MASSACHUSETTS STATE DEVELOPMENTS
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I. Corporate Excise Tax

A. Legislative Developments

1. FY 2023 budget enacted without proposed corporate excise tax changes: The Governor's FY 2023 budget released in January proposed amending the qualified research tax credit to clarify that financial institutions, insurance companies and other business corporations taxable under Chapter 63, but not subject to the general business excise tax under Section 39 of the chapter, are eligible for the credit for tax years beginning on or after January 1, 2022. However, the proposal was not included in the final budget, and the final budget did not include any other corporate excise tax changes. *Acts of 2022, Ch. 126 (H. 5050) (Aug. 2, 2022).*

2. Legislature overrides Governor's veto to eliminate long-standing tax credits and deduction, and enact partial state and local tax cap workaround: The budget bill passed by the Legislature in July 2021 repealed two longstanding credits—the medical device user fee tax credit and the harbor maintenance tax credit—as well as the energy patent deduction. The Governor vetoed the repeals, but on September 30, 2021, the legislature garnered sufficient 2/3 vote of both the House and Senate to override the veto. The credits and deduction have now been repealed.

   The Legislature's July 2021 budget bill also included a provision to allow taxpayers to elect into a regime that would act as a workaround the federal $10,000 cap on the state and local tax deduction (enacted by Congress as part of the 2017 Tax Cuts and Jobs Act ("TCJA")) by imposing an entity-level tax on pass-through entities equal to the personal income tax rate. The individual owners would then be entitled to a refundable credit equal to 90% of their share of the tax. In this way, the Legislature's budget bill provided pass-through entity owners the option to obtain 100% relief on the federal cap, at the price of sacrificing their credit for 10% of the tax paid at the entity level, thus raising revenue for the Commonwealth. The Governor vetoed the 10% tax credit haircut, making the workaround revenue neutral. However, on September 30, 2021 the Legislature overrode the Governor's veto. Massachusetts has now joined many other states that have enacted a workaround—albeit with a unique revenue raising mechanism.

The budget also adopted provisions that coordinate Massachusetts' audit process with federal audits under the Centralized Federal Partnership Audit ("CFPA") regime.

3. <u>Bill establishing new gross receipts tax referred to Joint Rules Committee</u>: First introduced in early 2021, H. 2855 would establish the Homelessness Prevention and Housing For All Fund financed by a new gross receipts tax ("GRT") on businesses. The bill would impose a new annual 0.25 percent tax on gross receipts of each business entity engaged in business in the Commonwealth, with an exemption on the first $50,000,000 of gross receipts received by each business entity. The tax would apply to all receipts obtained from sales, services, property deals, interest, rent, royalties, and miscellaneous other fees.

   As currently drafted, Massachusetts' proposal does not seem to eliminate other corporate income taxes imposed. Meaning, unlike other states that impose a GRT, the proposed GRT would be in addition to other corporate income taxes imposed, rather than in lieu of them.

   The proposal has received criticism, including a formal opposition from COST. In August 2022 the bill was reported out of the Joint Committee on Revenue, and referred to the Joint Rules Committee. *H. 2855 (Mar. 29, 2021).*

   <u>Interest expense limitation decoupling legislation re-introduced</u>: In April 2022, Massachusetts' Joint Committee on Revenue referred a bill to the House Ways and Means Committee that would decouple the corporate excise tax base from the federal interest expense limitation introduced under the TCJA, and conform to Internal Revenue Code ("IRC") § 163(j) as it existed before 2018. Similar bills were introduced to the House and Senate in prior years. The Department of Revenue has estimated decoupling from the federal interest expense limitation would result in a $37 million reduction in tax revenue for the Commonwealth. *H. 2606 (Jan. 22, 2019); H. 2967, S. 1935 (Mar. 29, 2021).*

4. <u>Bill reintroduced to allow elective single sales factor apportionment</u>: A bill that would allow all business corporations and financial institutions to

elect an alternative apportionment method to compute their corporate excise tax has been reintroduced. The bill would allow corporations to elect a different apportionment method for tax years in accordance with a sliding scale moving toward single sales factor apportionment. The bill was introduced in the House in 2019, and again in the Senate in 2021. A hearing was held on the bill in January 2022. *H. 2607 (Jan. 22, 2019); S. 1936 (Mar. 29, 2021).*

5. <u>Massachusetts enacts legislation in response to federal tax reform</u>: TCJA included two significant international provisions affecting the Massachusetts corporate excise tax base. First, IRC § 965 imposes a one-time tax on the post-1986 foreign earnings of certain U.S.-owned foreign subsidiaries not yet repatriated to, or taxed by, the U.S. The deemed repatriation requires taxpayers to include these untaxed earnings in federal gross income (as a subpart F inclusion) in their last tax year beginning before January 1, 2018. Deemed repatriation income is eligible for a deduction under IRC § 965(c) in the amount necessary such that the deemed repatriation amount is taxed at an effective rate of either 15.5% or 8% (depending on the extent to which the deemed repatriation relates to income held as cash or non-cash assets). Second, effective for tax years beginning on or after January 1, 2018, IRC § 951A requires taxpayers to include in federal gross income their global intangible low-taxed income ("GILTI"). GILTI is intended to capture low-taxed intangible income earned by certain U.S.-owned foreign subsidiaries. GILTI income is subject to a partial deduction (up to 50%) under IRC § 250(a)(1)(B). The TCJA also introduced a related deduction for foreign-derived intangible income ("FDII") under IRC § 250(a)(1)(A), intended to incentivize taxpayers to hold intangibles that generate foreign income in the U.S.

   On October 23, 2018, Governor Baker signed legislation explicitly providing that deemed repatriation income under IRC § 965 and GILTI under IRC § 951A are treated as dividends subject to Massachusetts 95% dividends received deduction ("DRD"). Because these amounts are treated as dividends, they are excluded from the sales factor. The legislation also disallows the partial deemed repatriation deduction under IRC § 965(c), the partial GILTI deduction under IRC § 250(a)(1)(B), and the FDII deduction under IRC § 250(a)(1)(A). *Chapter 273, Acts of 2018.*

B. Judicial Developments

1. <u>Supreme Judicial Court ("SJC") holds Department lacks statutory to tax out-of-state corporation on the gain from the sale of its in-state non-unitary partnership</u>: On May 16, the SJC held that there was no statutory authority for the Commonwealth to tax gain recognized by an out-of-state corporation from the sale of a non-unitary in-state pass-through entity subsidiary on the basis of the subsidiaries' factors. But, because the court also held that taxing such gain does not violate the U.S. Constitution, the

decision may allow the Commonwealth to tax such gain in the future if it legislature so decides.

The taxpayer was an LLC formed under Florida law and classified as a Subchapter S corporation for federal and Massachusetts tax purposes. The taxpayer held a 50% membership interest in Cloud5, an LLC operating in Massachusetts, formed under Massachusetts law, and classified as a partnership for federal and Massachusetts tax purposes. Cloud5's remaining 50% ownership was held by two Massachusetts residents who were unrelated to the taxpayer.

During 2013, the taxpayer sold its 50% interest in Cloud5, resulting in the gain at issue. Under the Department's regulations, 100% of the gain was attributed to Massachusetts because the sum of Cloud5's property and payroll factors were greater in Massachusetts than any other state.

At the Appellate Tax Board ("ATB"), the taxpayer argued that apportioning its income using Cloud5's factors (so-called "investee apportionment") in the absence of a unitary relationship between it and Cloud5 violates the unitary business principal. The ATB disagreed, holding that Massachusetts could constitutionally tax the gain because the income had sufficient nexus with the state, notwithstanding the lack of the unitary relationship: "the protection, opportunities and benefits afforded by Massachusetts, for Constitutional purposes, supplied the requisite connection between Massachusetts and business activities that resulted in the Sale Gain."

The taxpayer argued before the SJC that the unitary business principle is the sole test governing a state's power to tax extraterritorial value earned by an out-of-state corporation from its investment in an in-state subsidiary, and therefore, imposing tax solely based on the investee entity's presence in the state was unconstitutional. The SJC disagreed that the US Constitution required a unitary business, but nonetheless granted the taxpayer its requested refund on the basis that Massachusetts statute imposed tax by reference to the unitary business. As written, the statute did not permit taxation to full extent permitted by the US Constitution. *VAS Holdings & Investments LLC v. Commissioner*, 489 Mass. 669 (2022).

2. <u>ATB disallows taxpayer from computing gain without regard to basis adjustments occasioned by depreciation that produced no Massachusetts tax benefit</u>: The case involved an individual taxpayer's minority ownership interest in three limited partnerships that owned urban redevelopment projects under G.L. c. 121A, § 6A. So-called "Chapter 121A" projects allowed taxpayers to receive favorable tax treatment with respect to income from qualifying investments in blighted areas. In lieu of

individual or corporate income tax, qualifying income from such projects was subject to favorable tax treatment provided in Chapter 121A.

The first issue in the appeal was whether the favorable Chapter 121A treatment for income from qualifying investments extended to *gain* from the sale of the investments, such that the gain was exempt from income tax. Viewing the Chapter 121A treatment as an exemption from income tax, the ATB narrowly construed its application. The ATB concluded that the special Chapter 121A treatment was limited to income from qualifying investments, and did not apply to gain from the disposition of the investments. The gain was therefore was subject to income tax.

Having concluded the sale gain was subject to income tax, the second issue was how to compute that gain. The taxpayer sought to compute its gain without regard to federal basis adjustments occasioned by depreciation on the redeveloped property that produced no Massachusetts tax benefit. The ATB recognized that a taxpayer may be able to compute gain without regard to federal basis adjustments in certain circumstances—for example, when the federal depreciation produced no Massachusetts tax benefit because the federal depreciation rules in effect during a property's depreciable life differed from the Massachusetts rules in effect during the same period. In this case, however, the federal depreciation produced no Massachusetts tax benefit for a different reason: the special tax benefit granted to the taxpayer through Chapter 121A treatment. According to the ATB, computing the gain differently for Massachusetts income tax purposes in such a circumstance would amount to granting the taxpayer a greater benefit than the legislature intended through the Chapter 121A scheme. *Reagan v. Comm'r*, ATB Docket No. C332548, 2021 MASS. TAX LEXIS 16 (Aug. 18, 2021).

