

## *They Don't Call it Taxachusetts for Nothing*

In 2002, the Massachusetts Legislature in their continued effort to separate taxpayers from their hard earned money increased the rates at which long-term capital gains were taxed. A long-term capital gain is the sale for a gain of property held more than one year.

Prior to the statute, long-term capital gains were taxed at rates from 0% to 5%, depending on the number of years that the property was held prior to the sale. If the property was held between one and two years, the tax rate was 5%, between two and three years, the tax rate was 4% and so on. Thus, an item of property held for more than six years was taxed at a rate of 0%. The Massachusetts Legislature changed the rule for all property sold after April of 2002 to a flat tax rate of 5.3% on all long-term capital gains. Therefore, property held for more than six years was taxed at 5.3% under the statute instead of not being taxed at all.

Living in Massachusetts, we are used to the Legislature increasing our taxes and we planned based on this tax increase. Many taxpayers, at the direction of professional advisors, sold property prior to May 1st to avoid the increased tax rates. If the story ended there, it would simply be another tax increase, something to which we have become quite accustomed.

### *Is the tax statute constitutional?*

The constitutionality of the statute was challenged and the Massachusetts Supreme Judicial Court (SJC), the highest court in our beloved Commonwealth, found the statute to be unconstitutional because the Massachusetts constitution requires that, "a single tax rate must be applied to income from the same class of property received during the period specified by the Legislature for measuring income", which is a calendar year. The SJC remanded the case for a determination as to whether it was more likely that the Legislature meant January 1, 2002 or January 1, 2003 to be the effective date of the tax statute.

If January 1, 2003 is determined to be the effective date of the tax increase, those people who had long term capital gains after April in 2002 and paid the higher tax will be entitled to refunds. If January 1, 2002 is determined to be the effective date of the tax change, those people who had capital gains prior to May in 2002, will owe tax at the higher rates even though when they sold the property, they relied on the tax laws in effect at that time. As indicated above, many people sold property prior to May 1st just to avoid the higher rates.

### *Legislature takes remedial action*

After the case was remanded by the SJC, the Legislature stepped in to remedy the situation. It passed legislation that shifted the effective date of the tax increase to January 1, 2002, but said that the Commissioner of Revenue should not adjust the tax liability of anyone with a long-term capital gain from January through April.

When the case came back to the SJC, it held that the effective date of the tax increase was January 1, 2002 based on the Legislature's remedial action. However, the SJC also held that the exemption for those with long-term capital gains prior to May was unreasonable and unconstitutional. Thus, the SJC held that the increased rates apply as of the beginning of 2002 and there is no exemption applied for those taxpayers with long-term capital gains prior to May 1st.

The Massachusetts Department of Revenue (MA DOR) has only until April of 2006 to assess the tax and have the authority to collect it. The MA DOR has already begun to send Notices of Assessment (NOAs) that instruct the taxpayer to pay the balance due within thirty days. If the assessment is paid within thirty days, no penalty will be assessed; however, interest will accrue from April 15, 2003. If a taxpayer fails to pay the NOA within the thirty days, a penalty will accrue. How can it possibly be fair that a taxpayer who followed the tax laws gets charged interest when the rules are retroactively changed years later?

#### *Pending Legislation*

There are two bills currently under consideration to change the implications of the SJC's decision. The first, "An Act Amending the Taxation of Capital Gains", was filed by Governor Romney and would change the effective date of the tax increase to January 1, 2003. If this bill becomes law, taxpayers with long term capital gains after April of 2002 would be entitled to refunds of the tax paid at the higher rates.

The second bill, "An Act Relative to the Tax Laws of the Commonwealth" provides that interest will not be charged if a taxpayer pays the entire NOA within thirty days. This bill also enables the MA DOR to consider installment payments on an individual basis. Finally, this bill provides that the MA DOR does not have to send a NOA if the tax due is less than \$100. Currently, if the tax due is less than \$50, no NOA is required as it is deemed more costly to send the required notices and collect the tax than the tax to be collected.

#### *Stay Tuned*

So where does that leave our law abiding taxpayers who had long term capital gains between January 1st and April 30th of 2002? I wish I could say. I expect that a challenge to the constitutionality of retroactively changing the tax rates will be brought to the Supreme Court (the Court), the only other court in the country with jurisdiction over the matter. I do not know if the Court will agree to even hear the case, as the case requires an interpretation of Massachusetts law. I also expect the public to be (rightfully) outraged at the resolution of the matter. Perhaps one of the two pending bills will be passed into law. I do not know. I strongly recommend that you stay tuned and suggest that a resolution may already have been reached between the drafting and publishing of this article.

#### *Update prior to publication*

The uproar from many of the 48,000 taxpayers who would have been retroactively taxed was immense. Politicians were called and protests were held. Finally, on December 1<sup>st</sup>, the Massachusetts Legislature announced that it would pass a bill similar to the Governor's proposal (see above) to change the effective date of the tax increase to January 1<sup>st</sup> 2003 which will eliminate the retroactive taxation of capital gains from January through April of 2002 and will result in refunds to taxpayers with capital gains from May through December of 2002.

*The Final Chapter*

The final chapter in this tax saga was not written until a week later, on December 8, 2005, when Governor Romney signed the bill into law. You can enjoy your holidays knowing that the people who elect the politicians are occasionally heard by them.

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