Gesmer Updegrove LLP

ClientUpdate
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Massachusetts Voters Narrowly Approve "Millionaires Tax"

Since the inception of Massachusetts' income tax, the Commonwealth's constitution has provided that tax could only be assessed at a flat rate across all income levels--currently 5%. When Massachusetts voters went to the polls on Tuesday, November 8, they were asked for the sixth time in the last 107 years whether this constitutional provision should be amended to allow for graduated income tax rates. For the first time, voters--narrowly--said yes. The result is a significant new tax that will go into effect on January 1, 2023.

The text of the constitutional amendment expressly adds a 4% surtax on the income of Massachusetts taxpayers that exceeds $1 million, with the income threshold adjusted annually to account for cost-of-living increases. Such income could include ordinary wages, but also dividends, interest, and capital gain from the sale of securities, a small business, or real estate. Proponents of the amendment cited statistics that showed only 0.6% of Massachusetts taxpayers would be subject to the surtax, and that its proceeds would be directed exclusively for use in education and infrastructure projects. Critics pointed out that the amendment was likely to chill business investment in the Commonwealth and that resulting revenue may not meet expected targets due to wealthy taxpayers moving out of state or using other tactics to mitigate the surtax.

The true economic impact of the constitutional amendment will take years to assess. In the meantime, Massachusetts taxpayers who may be subject to the surtax can consider a few strategies to help mitigate or defer its effects:

- **Accelerating income to 2022**. Income deferral is a pillar of most tax planning strategies, but in this case accelerating income to 2022 would avoid the imposition of the surtax. This strategy may be useful for business owners who are planning an exit soon but otherwise had no rush to close the sale this year. With the new tax going into effect on January 1, a fast-track closing before the end of the year may yield considerable tax savings. This strategy may also be helpful for taxpayers sitting on unrealized capital gains from the appreciation of securities or other assets.

- **Spreading income over multiple tax years**. For a business owner considering an exit, there may be added incentive to explore an installment sale where sale proceeds are paid over a period of years, thereby lowering or eliminating the extent to which the seller will surpass the $1 million threshold in any given year.

- **Tax-free transactions**. Sellers of real estate should consider entering into a so-called "1031 exchange," which allows for a tax-free exchange of real property. Any cash received in the transaction is taxable, but deferring at least some gain on the real estate sale may help taxpayers stay under the surtax threshold. Business owners engaged in exit planning should consider tax-free equity rollovers or other techniques to defer income recognition.

- **Relocating**. The "nuclear option," of course, is for taxpayers to vote with their feet and relocate to a lower-tax state. State tax residency is determined by domicile, which is a technical tax term combining physical location and the intent of the taxpayer. Changing domicile requires not only a demonstrated intent to leave Massachusetts and establish residency elsewhere, but also the intent not to return. Simply buying a vacation home in Florida, for example, is likely not enough to establish domicile there if the taxpayer continues to retain a home or significant business interests in Massachusetts, even if the taxpayer spends more time in Florida than Massachusetts. Tax residency planning is an intricate process that requires careful planning months before an intended exit.

The corporate and tax team at Gesmer Updegrove is ready to assist all Massachusetts taxpayers in navigating this new surtax. Please contact us to discuss in more detail.

This advisory is for information purposes only, and does not constitute legal advice. If you would like to discuss tax law, please contact Aaron Kriss at (617) 350-6800 or email him at aaron.kriss@gesmer.com.

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