Although the ATB disallowed relief in this case, it has in other contexts allowed taxpayers to compute gain without regard to certain federal basis adjustments. Taxpayers recognizing gain that is a consequence of federal basis adjustments such as depreciation, and consolidated return rules, should carefully evaluate the case law in this area.

3. Appeals Court affirms ATB ruling that litigation awards and settlement payments are sourced to taxpayer's Massachusetts domicile: On January 27, 2021, the Appeals Court issued a decision addressing the sourcing of litigation proceeds under Massachusetts' costs of performance statute (effective for tax years beginning before January 1, 2014).

SynQor, Inc. was headquartered in Massachusetts and used patents to manufacture tangible personal property worldwide. SynQor sued several third party defendants in federal District Court in Texas claiming damages for unauthorized use of its patents. As a result of the suits, SynQor received three types of receipts: (1) jury-awarded lost profits and royalties for patent infringement, supplemental damages, civil contempt sanctions, costs, attorneys' fees, and interest; (2) settlement payments; and (3) royalties (the royalties were paid to SynQor after the federal court enjoined defendants from selling products incorporating SynQor's patented technology). SynQor filed its Corporate Excise Tax returns for the 2011 and 2013 tax years by including all the lawsuit proceeds in its sales factor numerator and denominator. It then filed a refund claim.

During the tax years at issue, Massachusetts statute required taxpayers to source sales other than sales of tangible personal property to Massachusetts if the greater proportion of the income producing activity occurred in Massachusetts, based on the location of the costs of performance. The Department's regulation in effect provided that "receipts from the enforcement of legal rights by taxpayers domiciled in Massachusetts are presumed to be attributable to Massachusetts . . . unless the legal dispute or claim relates directly and exclusively to real or tangible personal property of the taxpayer located outside the Commonwealth." Relying on its regulation, the Commissioner argued—and the ATB agreed—that SynQor's receipts from the patent suits were presumed to be attributable to Massachusetts, because the company was headquartered in Massachusetts and the receipts did not relate to property located outside the Commonwealth.

SynQor proposed three alternative methods to source the receipts from the patent suits. First, the company argued that the receipts should be sourced based on its average Massachusetts sales factor during the period in which the patent infringement occurred. (SynQor relied on a California State Board of Equalization decision employing that methodology to source litigation proceeds.) The ATB rejected this method because (among other reasons), SynQor's receipts were not lost profits. Even if the receipts could be characterized as representing lost profits, there was no evidence that SynQor's actual sales of tangible personal property during the period had any relation to the infringing companies' locations.

Second, SynQor argued that the receipts should be sourced using Massachusetts' method for sourcing receipts from licensing intangible property. Under this method, the receipts would have been sourced to the commercial domicile of each of the infringing companies, because SynQor would have received licensing fees from each of the infringing companies if it had authorized them to use the patents. The ATB rejected this method, because (among other reasons) SynQor's business model was selling tangible personal property—not licensing intangible property—so there was no basis to presume it would have received licensing receipts from the infringing companies.

Third, SynQor argued it should have been entitled to exclude the receipts from its sales factor entirely, based on the method that the Department adopted for sourcing litigation proceeds in regulations that went into effect for tax years after those covered by SynQor's appeal. The ATB rejected this method on the basis that the Commissioner's sourcing rule for litigation proceeds applicable to later years "could not inform the interpretation of the Commissioner's long-standing regulation in effect during the tax years at issue."

On January 27, 2021, the Appeals Court affirmed the ATB's decision in a short unpublished decision. *SynQor. Inc. v. Commissioner*, Massachusetts Appeals Court Docket No. 19-P-1695 (2021).

4. Appeals Court holds that Indiana's utility receipts tax ("URT") is deductible, overturning ATB decision: The Appeals Court recently held that Indiana's URT is deductible from the income measure of the corporate excise tax because it is not a franchise tax imposed for the privilege of doing business. Massachusetts requires taxpayers to add back to federal taxable income net income taxes and "franchise taxes for the privilege of doing business" imposed by other states.

Indiana statute calls the URT an "income tax," but it is imposed on taxable gross receipts from the retail sale of utility services for consumption. The Appeals Court held that the URT was not imposed on the privilege of doing business, first, because it was imposed on certain receipts only therefore was not imposed on the taxpayer as a whole. Second, the Court found it was not relevant that the URT statutory language stated it was imposed as a condition to doing business in the state. That statutory language did not change the fact that the statute was imposed on certain receipts rather than certain whole taxpayers. Third, the Court found the URT was akin to a sales tax because it had a compensatory use tax component intended to capture receipts from utility services delivered in Indiana by out-of-state vendors. *Bay State Gas Co. & Affiliates v. Commissioner, 157 N.E.3d 660 (Mass. App. 2020).*

In response to the Appeals Court's decision in *Bay State Gas*, on February 4, 2022, the Department issued TIR 22-4 to provide guidance to taxpayers on the application of the Appeals Court's decision to the deduction for taxes imposed by other states. In the TIR, the Department reaffirms its positions in Directives 08-7 and 99-9 that Massachusetts law does not allow a deduction for income and franchise taxes, which is correlated to taxes imposed on a corporation's business as a whole. What is deductible are transactional taxes imposed on separate business activities. Although the Appeals Court determined that the Indiana URT was fundamentally similar to a transaction tax on retail sales, the Department advises taxpayers that Directives 08-7 and 99-9 continue to apply and therefore, taxpayers need to independently analyze each separate tax paid to determine if the tax is imposed on a the entirety of a corporation's business or whether the tax is a transactional tax imposed on a separate business activity. *Technical Information Release ("TIR") 22-4: Bay State Gas Company & Affiliates v. Commissioner of Revenue – Deductibility of Indiana Utilities Receipts Tax (February 4, 2022).*

5. <u>ATB upholds single-factor apportionment for corporation using third party contract manufacturers; follow-up cases apply manufacturing test</u>: The ATB issued findings of fact upholding the Department's determination that the activities of a corporation's U.S.-based design team constituted manufacturing, notwithstanding that the creation of the physical products was performed by third party contract manufacturers located outside the U.S. As a result, the company was required to apportion its income using a single sales factor, rather than the standard three-factor formula.

The taxpayer, Deckers Outdoor Corporation, was headquartered in California and had between 350 and 900 U.S.-based employees. In addition to corporate offices and distribution centers, Deckers maintained a warehouse in California to hold materials (e.g., shoe fabrics) used by its designers to create shoe prototypes. Deckers did not perform mass production of shoes in the U.S. Rather, Deckers used third-party contract manufacturers in China and Macau. Deckers used subsidiaries in those countries to engage the third party manufacturers and oversee their operations.

The Court focused heavily on the testimony of Deckers' Chief Operating Officer, who described the activities of Decker's U.S.-based employees. Those employees were responsible for initial shoe concepts, product design, and material and color selection. The U.S. team would send two-dimensional drawings to its China and Macau teams, who would work with a third party contract manufacturer to create a prototype. After several redesigns and multiple prototypes, the U.S. team would create a "tech pack", a document detailing the final shoe's specifications. The third party manufacturers would use the tech pack to get the shoe into mass production.

The Board concluded that Decker's activities fit into the statutory definition of manufacturing: transforming "raw or finished physical materials by hand or machinery, and through human skill and knowledge, into a new product possessing a new name, nature, and adapted to a new use." The Board focused on the involvement of the U.S. team in the design process—specifically the physical handling of materials for designs and redesigns, and the importance of the tech packs in creating a unique product necessary for mass production. *Deckers Outdoor Corp. v. Comm'r of Revenue*, ATB Docket Nos. C320020 & C321955 (Jun. 21, 2018).

- *Samsonite, LLC v. Commissioner*

In contrast to the *Deckers* decision, a Massachusetts-based taxpayer was successful in challenging the Department's refusal to acknowledge its manufacturer classification for property tax purposes. The case, *Samsonite, LLC v. Commissioner*, was resolved without an ATB decision, but public documents suggest that Samsonite was successful in using the ATB's decision in *Deckers* to its advantage.

For local property tax purposes, the Department annually publishes a list of "Corporations Subject to Tax in Massachusetts." This list includes is a description of the each corporation's classification as either a manufacturing corporation or non-manufacturing corporation for local property tax purposes. Manufacturing corporations benefit from a property tax exemption for personal property.

In January of 2018, Samsonite filed Form 355Q with the Department seeking classification as a manufacturing corporation. However, when the Department published its list of Corporations online in July of 2018, it did not classify Samsonite as a manufacturer. Less than a month later, Samsonite filed a petition with the ATB seeking recognition as a manufacturing corporation. Samsonite, which is headquartered in Mansfield, Massachusetts, uses contract manufacturers to produce its products.

The test for classification as a manufacturing corporation for property tax purposes is different from the test applied for determining the classification of a corporation as a manufacturing corporation for corporate excise tax purposes. Nonetheless, Samsonite referred to *Deckers*, a corporate excise tax case, to support its position.

In its challenge, Samsonite described in detail its role in every step in its manufacturing process, including its design team activities performed in Massachusetts and its involvement in the sourcing of raw materials and testing and inspection of its products. In this way, Samsonite argued that its activities were indistinguishable from the activities of Deckers. Samsonite argued that its employees fulfilled the same role as Deckers' employees in developing the initial design, selecting raw materials, approving prototypes, and preparing a pack with detailed specifications for the contract manufacturers to use in mass production. Samsonite's appeal was resolved without a decision in early 2019. Samsonite is now included in the Department's list as a manufacturing corporation. *Samsonite, LLC v. Commissioner,* ATB Docket No. C337052 (resolved without decision).

- *Zero Waste Solutions, LLC v. Commissioner*

Unlike *Samsonite*, in *Zero Waste Solutions*, the ATB granted summary judgment upholding the Department's denial of the taxpayer's request to be classified as a manufacturer for local property tax purposes.

