Alice Hanlon Peisch	*14th Norfolk*

HOUSE . . . . . No. 2559

[Pin Slip]

The Commonwealth of Massachusetts

In the Year Two Thousand Eleven

An Act to continue tax basis rules for property acquired from decedents.

Be it enacted by the Senate and House of Representatives in General Court assembled, and by the authority of the same, as follows:

SECTION 1. Subparagraph 2 of paragraph (b) of section 6F of chapter 62 is hereby amended by striking out subparagraph (C), as so appearing, and inserting in place thereof the following subparagraph:-

(C) Notwithstanding subparagraphs (A) and (B), in the case of property acquired from a decedent within the meaning of section one thousand and fourteen (b) of the Code, the initial basis of such property shall be determined under section one thousand and fourteen of the Code, without giving any effect to section one thousand and fourteen (f) of the Code and without reference to section one thousand and fourteen (d) of the Code.

SECTION 2. Paragraph (c) of section 6F of chapter 62 is hereby amended by striking out subparagraph (2), as so appearing, and inserting in place thereof the following subparagraph:-

(2) There shall be disregarded any federal adjustment resulting from provisions of the Code that were not applicable in determining Massachusetts gross income at the time such federal adjustments were made, including specifically any increase in basis made under section one thousand and twenty-two (b) or one thousand and twenty-two (c) of the Code.

SECTION 3. This act shall apply with respect to property acquired from decedents dying after December 31, 2009.

Boston Bar
ASSOCIATION

Testimony of the Boston Bar Association
Before the Joint Committee on Revenue
In Support of H 2559
An Act to continue tax basis rules for
property acquired from decedents

Presented by: Kenneth Brier, Member, Boston Bar Association
Melvin Warshaw, Member, Boston Bar Association
May 5, 2011

The Boston Bar Association supports passage of H2559, which would provide for continuation of the "step-up" in the Massachusetts tax basis in property acquired from a decedent, a step-up that was allowed for decades under Massachusetts law, until it unexpectedly fell out of the law in 2010 due to the technical interrelation of various federal and state tax statutes. Failure to pass this bill will result in a substantial, hidden Massachusetts tax for successors to property of decedents who died in 2010, and each and every year thereafter, until the Massachusetts statute is corrected.

EGTRRA

When the federal government decided in 2001 (by way of the "Economic Growth and Tax Relief Reconciliation Act of 2001," or "EGTRRA") to reduce and, by 2010 (for one year only), repeal the federal estate tax, it planned to offset some expected revenue loss by eliminating, for property passing from a decedent who died in 2010 only, the so-called "step-up" in cost basis provided for in Section 1014 of the Internal Revenue Code (the "Code"). Accordingly, EGTRRA added a new Section 1014(f), which provided that Section 1014 would not apply to decedents dying after December 31, 2009.

Under EGTRRA, the estate of a 2010 decedent would pay no federal estate tax, but the decedent's heirs would instead be responsible for paying income tax on at least

some of the pre-death capital gains (after application of certain cost-basis increases allowed under 2010 federal law) on inherited appreciated property when they sell it. This change in the federal law provided a tradeoff – capital gains taxes on pre-death gains in lieu of much higher estate taxes.

Massachusetts Response

Under pre-EGTRRA law, Massachusetts estate taxes were determined by reference to the federal "credit for state death taxes," which EGTRRA gradually eliminated. Therefore, in response to EGTRRA, Massachusetts changed its own estate tax laws, effective for decedents dying after December 31, 2002. The effect of this change in the law, for estate tax purposes, was to provide Massachusetts with the same revenue it would have received had EGTRRA not been enacted. However, Massachusetts did not, at that time, make any changes to its rules relative to the basis of property inherited from a decedent.

Massachusetts Tax Basis Rules

Massachusetts has its own tax basis rules set forth in Chapter 62, section 6F of the Massachusetts General Laws ("MGL"). These rules interrelate heavily with the federal basis rules, but are independent of them. MGL Chapter 62, section 6F(b)(2)(C) generally provides that initial basis of property acquired from a decedent "shall be determined under section 1014 of the Code." For Massachusetts purposes, however, this reference to Section 1014 of the Code must be read in conjunction with the definition of "Code" for purposes of MGL Chapter 62. As it applies here, the "Code" means "the Internal Revenue Code of the United States, as amended on January 1, 2005 and in effect for the taxable year." "Code" as so defined would appear also to include Section 1014(f) (which, as discussed above, provided that Section 1014 would not apply to decedents dying after December 31, 2009).