The taxpayer sought classification as a manufacturer for the 2019 tax year. However, in its application, the taxpayer stated that it was not currently engaged in manufacturing (as of January 31, 2019) but that it would begin manufacturing activities in May of 2019. The Department denied the taxpayer's request for a manufacturing classification because the taxpayer was not engaged in manufacturing as of January 1, 2019 (the year for which the classification was sought), as required by regulation. The taxpayer appealed the Department's denial and argued that the proper date to measure manufacturing activities was July 1, not January 1, because the property tax statutes use July 1 as the date to determine exemptions, age, ownership etc. As such, the taxpayer argued that the Department's regulatory provision requiring manufacturing to begin by January 1 frustrated the statutory purpose for the manufacturing classification, which is meant to attract new industries and manufacturing to the Commonwealth.

In upholding the Department's denial of the manufacturing classification the ATB determined that the taxpayer's reading of the property tax statutes was incomplete because later provisions of the same statute made it clear that classification as a manufacturer under the Department's regulation was a prerequisite to application of the property tax exemptions specified in the statute. Further, the ATB concluded that January 1 was not an arbitrary date set by the Department. Rather, it was consistent with the Department's statutory mandate to provide a list of classified manufacturers, which is determined using January 1 as the benchmark. Finally, the ATB determined that the Department's application of the regulation did not frustrate regulatory intent because the Department has no authority to extend a time period set by statute. Therefore, the ATB held that January 1 was the appropriate date to use for determining manufacturing classification and since the taxpayer had not manufacturing activities on that date, the taxpayer was not a manufacturer. *Zero Waste Solutions, LLC v. Commissioner,* ATB Docket No. C337570 (Sept. 22, 2021).

- *Akamai Technologies, Inc. v. Commissioner*

In *Akamai Technologies*, the taxpayer, a software development company challenged a Department assessment computing its 2010-2012 corporate excise tax using the three-factor apportionment formula applicable to business corporations. Akamai argued that it was a manufacturing subject to single-factor apportionment under Section 38, and further argued that it must be classified as a manufacturing corporation on the Commissioner's annual List of Corporations Subject to Tax for 2017 and 2018.

Akamai internally developed software programs. For federal income tax purposes, Akamai had been classified as a manufacturer by the Internal Revenue Service, and was eligible to claim the domestic production activities deduction under IRC Section 199 because its software programs were comparable to the software as a service programs available from its competitors in tangible format and because its software platform performed virtually all of the same functions as tangible software. In 2014, Akamai applied to be classified as a manufacturing corporation in Massachusetts and also filed amended returns for its 2010-2012 tax years seeking to recompute its corporate excise tax as a manufacturing corporation.

The Commissioner originally approved Akamai's application to be classified as a manufacturer beginning January 1, 2015. However, at the end of 2016, the Commissioner revoked Akamai's manufacturing classification after concluding that Akamai was exclusively an Internet service provider of cloud computing services and their research activities were exclusively for their own internal purposes. Akamai appealed the revocation of its manufacturing classification.

On appeal, the ATB held, based on testimony and documentary evidence that Akamai engineers created, modified, improved, and oversaw the development and production of standardized software products that were provided to Akamai's customers via an SaaS model. Therefore, the ATB ruled that Akamai was engaged in manufacturing in Massachusetts from 2010-forward, and was properly classified as a manufacturing corporation for the tax years at issue in the amended returns (2010-2012) and for the 2017 and 2018 years when Akamai sought to be included as a manufacturing corporation on the Commissioner's List of Corporations Subject to Tax. *Akamai Technologies, Inc. v. Commissioner,* ATB Docket Nos. C332360, C334907, and C336909 (December 10, 2021).

In a follow-up decision, the ATB held that Akamai was also entitled to classification as a manufacturing corporation for its 2020 and 2021 tax years. *Akamai Technologies, Inc. v. Commissioner*, ATB Docket Nos. F334706-F334713, F334772-F334778, F339718, F339719, F341308, F341309, F342198-F342203, C341712, and C337558, Decision with Findings (March 10, 2022).

These cases have been appealed to the Appeals Court and briefing is ongoing.

6. Comcast cost of performance case reaches its conclusion in appellate courts: In November 2017, the ATB issued a decision in favor of the Department in 12 related appeals filed by various Comcast affiliates. *Comcast of Massachusetts I, Inc., et al. v. Commissioner,* ATB Docket Nos. C321986, C321987, C321988, C321989, C321990, C321991, C321992, C321993, C321994, and C322268 (Nov. 10, 2017). The taxpayers in these appeals (which we will refer to collectively as the "Comcast Entities") filed refund claims revising their apportionment fractions under Massachusetts' cost of performance sourcing rules, and also appealed a variety of audit adjustments.

   The largest issue in the appeals involved the sourcing of the Comcast Entities' receipts from video and internet services provided by the entities to Massachusetts-based customers. Several of the Comcast Entities (the "in-state Comcast Entities") provided services solely to Massachusetts-based customers pursuant to franchise agreements that had been entered into with various Massachusetts localities.

   The Department argued that the in-state Comcast Entities were not entitled to apportion their income. The Department requested summary judgment against several of the in-state Comcast Entities on this issue. At the hearing, the Department argued that all of the income-producing activity for each of the in-state Comcast Entities occurred in Massachusetts, and therefore, a cost of performance analysis was not necessary. Interestingly, the Department argued that if the ATB found that the income-producing activity of these entities was performed in both Massachusetts and another state, it would apply an operational approach, not a transactional approach in applying its cost of performance analysis.

   Comcast argued that the in-state Comcast Entities performed their income-producing activities in multiple jurisdictions. Furthermore, it argued that in applying a costs of performance analysis to each of those entities, it should consider costs incurred by affiliated entities, not just by the in-state Comcast Entities.

   Despite these arguments, the ATB entered an order deciding the cases in favor of the Department and published Findings of Fact and Report on November 10, 2017. The Comcast Entities appealed to the Appeals Court, which affirmed the ATB's order on April 26, 2019. An application for review was filed with the SJC, but was denied on June 28, 2019. *Comcast* *of Massachusetts I, Inc., et al. v. Commissioner*, 95 Mass.App.Ct. 1110 (2019) *appeal denied* 482 Mass. 1105 (2019).

C. Administrative Developments

1. Department explains SALT cap workaround: Massachusetts enacted a work-around for the TCJA's $10,000 cap on the federal deduction for state and local taxes, effective for tax years beginning on or after January 1, 2021. The work-around allows a pass-through entity, such as an S corporation or partnership (including an LLC classified as a partnership for federal income tax purposes) to elect to pay a 5 percent entity-level tax, and then allows the qualified members (natural persons and certain trusts) of the entity to claim refundable tax credits for 90 percent of their respective shares of the entity-level tax.

   On March 18, 2022, the Department finalized its December 31, 2021 working draft TIR explaining the pass-through entity tax (there were no material changes between the working draft and final TIR). The TIR largely follows the statutory provisions, for example: that the election to be subject to the entity-level tax must be made on a timely filed original return and may not be made on an amended return; all members are bound by the election; and the election is made annually and is irrevocable for a given year. The working draft includes additional rules, including rules on the computation of the tax when the pass-through entity has members that are not natural persons, and estimated payments. *TIR 22-6: Pass-through Entity Excise (Mar. 18, 2022).*

2. Department explains Massachusetts coordination with Centralized Federal Partnership Audit regime: The CFPA regime, effective for tax years beginning on/after January 1, 2018, moved aspects of federal audits of partnerships from the partner level to the partnership level—in particular, underpayments are assessed and collected at the partnership level, rather than at the partner level. In 2021, Massachusetts enacted rules to coordinate its audit and report of federal change rules with the CFPA rules. On January 6, 2022, the Department released a TIR explaining the new coordination rules, and the duties imposed on partnerships and partners triggered by federal audit changes. *TIR 22-1: Reporting Rules Related to Centralized Federal Partnership Audits (Jan. 6, 2022).*

3. Department explains impact of CARES Act: The federal government's modifications to the IRC enacted through the Coronavirus Aid, Relief, and Economic Security ("CARES") Act (P.L. 116-136) impacted the Massachusetts corporate excise tax. This is because the corporate excise tax base starting point is federal gross income (as defined by IRC § 61) minus the deductions allowable under the IRC. The Department issued a TIR providing guidance to taxpayers regarding the impact of the CARES Act. The TIR concludes that Massachusetts: conforms to the exclusion

from gross income for cancellation of indebtedness income arising out of loans under the paycheck protection plan; conforms to modifications to the IRC § 163(j) interest expense limitation; conforms to modifications to the charitable contribution deduction limitation; and does not conform to federal changes to the net operating loss carryover deduction, for purposes of computing the corporate excise tax. *TIR 20-9: Massachusetts Tax Implications of Selected Provisions of the Federal CARES Act (Jul. 13, 2020).*

Consistent with existing law and Department guidance, taxpayers that file as a combined group are permitted to share the CARES Act-modified excess interest expense limitation and charitable contribution deduction limitation among combined group members.

4. <u>Department's regulation imposing tax on nonresident employees working from home expires</u>: The Department adopted several measures that effectively treated an employee working from home due to employer or government COVID-19 safety measures as working from his or her work location immediately before the pandemic. Those measures expired on September 13, 2021. Accordingly, after September 13, income earned by non-resident employees should be sourced based on where they actually work, regardless of where they worked prior to COVID-19. For non-resident employees who started a new job on or after March 10, 2020 (the day the COVID-19 state of emergency was declared in Massachusetts), the special rules do not apply and income should be apportioned based on actual days worked in and out of Massachusetts.

Prior to September 13, 2021, while the special rules were in effect, an employer was required to continue to withhold personal income taxes for an employee who was working in Massachusetts before COVID-19, but was working from home outside the Commonwealth during the pandemic. Conversely, an employer would not have had a withholding tax obligation with respect to employees working remotely in Massachusetts solely due to government pandemic responses, remote work policies adopted by an employer in good faith, or quarantine circumstances.

New Hampshire perceived Massachusetts' attempt to tax its residents working from home as an infringement on its sovereignty, and sought to file an original jurisdiction action before the U.S. Supreme Court. But on June 28, 2021, without a written decision, the Supreme Court declined to hear the case. Because the regulation is no longer in effect, New Hampshire's concerns are moot going forward. However, the extent to which states can tax nonresidents working from locations out of state certainly is not, and is the subject of ongoing litigation in other states. *New Hampshire v. Massachusetts*, No 154, ORIG, 2021 U.S. LEXIS 3408 (Jun. 28, 2021).

The temporary regulation also had corporate excise tax consequences. A corporation is generally considered to have nexus with Massachusetts if it has an employee working in the Commonwealth, even if that employee is working from a home office. The Department's now-expired COVID-19 guidance provided that a corporation would not be considered to have nexus solely due to the presence of employees in the Commonwealth as a result of COVID-19 safety measures. For apportionment purposes, an employee working in the Commonwealth solely due to the pandemic will not be included in the company's payroll factor numerator, and the presence of business property in the state will not increase the company's property factor numerator. *Regulation 830 CMR 62.5A.3: Massachusetts Source Income of Non-Residents Telecommuting due to the COVID-19 Pandemic (Mar. 5, 2021); TIR 20-10: Revised Guidance on the Massachusetts Tax Implications of an Employee Working Remotely due to the COVID-19 Pandemic (Jul. 21, 2020).*

5. <u>Department finalizes Brownfields Tax Credit Regulations</u>: The Department finalized regulations addressing various aspects of the Brownfields tax credit available for costs incurred to remediate and maintain environmentally damaged property in economically distressed areas. The regulations provide rules defining an eligible person that may claim the credit, what constitutes an eligible cost for which a credit may be claimed, credit limitations, credit carryforwards, selling and assigning credits, credit recapture, and appeals procedures for denied credits. *Regulation 830 CMR 63.38Q.1: Massachusetts Brownfields Tax Credit (Jul. 23, 2021).*

6. <u>Department adopts hybrid separate company/combined group approach to federal interest expense limitation</u>: On December 19, 2019, the Department finalized a TIR addressing the application of the new federal interest expense limitation introduced by the TCJA to Massachusetts corporate excise taxpayers. New IRC § 163(j) generally limits a corporation's deductible interest to business interest income plus 30% of adjusted taxable income (generally, taxable income before NOL, interest, and depreciation).

   First, the draft TIR recognizes that Massachusetts follows the interest expense limitation as a result of using federal gross income and federal deductions as the starting point for the corporate excise tax. The TIR then states that taxpayers must compute the interest expense limitation on a separate company basis. To the extent that a separate company's interest expense is limited, the company can share that interest expense with other members of its combined group to the extent that other members have an excess interest expense limitation. The TIR also provides special rules for carrying interest expense forward, and to account for interest expense carryforwards when a combined group member leaves or enters the group.

The Department's proposed approach is generally taxpayer friendly. First, by testing the limitation on a separate-company basis, taxpayers get the benefit of applying the small business exemption on a separate company (rather than combined group) basis. As a consequence, any combined group member with gross receipts of $25 million or less will not be subject to the limitation. Second, by allowing group members to share excess interest expense among group members, taxpayers get the benefit of effectively testing the limitation on a combined group basis. Third, the draft TIR states that taxpayers must reduce interest expense by the amount of any add back before applying the interest expense limitation. Applying add back before the interest expense limitation should generally result in less interest expense being denied than would be the case if the interest expense limitation were applied before add back. *TIR 19-17: Application of IRC § 163(j) Interest Expense Limitation to Corporate Taxpayers (Dec. 18, 2019).*

7. <u>Department guidance on deemed repatriation and GILTI raises alternative apportionment questions</u>: On August 8, 2019, the Department issued TIR 19-11 addressing the international provisions of federal tax reform. (The TIR updates the Department's prior guidance, TIR 18-11, issued on October 4, 2018, to reflect legislation enacted on October 23, 2018.) The TIR suggests that taxpayers cannot claim alternative apportionment for dividends, subpart F inclusions, deemed repatriation income, or GILTI. To the extent that the TIR reaches that conclusion, we disagree.

   The TIR concludes that the deemed repatriation amount is not included in the sales factor because the deemed repatriation "does not implicate" a taxpayer's apportionment. The Department reasons that the 5% portion of the deemed repatriation not covered by the Massachusetts dividends received deduction is intended as an expense disallowance and, in general, an expense disallowance does not implicate apportionment. Rather than supporting the Department's conclusion, the TIR relies on statutory authority that supports the opposite conclusion. G.L. c. 63, § 30.4 states that the inclusion is "in lieu of"—i.e., is not—an expense disallowance. Under this view, a taxpayer should not be foreclosed from petitioning the Department or courts for alternative apportionment if the lack of sales factor representation for the deemed repatriation (or GILTI or Subpart F) results in distortion. *TIR 19-11: Legislation Impacting the Massachusetts Tax Treatment of Selected International Provisions of the Federal Tax Cuts and Jobs Act (Aug. 8, 2019).*

8. <u>Massachusetts conforms to federal treatment of investments in qualified opportunity zones</u>: On June 17, 2019, the Department issued TIR 19-7 addressing Massachusetts' treatment of investment in qualified opportunity zones ("QOZ"). The TCJA created QOZs as a new incentive to invest in areas identified as economically distressed or low-income. To claim a benefit, a taxpayer must invest in a qualified opportunity fund. A

qualified opportunity fund is an investment vehicle organized to hold assets in areas designated by the U.S. Department of Treasury as a QOZ. The new federal rules allow certain investors to defer certain capital gains by reinvesting proceeds in a qualified opportunity fund. Gain on reinvested proceeds are then deferred until the taxpayer sells its investment in the qualified opportunity fund, or December 31, 2026. Moreover, any appreciation in an interest in a qualified opportunity fund may be excluded from income when the interest is ultimately sold.

The TIR states that for corporate excise purposes, Massachusetts follows the federal QOZ rules as a result of using federal gross income as the income tax base starting point. As of this writing, there were 138 designated zones across the Commonwealth. *TIR 19-7 Massachusetts Treatment of Investments in Qualified Opportunity Zones (June 17, 2019).*

9. Department issues guidance for taxpayers changing from accrual to cash method of accounting: On May 14, 2019, the Department issued TIR 19-6 providing guidance to corporate excise taxpayers who change their federal income tax method of accounting. The TIR was issued because of a change made by the TCJA that allows taxpayers with average gross receipts of $25 million or less to use the cash method of accounting. (Before the TCJA, the threshold was $5 million).

   The TIR states that because business corporations determine their Massachusetts tax base by reference to federal gross income, a corporation that changes its federal accounting method must likewise change its Massachusetts corporate excise tax accounting method and file IRS Form 3115 with its Massachusetts return.

   The TIR also addresses Massachusetts' conformity to the IRC rules that account for any duplication or omission from income as a result of an accounting method change. The TIR states that Massachusetts conforms to the federal accounting method change adjustments to the income tax base because Massachusetts conforms to the federal definition of gross income. However, Massachusetts does not conform to the federal accounting method change adjustments to a person's federal tax liability because such adjustments are not reflected in federal gross income, and thus, not reflected in the Massachusetts tax base. *TIR 19-6: Impact of the Federal Tax Cuts and Jobs Act on a Taxpayer's Overall Method of Accounting for Massachusetts Purposes (May 14, 2019).*

10. Department finalizes changes to NOL regulation: On March 20, 2020, the Department promulgated its revised regulation 830 CMR 63.30.2: Net Operating Loss Deductions and Carryforwards. The revisions modernize the regulation to conform to various statutory changes that have occurred since the regulation was originally promulgated in 1993, including combined reporting and an extended carryover period. The revisions also

streamline the regulation by removing references to the separate start-up corporation NOL deduction, and by simplifying the carryforward calculation for losses applicable to a periods before a corporation becomes subject to Massachusetts taxation. A working draft of the regulation was issued in April of 2019, and the regulation was proposed in November of 2019. *830 CMR 63.30.2: Net Operating Loss Deductions and Carry Forward (Mar. 20, 2020)*.

11. Department finalizes amendments to corporate nexus regulations to add language regarding *Wayfair*: On October 18, 2019, the Department promulgated its final amendments to regulation 830 CMR 63.39.1: Corporate Nexus. The process for revising this regulation began on December 19, 2017, when the Department proposed amendments to the corporate nexus regulation. The draft amendments did not make significant substantive changes to the current corporate nexus regulations. Rather, the draft regulation proposed to simplify and modernize the regulation. On May 3, 2019, The Department revised the proposed regulation by adding a paragraph indicating that, consistent with the Supreme Court's decision in *South Dakota v. Wayfair*, a corporation that does not have other nexus-creating contacts with the state will nonetheless have nexus if it has "considerable" in-state sales derived through economic or virtual contacts. The revised proposed regulation also added language to the section discussing the application of P.L. 86-272 to clarify that P.L. 86-272 is not applicable to corporations selling services or licenses of intangible property in Massachusetts and that any activity that is not entirely ancillary to solicitation will exceed the limits of P.L. 86-272. The Department finalized the regulatory amendment in October, 2019, incorporating the *Wayfair* and P.L. 86-272 language proposed in May 2019. *830 CMR 63.39.1: Corporate Nexus (Oct. 18, 2019).*

D. Hot Issues for 2022 - 2023

1. Massachusetts resolves case challenging Department's forced inclusion of insurance subsidiary in combined group: It has been common in recent years for the Department to challenge taxpayers' classifications of certain entities for corporate excise tax purposes. The Department has also been aggressive in challenging the classification of corporations as insurance companies. In a case recently resolved without litigation, a taxpayer challenged the Department's ability to deny insurance company treatment to a captive insurer.

   The case involves a Massachusetts combined group engaged in the production of scientific and analytical instruments, equipment, software, and reagents used in manufacturing and research and development applications. At audit, the Department asserted that a Bermuda insurance company affiliated with the group was not an insurance company for corporate excise tax purposes and, therefore, required to be included in the combined group for purposes of computing the tax.