Therefore, while property passing upon death after December 31, 2009 would be subject, for federal tax purposes, *either* to estate tax *or* to capital gains tax upon sale by legatees, because of this convoluted and technical interplay of federal and state statutes, such property is now subject to *both* taxes for Massachusetts purposes. In effect, assets that historically (both federally and for Massachusetts purposes) were subject to only one level of tax will now be subject to two levels of tax.

Example

Consider, for example, a son who inherits stock in his father's family business, worth $1.5 million. Under the rules that existed in 2009, the father's estate would have paid $64,400 in Massachusetts estate tax (or more, depending on the aggregate value of the father's estate), and the son would have inherited the stock with a cost basis equal to the date-of-death (or 6-month alternate) value. If the son were to sell the stock for its date of death value the day after his father died, there would be no Massachusetts capital gains tax.

Under the rules that exist in 2010 and thereafter, the father's estate would still pay $64,400 (or more) of Massachusetts estate tax, but would inherit the stock with the father's cost basis (presumably minimal), without benefit of the "step-up." In this case, if the son subsequently sells the stock, there would be a 5.3% Massachusetts capital gains tax on $1,000,000 of gain, resulting in $53,000 of extra tax, for a total aggregate tax of $117,400.

Tax Relief Act of 2010

On December 17, 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Tax Relief Act") re-instituted the estate tax for decedents who died in 2010 or thereafter. However, in order to ease the retroactive effects of the new law, the estates of those who died in 2010 were given the

option to elect either (1) application of estate tax or (2) exemption from estate tax, but with limited step-up in cost basis for capital gains tax purposes. While this new law provides some clarity regarding federal estate tax and capital gains tax laws, because applicable Massachusetts law references the Code as amended on January 1, 2005, passage of the Tax Relief Act appears to have no effect on the Massachusetts cost basis conundrum.

Consequences

This technical failure of the Massachusetts cost basis step-up creates serious complications for any taxpayer acquiring property from a decedent in 2010 or thereafter. Without any cost basis step-up, Massachusetts cost basis will be lower than federal, and Massachusetts gains will be commensurately higher. Moreover, this disconnect between death and cost basis creates a serious trap for so-called pourover trusts containing a "pecuniary" subtrust funding formula. Such a funding formula, though offering several advantages, has always imposed the potential of triggering of the recognition of gain upon funding. That problem has typically been manageable to the extent persons administering the trust are dealing only with post-mortem gains. It is a lot more serious to deal with gains accrued over the decedent's lifetime and not reduced by the federal allocation of increased basis.

This problem does not affect only those subject to estate tax, or beneficiaries of trusts. This step-up in cost basis has fallen away with respect to everyone, regardless of net worth. Widows, widowers, children, grandchildren, and other legatees will find themselves with considerable, unexpected, and unintended capital gains tax liabilities for inherited property as a result of this accidental loss of step-up in cost basis for purposes of Massachusetts tax.

Furthermore, the complexity of the interrelationship between the various federal and state statutes outlined above allows for alternative interpretations. Some taxpayers and practitioners, noting the apparently unintentional nature of this Massachusetts double taxation, are likely to take inconsistent tax filing positions regarding whether Massachusetts law does, in fact, still allow a full step-up in cost basis. Such inconsistent filing positions likely will lead to controversies that may require costly and time-consuming court action to resolve.

H2559 states explicitly that IRC section 1014(f) is not to be given any effect for Massachusetts purposes, thereby reading IRC section 1014 back into Massachusetts law regarding cost basis for 2010 (applied retroactively) and thereafter. This long-standing Massachusetts taxation scheme – estate tax, but full step-up in cost basis – has commonly been thought of as "fair play" in mitigating the potential for double taxation. Given the Commonwealth's continuation of its estate tax in opposition to EGTRRA and subsequent law, a corresponding continuation of the cost basis step-up rules is both consistent and fair.