Under G.L. c. 63, § 32B(c)(1), a corporation that qualifies as an insurance company for federal income tax purposes under either Section 816(a) or Section 831(c) of the IRC is excluded from a combined group. In challenging the assessment, the taxpayer is arguing that the insurance company made a valid election under IRC 953(d) to be taxed as US corporation and that such election is only available to insurance companies qualified as such under IRC §§ 801-847. Because the IRS audited the years covered by the Massachusetts audit and did not challenge the entity's status as an insurance company, the taxpayer argued that the insurance-company classification should be followed by Massachusetts. In doing so, the taxpayer also directly challenged a Department policy that dates back to 2008. The policy, expressed in TIR 08-11, is that captive insurance companies are generally included in a Massachusetts combined group. The TIR provides no analysis or reasoning in support of this policy. However, the effect of the policy is to create a presumption that all transactions with a captive insurance company have a tax avoidance purpose. The taxpayer argued that the distinction between a captive insurer and a non-captive insurer is not relevant to the statutory analysis used to determine whether a corporation is included in a combined group. The combined reporting statute simply provides that an insurance company qualified under IRC § 816(a) or IRC § 831(c) is excluded from the combined group.

The case was filed at the ATB and resolved without litigation in 2021.

2. Massachusetts applies the "duty of consistency" to prevent taxpayer from claiming double-deduction: In a recent case, the Appeals Court found a taxpayer could not change the treatment of a loss-generating transaction in a prior closed year to take, in essence, the same deduction again in the current tax year.

In 2007, the individual taxpayer treated a refinancing of a rental property as a deemed sale and recognized a loss. The taxpayer used that loss to reduce his 2007 and 2008 Massachusetts personal income tax by $200,000. In 2011, the taxpayer sold the property, which resulted $365,078 of Massachusetts tax on the gain. The taxpayer then filed a refund claim, on the premise that his treatment of the 2007 sale was erroneous, and as a consequence, he should be entitled to compute his 2011 gain as if the 2007 transaction were not a deemed sale. Changing the treatment of the 2007 transaction would have resulted in the taxpayer recognizing no gain in 2011.

The taxpayer argued that his treatment in the initial 2007 transaction was incorrect because Massachusetts does not recognize fictional or deemed transactions. The ATB disagreed, and held that the taxpayer's treatment on his 2007 return was correct. As a consequence, his 2011 gain could not be recomputed as if the 2007 transaction did not happen, and he was not entitled to a refund.

The Appeals Court affirmed on an alternative basis. Rather than determine whether Massachusetts recognized the 2007 transaction as a deemed sale, the court adopted the federal doctrine of "duty of consistency" to disallow the treatment sought by the taxpayer. The court established the duty applies when a taxpayer makes representations in one year that produces a tax benefit, the Commissioner acquiesces to or relies on those representations, and the taxpayer attempts to change the representation or characterization in a way that harms the commissioner due to the statute of limitations.

The adoption of the duty of consistency may give taxpayers the ability to argue that the Department should be held to the same standard in the opposite situation—for example, if a taxpayer improperly recognizes *gain* in an earlier closed year and the Commissioner seeks to disallow a related loss in a later open year. *Pogorelc v. Commissioner, 98 Mass. App. Ct. 41 (2020).*

3. <u>Department's position that taxpayers must include foreign tax credit gross-up in Massachusetts income susceptible to challenge</u>: TIR 19-11, addressing the international provisions of federal tax reform, takes the position that taxpayers must include the foreign tax credit gross-up under IRC § 78 in Massachusetts income (subject to Massachusetts' 95% DRD). The TIR instructs taxpayers that failed to include in income the gross-up relating to the deemed repatriation to amend their returns. In our view, taxpayers may be able to take the position that the Massachusetts Constitution prohibits the Commonwealth from taxing the gross-up because the gross-up is fictional or phantom income.

A taxpayer who elects to claim a federal foreign tax credit for Subpart F income, deemed repatriation income, or GILTI is required to include the amount of foreign taxes paid on that income in its federal gross income. This fictional inclusion is referred to as the IRC § 78 foreign tax credit "gross-up", and is required solely to properly compute the benefit of the foreign tax credit. Massachusetts does not provide a foreign tax credit, but still taxes 5% of the gross-up. We would argue that the inclusion of any portion of the gross-up in Massachusetts taxable income would violate the Massachusetts Constitution because the gross up is not "income." The SJC has interpreted Article 44 of the Massachusetts Constitution, which allows the Commonwealth to "levy a tax on income", as a limitation on the Commonwealth's taxing power. *See Bill DeLuca Enterprises, Inc. v. Commissioner of Revenue*, 431 Mass. 314 (2000) ("'income' must be rationally construed and not stretched to include purely theoretical as distinguished from practical conceptions. Income as a subject to taxation imports an actual gain."). Taxpayers that did not include the gross-up on their original returns should consider whether amending their return is necessary. Taxpayers that did include the gross-up on their original return may be entitled to a refund.

4. Department Treats "Check-the-Box" Election as a "Sham" and Ignores Federal Disregarded Entity Treatment: In a pending ATB case, the Department's broad application of the sham transaction doctrine is coming under attack. The Department of Revenue ("Department") has a long history of asserting the sham transaction doctrine against taxpayers. A recent petition filed with the ATB demonstrates that the Department is now taking the position that it can ignore a federal election made by a foreign entity to be disregarded as a separate entity from its owner, on the basis that the election was a "sham". If the Department's position is upheld, it could have sweeping implications for any taxpayers that have structured their business operations in a way that had the effect of reducing their corporate excise tax liability.

The taxpayer involved is a parent holding company for a group of U.S. and foreign corporations. The holding company was formed in 2006 in connection with a corporate spin-off transaction. As part of the spin-off, the holding company elected to treat an entity incorporated and doing business in Portugal as a disregarded entity for U.S. federal income tax purposes.

The Department audited the holding company's 2009 corporate excise tax return. Although the holding company did not have any property, payroll, or sales of its own, the Portuguese subsidiary's factors were included in its apportionment fractions because the Portuguese subsidiary was a disregarded entity. This treatment was consistent with G.L. c. 63 § 30, which provides that "without limitation, all income, assets, and activities of [a disregarded entity] shall be considered to be those of the owner."

The Department applied the sham transaction doctrine to compute the holding company's apportionment fractions without taking into account the factors of the Portuguese subsidiary. Because the holding company had no property, payroll, or sales of its own, and had its headquarters in Massachusetts, ignoring the factors of the Portuguese subsidiary had the effect of increasing the holding company's Massachusetts apportionment from 0% to 100%.

The Department's application of the sham transaction doctrine in this instance seems aggressive. Although G.L. c. 62C § 3A places the burden on the taxpayer to demonstrate by clear and convincing evidence whether a transaction has a non-tax business purpose and economic substance, the burden is on the Commissioner to show that its adjustment was an "application of the sham transaction or any other related tax doctrine".

There is little support for applying the sham transaction doctrine to a "check-the-box" election. The federal entity classification regulations, Treas. Reg. § 301.7701-3(a), simply state that such elections are authorized "for federal tax purposes." Moreover, the U.S. Tax Court has explicitly held that a business purpose is not required for a "check-the box" election. As we move into 2021, it will be interesting to see if the ATB criticizes the Department's broad use of the sham transaction doctrine in this instance.

5. <u>Department Applied Sourcing Rule for Licensing Intangible Property to the Sale of Digital Goods</u>: A resolved case at the ATB in late 2021 involved a Department assessment of additional corporate excise tax against for the 2010 through 2013 tax years by recharacterizing a corporation's receipts from the sale of music, books, videos, and applications sold on its digital platforms (e.g., iTunes and the app store) as receipts from the licensing, rather than the sale, of intangibles. Consequently, the Department sourced the receipts based on the location of use, rather than the location of the income producing activity determined based on the corporation's costs of performance.

Under the corporate excise tax statute applicable to the tax years at issue, a taxpayer was required to source receipts from sales, other than sales of tangible personal property, to Massachusetts if the greater proportion of the income producing activity occurred in Massachusetts, based on the location of the costs of performance. Under that rule, receipts from sales of intangibles were sourced to Massachusetts only if the taxpayer incurred the greatest proportion of its costs attributable to delivering the intangible in Massachusetts. However, the statute also included a presumption that the income producing activity of a taxpayer licensing the right to use intangible assets occurred at the location where the use of the intangibles occurred (generally, this was the customer location).

In this case, the Department took the position that the corporation's receipts from its sales of digital goods were receipts from licensing intangible property through its platforms, and therefore, such receipts should be sourced to the location of the customer. By treating sales of music, books, videos, and applications purchased on digital platforms as licensing transactions the Department was effectively sourcing the receipts from such sales on a market basis for tax years before Massachusetts' market sourcing legislation became effective. (The legislation was effective for tax years beginning on/after January 1, 2014.) This issue impacts taxpayers with receipts from the sale of electronically delivered goods that have open tax years before 2014.

6. <u>Department Taking Position that "Wrap Fees" are not Mutual Fund Sales</u>: The Department assessed additional corporate excise tax against an investment advisor on the theory that "wrap fees" received by the advisor should be sourced to Massachusetts for apportionment purposes, because these fees did not qualify as receipts from mutual fund sales.

   For corporate excise tax purposes, Massachusetts requires a mutual fund sales corporation to apportion its income from mutual fund sales using a single sales factor formula. A mutual fund service corporation is a corporation that generates more than half its gross income from mutual fund sales. Mutual fund sales are defined to include the provision of management, distribution or administration services to or on behalf of a regulated investment company ("RIC"). (A RIC is an investment vehicle, commonly referred to as a "mutual fund," that qualifies for special treatment under the IRC.) Under G.L. c. 63 § 38(f), a mutual fund sales corporation sources its receipts from mutual fund sales based on the domicile location of the RIC shareholders.

   In a pending case at the ATB, an investment advisor takes the position that the wrap fees qualified as receipts from mutual fund sales, because the fees were effectively earned by advertising, marketing, and selling mutual funds shares. Rather than treating the advisor's wrap fees as receipts from mutual fund sales, the Department treated the fees as receipts from services. Consequently, the Department did not classify the advisor as a mutual fund service company, and sourced the advisor's receipts to Massachusetts using the costs of performance sourcing rule (which was still in effect for the tax years at issue). This resulted in the advisor apportioning 100% of its income to Massachusetts.

7. <u>Auditors continue to aggressively challenge classification of intercompany liabilities</u>: Taxpayers continue to face audit challenges regarding (1) interest deductions for interest paid to foreign affiliates that are not members of the unitary combined group and (2) the classification of liabilities to affiliates as "true debt" for net worth purposes.

   A resolved case at the ATB highlights the issue. In the appeal, members of an affiliated group borrowed funds from a Hungarian affiliate and deducted interest paid to the affiliate in computing the group's combined income. The group claimed an exception to addback on interest paid to the Hungarian affiliate because Hungary has a comprehensive income tax treaty with the United States, the Hungarian affiliate was not a controlled foreign corporation, and the interest was deductible for federal income tax purposes. The debtor entity also deducted the value of the loan to the affiliate when computing its net worth. At audit, the Department challenged the treatment of the intercompany debt owed to the Hungarian affiliate, arguing it was not "true debt." As a result, no deduction was allowed for the interest paid to the Hungarian affiliate for purposes of computing the group's combined income, and the obligation was not treated as a liability for purposes of computing net worth.

The case illustrates that even taxpayers with seemingly strong facts supporting an addback exception and deduction for net worth related to intercompany liabilities should expect pushback at audit, and therefore, should be sure to maintain sufficient documentation to show that an intercompany obligation is true debt, and that any interest paid to a foreign affiliate is eligible for an addback exception.

8. Department argues it can reduce a taxpayer's NOL generated in a tax year that is otherwise closed by statute: A telecommunications company audited for the 2007–2009 period had an NOL carryforward that it applied to reduce Massachusetts taxable income for years during the audit period. As a result of the audit, the Department disallowed the interest deductions claimed for payments to affiliates under a cash management arrangement during otherwise closed tax years, resulting in a reduction of the taxpayer's claimed deduction for NOL carryforwards during the years included in the audit. In effect, the Department conducted an audit of a year that would otherwise have been closed by statute, in order to make adjustments that could be carried forward to open tax years.

   The taxpayer argued that the adjustments to its NOL carryforwards were invalid, in part, because the Department did not have the authority to revise its net income (or loss) for years that were otherwise closed by the statute of limitations. The case was recently resolved before the ATB.

   The position taken by the Department in this case may present an opportunity for some taxpayers. Taxpayers should consider whether adjustments to otherwise closed tax years could create or increase NOL carryforwards that can be used to reduce taxable income in open tax years.

9. Excess inclusion income for corporations and financial institutions that hold REMIC residual interests: REMICs are essentially pools of mortgages taxed on a pass-through basis for federal income tax purposes. Typically, the holders of the REMIC "residual interests" are not entitled to any payments with respect to their interests until the "regular interests" have been fully satisfied. However, under the federal income tax rules governing REMICs, residual interest holders may still be required to recognize income in years in which they receive no payments with respect to their interests. This "phantom" income recognition is referred to as "excess inclusion income".

   Mechanically, excess inclusion income is reported as an annual "true up" to the federal taxable income of a residual interest holder. Thus, REMIC residual interest holders are instructed that the taxable income they report on Line 30 of their federal income tax return (Form 1120) for each year must be no less than the excess inclusion amount. The excess inclusion amount operates as a minimum, or floor, imposed on the calculation of federal taxable income after NOL and special deductions (Form 1120, Line 30).

Many residual holders assume that excess inclusion income must also be included in net income for Massachusetts corporate income tax purposes. However, it is not clear that this treatment is correct. First, as excess inclusion income is not included in gross income for federal purposes, and the starting point for computing net income for Massachusetts corporate excise tax purposes is gross income as defined under the provisions of the IRC, excess inclusion income should not be included in the calculation of Massachusetts net income. Second, Massachusetts courts have long viewed the authorization for the imposition of an income tax in under the Massachusetts Constitution as limited to taxes imposed on "true" income, and have found taxes to be invalid to the extent they are imposed on "fictional" or "paper" income. Excess inclusion income would seem to fall squarely within the scope of fictional income—because it can be recognized by a residual interest holder independent of any distribution, disposition or other realization event.

II. Sales and Use Tax

A. Legislative Developments

1. Bills introduced to exempt zero-emissions and commercial trucks and trailers: On March 29, 2021, representatives David M. Rogers (D) introduced House Bill 3044, which would exempt from sales tax the first $50,000 on a retail sale of a "battery electric vehicle or a fuel cell powered vehicle." A similar bill, Senate Bill 1832, was also introduced the same day by Senator Brendan Crighton (D). On July 25, 2022, both bills were approved by the Joint Revenue Committee and House Bill 3044 was referred to the House Ways and Means Committee for further review.

   Separately, on March 29, 2021, bills were introduced in the House (House Bill 2959, Rep. Bradley Jones, Jr. (R)) and Senate (Senate Bill 1984, Sen. Bruce Tarr (R)) to add the definition of "rolling stock" to the tax code and exempt it from taxation. The bills define rolling stock as "trucks, tractors, and trailers, used by common carriers to transport goods in interstate commerce." On July 25, 2022, both bills were approved by the Joint Committee on Revenue and House Bill 2959 was referred to the House Ways and Means Committee. *H. 2959, H. 3044, S. 1832, S. 1984.*

2. Governor's FY 2023 budget proposal introduced remote software clarification and included daily remittance proposal: On January 26, 2022, the Governor released his proposal for the FY 2023 budget. Within this

budget proposal, the Governor proposes new language to address the taxation of remote software. Specifically, the bill proposed adding language to clarify that the purchase of a license to access remotely hosted computer software is a taxable transfer of tangible personal property. This language would have codified the Department's existing position regarding charges for access to remotely hosted software.

The bill also proposed adding a provision that, effective July 1, 2025, would require third party processors (predominantly credit card companies) to remit to the Commonwealth, on a daily basis, the portion of a sale that is attributable to sales tax. These proposals were not included in the enacted budget.

This was the fifth consecutive year the daily sales tax remittance provision has been proposed and it is expected to be proposed again in future years. *H. 2 (Jan. 26, 2022).*

3. <u>Fiscal year 2021 budget enacted, including accelerated sales tax remittance procedures to require certain third-party processors (e.g., credit card companies) to remit sales tax collected more frequently</u>: On December 11, 2020, Governor Baker signed the FY 2021 budget bill authorizing the Department to require certain vendors to remit sales tax collections earlier. The vendors are be required to remit the collected tax within a time period prescribed by the Department but prior to the monthly returns being due. The new law does not apply to vendors that remitted less than $100,000 in sales or use tax for the preceding 12 months. The law also imposes a 5% underpayment penalty. This law is similar to the law enacted as part of the FY 2018 budget but later rendered inoperable by the Department's determination that compliance with the law was not cost-effective or feasible within the time prescribed by the legislature. Since FY 2018, several budgets have included provisions that would have enacted similar accelerated remittance procedures. However, previous proposals have been removed in the House and Senate versions of the budget prior to enactment. *H. 5164.*

4. <u>The enacted fiscal year 2020 budget imposes sales tax collection responsibilities on remote marketplace facilitators</u>: On January 23, 2019, Governor Charlie Baker introduced House Bill 1 with his proposals for the Commonwealth's fiscal year 2020 budget, including a proposal to impose sales tax collection responsibilities on remote marketplace facilitators. The Governor's proposal was passed by both the House and Senate (despite industry objections) and was included in the final budget bill presented to the Governor. The law was enacted on July 31, 2019 and requires marketplace facilitators to collect sales tax for any sale made by a remote seller on its platform, if the marketplace facilitator's sales in Massachusetts exceed $100,000 in the current or prior year. There is threshold based on the number of transactions a taxpayer makes in the

Commonwealth. If the marketplace facilitator collects, reports, and remits the sales tax under this law, then the sale is not counted for purposes of determining whether the marketplace seller has substantial nexus with the state and thus is required to collect tax on its other sales. The General Assembly empowered the Department to promulgate guidance interpreting the law (*see* Section II.C.2 below). *Chapter 41, Acts of 2019.*

B. Judicial Developments

1. ATB decision striking down Department's application of "Cookie Nexus" to pre-Wayfair tax periods appealed to SJC: On December 7, 2021, the ATB promulgated its findings of fact and report in *U.S. Auto Parts Network, Inc. v. Commissioner*, which struck down the Department's assertion of nexus over remote Internet retailers for periods prior to the U.S. Supreme Court's 2018 decision in *Wayfair v. South Dakota*.

On September 22, 2017, the Department promulgated a final regulation (830 CMR 64H.1.7) imposing sales tax collection obligations on remote sellers lacking the in-state contacts that have traditionally been viewed as constituting a "physical presence" under the U.S. Supreme Court's prior precedent in *Quill Corp. v. North Dakota*. The regulation took effect on October 1, 2017 (and was subsequently withdrawn after the enactment of the statute requiring tax collection by marketplace facilitators).

The regulation required "internet vendors" to collect and remit sales tax on sales to customers in Massachusetts. "Internet vendor" was broadly defined to include vendors making sales to Massachusetts customers over the internet, regardless of whether the sales were made through the vendor's website or through the website of a third party, such as a "marketplace facilitator."

The regulation asserted that most internet vendors have physical presence in Massachusetts through their own contacts or those of a representative. Specifically, the regulation asserts that the following contacts created physical presence under *Quill*:

- In-state software;
- In-state cookies;
- Contracts with a content distribution network ("CDN");
- In-state representatives;
- Provision of additional services beyond delivery.

Any vendor that had the contacts with Massachusetts outlined in the regulation was required to collect and remit Massachusetts sales tax for its sales to Massachusetts customers so long as two conditions were satisfied during the prior calendar year:

- The internet vendor made $500,000 or more in sales to Massachusetts customers completed over the internet; and

- The internet vendor completed 100 or more transactions that were delivered to Massachusetts.

Shortly after the regulation took effect, the Commissioner contacted U.S. Auto Parts Network (“USAPN”) by letter and alleged that USAPN met the nexus criteria and failed to register and collect tax from customers as required. The Commissioner assessed USAPN and USAPN requested abatement. On appeal to the ATB, both USAPN and the Commissioner filed motions for summary judgment. USAPN alleged that it did not have physical presence under *Quill* for pre-*Wayfair* periods. The Commissioner argued that *Wayfair* overruled *Quill* and should be applied retroactively to the tax period at issue.

In holding that the Department’s regulation could not be applied to periods prior to *Wayfair*, the ATB extensively reviewed the language of the U.S. Supreme Court’s decision in *Wayfair*. In particular, the ATB noted that Wayfair itself had the same kind of contacts with South Dakota that the Department’s regulation stated constituted physical presence in Massachusetts (for example, in-state cookies). Yet, the U.S. Supreme Court clearly indicated that this activity did not amount to physical presence under *Quill*. Further, the ATB noted that the U.S. Supreme Court had specifically weighed the equities of overruling *Quill* and had emphasized the non-retroactive aspect of South Dakota’s law. Following the guidance of the U.S. Supreme Court in *Wayfair*, the ATB concluded that *Wayfair* was not to be applied retroactively and that *Wayfair* left “no doubt that [USAPN’s] Massachusetts presence in the form of the cookies, apps, and CDNs servers did not constitute physical presence within the meaning of *Quill*.

The Commissioner has appealed the ATB’s decision to the Appeals Court but the SJC took jurisdiction on Direct Appellate Review. Briefing at the SJC is scheduled to be completed by the end of September, 2022 and a hearing is tentatively scheduled for November 4, 2022 *U.S. Auto Parts Network, Inc. v. Commissioner*, Docket No. C339523 (December 7, 2021), *on appeal to Sup. Judicial Ct.*, Docket No. SJC-13283.

2. <u>SJC Affirms Refunds of Sales Tax Paid on Software Used Outside Massachusetts</u>: On May 21, 2021, the SJC affirmed an ATB decision allowing taxpayers refunds of sales tax paid on software, based on the application of the Commonwealth's multiple points of use (MPU) sourcing rules. The case involved refund claims for tax paid on software purchased

by a Massachusetts-based business (Hologic) from three different vendors. In each of the claims, the vendor (on behalf of Hologic) was seeking a refund of sales tax on sales of software to Hologic, based on the application of the Commonwealth's multiple points of use sourcing rules.

Each of the claims involved software downloaded onto a Hologic server located in Massachusetts, but used by Hologic employees located outside of Massachusetts. In each case, the vendor claimed refunds based on the percentage of Hologic users located outside of Massachusetts.

The Department denied the refund claims based on a narrow interpretation of its regulation—830 CMR 64H.1.3(15)(a). Under the Department's view, although Massachusetts has a multiple points of use sourcing rule, the rule was only available to purchasers that provided an exemption certificate to the vendor prior to the date that the tax was remitted to the Commonwealth. The ATB initially decided the case in 2017 and upheld the Department's denial of the refund claims.

However, in March 2019, the ATB, reconsidered and reversed its 2017 decision on its own motion. In the new order (a Rule 33 order), the ATB noted that, although there is a regulation requiring a purchaser of software to provide the vendor with a multiple points of use exemption certificate prior to the date the vendor remits the sales tax, that regulation also contains provisions that would permit the use of multiple points of use apportionment when no exemption certificate has been provided. The ATB also noted that there is no statutory or regulatory provision specifically barring a refund claim if multiple points of use data is provided to the vendor after remittance of the tax. As a result, the ATB held that the vendors were eligible to apportion the purchase price based on the user location data provided by Hologic and claim a refund, even though no exemption certificate had been provided by Hologic prior to the remittance of the tax.

Following the Rule 33 order, the Commonwealth quickly filed an application requesting that the ATB reconsider its new decision, and the taxpayers filed an opposition to the request for reconsideration. After a hearing on reconsideration, the ATB directed the parties to submit additional information in support of their positions. Finally, after additional submissions by both sides, the ATB denied the Department's motion for reconsideration and published its Findings of Fact and Report in support of its Rule 33 order.

In the Findings of Fact and Report, the ATB concluded that the Department's position requiring the provision of an exemption certificate prior to the remittance of the tax did not supersede the application for abatement process that entitles vendors to claim refunds of sales tax paid on behalf of their customers. In support of this finding, the ATB referenced other regulatory provisions that expressly prohibit taxpayers from seeking abatement in certain circumstances. In addition, the ATB noted that the regulation relied upon by the Department was specifically designed to apply to periods before its promulgation date. This undercut the Department's position that apportioning charges for software based on usage was not possible following the remittance of the tax. In addition, the ATB found the Department's position contrary to Massachusetts' general policy allowing abatement of sales tax paid in the absence of an exemption certificate.

The Department appealed the ATB's decision and the SJC took the case on direct appellate review. The SJC upheld the ATB decision that the Legislature had granted taxpayers a statutory right to apportion sales tax on sales of taxable software used, in part, outside of Massachusetts. Although the Department had been delegated authority to issue regulations implementing this statutory right, the Department could not preclude taxpayers seeking apportionment through the refund process, rather than through the exemption certificate process outlined in the regulations. *Oracle USA, Inc. et al. v. Commissioner of Revenue*, 168 NE.3d 349, (Mass. 2021).

3. <u>SJC affirms the ATB's characterization of remote-desktop access services as the taxable use of software</u>: On February 5, 2020, the SJC issued a decision in *Citrix Systems, Inc. v. Commissioner*, affirming the ATB's decision holding that sales of remote-desktop access services were sales of computer software subject to sales and use tax.

Massachusetts characterizes prewritten computer software, regardless of the method of delivery, as tangible personal property that is generally subject to sales and use tax. In 2012, the Department issued several letter rulings extending the tax to reach software as a service or cloud computing transactions where the true object of the transaction was the use of prewritten software. *See, e.g.*, Letter Ruling 12-10 (Sep. 25, 2012). Accordingly, the Department's authority to tax software as a service, application service providers, and computing transactions depends on the transaction's characterization as the use of prewritten software, which may be taxable as tangible personal property, or as a service transaction, which would generally not be taxable (unless it were a telecommunications service).

Citrix's remote-desktop access products provide customers the ability to establish a remote-access connection to a host computer. The SJC concluded that the true object of Citrix customers was the use of prewritten software and therefore, the transactions were transfers of tangible personal property subject to tax. This case was appealed to the SJC on direct review. *Citrix Systems, Inc. v. Commissioner*, 139 N.E.3d 293 (Mass. 2020).

C. Administrative Developments

1. Department issues TIR on apportioning software for sales and use tax: On May 19, 2022, in response to the SJC's decision in *Oracle USA v. Commissioner* (described above), the Department issued TIR 22-8 to provide guidance to taxpayers on the application of *Oracle* to sourcing software that is used contemporaneously in multiple places for sales and use tax purposes. In the TIR, the Department reiterates that the process outlined in the Department's regulation, 830 CMR 64H.1.3, which requires a purchaser to provide a vendor with an exemption certificate detailing the percentage of users in Massachusetts at the time of the purchase, remains a valid process for apportioning a purchase of software. The Department also restates the SJC's holding that purchasers may also seek to apportion the tax through the appeals process by filing an application for abatement pursuant to G.L. c. 62C, §37. In such cases, the TIR places the burden of proving that the apportionment methodology used to compute the tax accurately reflects the actual use of the software, or a reasonable approximation of the use, is on the purchaser. Moreover, the Department contends that a purchaser must also prove the apportioned use of the software in all states other than Massachusetts in addition to proving the portion of use attributable use within the Commonwealth. *TIR 22-8: Decision of the Massachusetts Supreme Judicial Court in Oracle USA, Inc. v. Commissioner of Revenue (May 19, 2022).*

2. Department releases proposed regulation on advanced sales and use tax, marijuana tax, and hotel occupancy tax payments: On November 23, 2021, the Department of Revenue published a proposed regulation for taxpayers subject to advanced payment of sales and use tax, marijuana tax, and hotel occupancy tax under G.L. c. 62C, § 16B. Under Section 16B of chapter 62C, effective April 1, 2021, certain vendors who collect sales or hotel occupancy tax from customers are required to remit the collected tax in advance of filing sales and use tax returns. (Prior to April 1, 2021, all vendors were permitted to remit the taxes collected at the time of filing a return.) The Department's regulation would provide additional guidance to taxpayers regarding which vendors are required to make advance payments, the timing of the advance payments, and the penalties for failing to do so.

   As detailed in the proposed regulation, the advance payment requirement, does not apply to the following taxpayers:

   - Taxpayers with less than $150,000 in tax liability on an annualized basis;
   - Quarterly or annual sales and use tax filers;
   - Taxpayers subject to the room occupancy excise tax who have no tax due during the month;
   - A materialman filing a return pursuant to G.L. c. 62C, §16(h).

For all other taxpayers, the advance payment must be made on or before the 25th day of the month that constitutes the taxable period. Where the due date falls on a weekend or holiday, the advance payment is due the next succeeding business day. The amount of the payment is the amount collected from the 1st through the 21st day of the month constituting the taxable period, and is calculated differently based on tax type. Where a taxpayer fails to pay the full amount of the advance payment, the taxpayer will be subject to a 5% penalty on the amount of underpayment. *Proposed Regulation 830 CMR 62C.16B.1: Advance Payments of Sales and Use Tax and Room Occupancy Excise.*

3. Department finalizes regulation for marketplace facilitators: On September 23, 2019, the Department issued regulations interpreting the new statutory requirements imposed on marketplace facilitators. The regulation took effect as an emergency regulation on October 1, 2019, the same date the marketplace facilitator collection requirements took effect. On December 2, 2019, the regulation received final approval and was promulgated on December 13, 2019.

   The regulation includes a detailed definition of marketplace facilitator. A person will be considered a marketplace facilitator if they contract with a marketplace seller to facilitate sales through a marketplace they operate, and provide one or more services from each list (A and B) below:

   A. One or more of the following electronic commerce services:

      - Transmitting or otherwise communicating the offer or acceptance between a buyer and the marketplace seller
      - Owning or operating the infrastructure, electronic or physical, or technology that brings buyers and sellers together
      - Providing a virtual currency that buyers are authorized or required to use to make purchases on the marketplace
      - Software development or research and development activities related to any of the logistical services described below if directly related to a marketplace operated by the person

   B. Any of the following logistical services, as provided with respect to the marketplace seller's tangible personal property or services:

      - Payment processing services
      - Fulfillment or storage services
      - Listing tangible personal property or services for sale
      - Setting prices
      - Branding sales as those of the marketplace facilitator

- Taking orders
- Advertising or promotion
- Providing customer service or accepting or assisting with returns or exchanges

The regulation also provides provisions and detailed examples to demonstrate the time period for measuring when the $100,000 sales threshold is crossed. The regulation further describes procedures for filing returns and for administration of the tax.

Finally, the regulation provides two important exceptions. First, a person is not a marketplace facilitator if they are not related to a marketplace facilitator and their sole activity with respect to marketplace sales is to provide payment processor services (a third-party payment processor). Second, a person is not a marketplace facilitator if they own or operate a marketplace that exclusively provides advertising services, so long as the person does not also engage in communication of the offer or acceptance between buyers and marketplace sellers, or contract with third-party payment processors to collect money from buyers and transmit the payment to the marketplace seller. *Emergency Regulation 830 CMR 64H.1.9: Remote Retailers and Marketplace Facilitators.*

On October 3, 3019, The Department issued a proposed regulation that was identical to the emergency regulation described above. The proposed regulation was approved and promulgated as a final regulation on December 13, 2019. *830 CMR 64H.1.9: Remote Retailers and Marketplace Facilitators.*

4. <u>Department rules that continuous glucose monitors are not exempt from sales tax</u>. The Department has ruled that continuous glucose monitors are not exempt from Massachusetts sales tax because they do not constitute medicine and they do not constitute equipment worn as a correction or substitute for a functioning part of the body. *Massachusetts Letter Ruling 22-1 (March 30, 2022).*

D. Hot Issues for 2022 – 2023

1. <u>Refunds for software used in multiple locations</u>: With the result in the *Oracle* case (described above), litigation should continue in Massachusetts for taxpayers requesting refunds on the basis that charges for software billed to a Massachusetts address should be apportioned to multiple locations under Massachusetts' multiple points of use provisions. There are now multiple appeals on the issue at the ATB involving taxpayers with a variety of fact patterns, including (1) software installed on the purchaser's servers in Massachusetts if employees access the software at locations around the country; and (2) software hosted by the vendor

outside of Massachusetts and used by employees around the country, but billed to a Massachusetts address. Taxpayers that paid Massachusetts sales tax on the full purchase price of software accessed by employees in multiple jurisdictions should consider filing protective refund claims on the issue.

2. Software services are still being taxed: Software services are still being taxed. The "object of the transaction" test outlined by the Department tilts heavily in the favor of taxing purchases that combine both software and services on the basis that the object of the customer's purchase was taxable software. For example, in publications the Department has expressed its position that merely branding a sale as a SaaS transaction—while not determinative of the tax treatment—is an indication that the object of the purchase is software, not related services. Several taxpayers, including Citrix in the case referenced above, have brought appeals to the ATB challenging the Department's application of the "object of the transaction" test. Although Citrix lost its case at the SJC, the SJC's decision leaves unanswered questions surrounding whether the level of control a taxpayer has to manipulate the underlying software is relevant to determining whether SaaS is taxable tangible personal property or a nontaxable service. Currently, there are other pending appeals filed by both SaaS and ASP vendors contending that their sales are not subject to sales tax in Massachusetts.

III. Other Taxes

A. Personal income tax conformity updated from 2005 to 2022 IRC, clarifies gross income exclusion for student loan forgiveness: The starting point for Massachusetts personal income tax was generally based on the IRC as in effect on January 1, 2005, except for certain enumerated provisions to which it conformed on a rolling basis (such as the exclusion from gross income for cancelation of indebtedness income arising from certain student loan forgiveness). The FYE 2023 budget legislation updated the generally applicable IRC conformity date for personal income tax from the IRC as it existed on January 1, 2005, to the IRC as it existed on January 1, 2022.

The budget legislation also included a provision that excludes from Massachusetts gross income cancelation of indebtedness income from certain student loan forgiveness. The language of the exclusion generally tracks the federal exclusion for student loan forgiveness income to which Massachusetts already conformed before law change. But, unlike the federal provision that applies to loan forgiveness between January 1, 2021 and December 31, 2025, the Massachusetts legislation is effective for tax years beginning on or after January 1, 2022, meaning the exclusion does not sunset on December 31, 2025. *Acts of 2022, Ch. 126 (H. 5050) (Aug. 2, 2022).*

B. <u>Digital Ad Tax Bills Introduced:</u> In February and March of 2021, multiple bills were introduced which would impose a new tax on digital advertising services provided in the Commonwealth. The bills (House Bills 2894, 2928, 3081, and 4179) vary in scope. Some bills would have enacted a 5% excise tax on digital advertising services while others would have created a commission to study the potential for a digital advertising tax.

Subsequently, on July 29, 2021 House Bill 4042 was introduced. The bill would establish a 6.25 percent excise tax on the annual revenue from digital advertising services provided within the state, except that the first $500,000 of revenue from such services would be exempted. According to the bill, the tax would apply to "advertisement services on a digital interface, including advertisements in the form of banner advertising, search engine advertising, interstitial advertising and other comparable advertising services." The term "digital interface" includes any type of software, including a website, part of a website, or an application. The bill would source the digital advertising services to the Commonwealth when received on a user's device having an IP address located within the commonwealth.

All five bills were referred to the Committee on Revenue. Hearings were held on the bills in January 2022 and the reporting date has been extended to May 4, 2022. *H. 2894 (Mar. 29, 2021); H. 2928 (Mar. 29, 2021); H. 3081(Mar. 29, 2021); H. 4179 (Mar. 29, 2021, rev. Sep. 30, 2021); H. 4042 (Jul. 29, 2021).*

C. <u>Millionaire's tax heading to the ballot in 2022</u>: On June 9, 2021, the legislature passed, for the second time, the proposed "Fair Share Amendment" to the Massachusetts Constitution. The proposed amendment would impose a 4% surtax on taxable income over $1 million, and must be approved by voters. Because the proposed amendment has now passed the legislature in two consecutive sessions, it will head to the ballot in November 2022.

Opponents of the measure sought to block the measure from being included on the November 2022 ballot, but the SJC rejected that challenge in August. Opponents were challenging the amendment on the basis that the ballot summary is misleading. The summary says that revenue raised from the measure would "dedicate revenue to education and transportation purposes." The challengers argued that is misleading because the tax does not require the Commonwealth to spend more on education and transportation—legislators could simply redirect general fund revenues away from education and transportation in an amount equal to the revenue from the new tax. The SJC previously blocked a similar millionaire's tax ballot initiative from going to voters in 2018 on the basis that it combined unrelated issues (taxation, education, and transportation) into one ballot measure, which is prohibited for citizen-initiated ballot initiatives. The new ballot initiative was not subject to that single-subject requirement because it was initiated by the legislature. *Christopher Anderson et. al. v. Healy*, 490 Mass. 26 (2022).

IV. Tax Administration

A. <u>Department proposes amended Record Retention Regulations</u>: On May 5, 2022, the Department a working draft of amendments to 830 CMR 62C.25.1 that explains the record retention requirements for Massachusetts taxpayers. The amendments were aimed at modernizing the regulation to extend the regulation to newly enacted taxes, and to reflect technological advances since the regulation was promulgated. The working draft also clarified the ramifications for taxpayers who run afoul of the record retention requirements, which include the Department's ability to issue summonses, determine the tax based on third-party information, and/or impose penalties. Following a period of public comment, on July 13, 2022, the Department released its proposed amendments that were substantively identical to those in the working draft. *Proposed Regulation 830 CMR 62C.25.1: Record Retention (July 13, 2022).*

B. <u>Department issues Directive on the effect of using electronic signatures</u>: On April 21, 2020, in the midst of the COVID-19 crisis, the Department issued Directive 20-1 to provide guidance to taxpayers on the use and acceptance of electronic signatures. According to the Directive, the Department will treat an electronic signature the same as if a person had signed a document in writing for purposes of the following Department forms: Form A-37: Consent Extending the Time for Assessment of Taxes, Form B-37: Special Consent Extending the Time for Assessment of Taxes, Form DR-1: Office of Appeals Form and Form M-2848: Power of Attorney and Declaration of Representative. In order for an electronic signature to be effective on one of these forms, the signature must be accompanied by a certification stating: "The attached [insert document name] includes [insert name of taxpayer or representative]'s valid signature and the taxpayer intends to transmit the document to the Massachusetts Department of Revenue." *Directive 20-1 Acceptance of Electronic Signatures (Apr. 21, 2020)*.

V. Biographies

A. Michael A. Jacobs

Mike is a partner in Reed Smith's State Tax Group. He focuses his practice on state tax planning and controversy matters, with an emphasis on income/franchise and sales and use taxes. Prior to joining Reed Smith, Mike was a partner at the Boston-based law firm of Choate, Hall & Stewart. He is admitted in Massachusetts and has more than 20 years of experience handling Massachusetts state tax matters. Mike writes and speaks frequently on Massachusetts tax issues.

B. Brent K. Beissel

Brent is counsel in Reed Smith's State Tax Group. He focuses his practice on state tax planning and controversy matters, with an emphasis on income/franchise and sales and use taxes. Brent writes frequently on Massachusetts tax issues, and has worked on several significant Massachusetts tax appeals.

C. **Sebastian C. Watt**

Sebastian is an associate in Reed Smith's State Tax Group. He focuses his practice on state tax planning and controversy matters, with an emphasis on federal-state tax conformity issues. Sebastian spent three years working in federal and international tax, giving him a unique perspective on state tax issues.