

CHAPTER 15

State Taxation

DAVID FLOWER, JR.

A. ADMINISTRATION

§15.1. State Tax Commission. During the 1959 SURVEY year Robert T. Capeless was appointed Commissioner of Corporations and Taxation and Chairman of the State Tax Commission and Edward C. Wilson was appointed an Associate Commissioner, in the places of Joseph P. Healey and John Dane, Jr., respectively, who resigned to enter industry and private practice.

Commissioner Capeless is placing additional emphasis on public information. He has also announced a policy of relentless pursuit of tax revenue under the law. To this end a Bureau of Special Investigation was formed under the direction of Thomas McDonough to investigate tax evasion.

The Commissioner has also announced a change in interpretation of G.L., c. 63, §51, pursuant to which the Department will disclose to the taxpayer any errors in his individual income tax return or corporate excise tax return and will treat the return as an automatic claim for refund if any mistakes involving overassessment are found therein.¹

B. PERSONAL INCOME TAX

§15.2. Withholding of income tax on wages. The system of withholding income tax on salaries and wages and of declaration of estimated tax became law on February 6, 1959.¹ Employers were required to withhold tax from all wages commencing February 15. Since the withholding system was made applicable to all wages paid on or after January 1, 1959, employers were required to deduct and withhold double the amount otherwise required for as many wage pay-

DAVID FLOWER, JR., is General Tax Counsel for Raytheon Company, Waltham. He is President of the New England Chapter of the Tax Executives Institute and Chairman of the Subcommittee on Manufacturers Excise Taxes of the Tax Section of the American Bar Association. He has lectured in taxation for the Practising Law Institute and was for many years a Lecturer in Federal Taxation at Northeastern University School of Law.

§15.1. ¹ See §15.17 *infra*.

§15.2. ¹ G.L., c. 62B, added by Acts of 1959, c. 17, effective February 6, 1959.

ments on or after February 15 as were made to each employee prior to that date, in order to have a full year's tax withheld in 1959.

Temporary emergency regulations were promulgated and were replaced by final regulations, adopted by the State Tax Commission on September 2, 1959. The law adopted the definitions of "wages," "employer," and "employee" as set out in Section 3401 of the federal Internal Revenue Code in effect on January 1, 1959, except that full-time students engaged in seasonal or temporary employment whose estimated annual income would not exceed \$2000 are excluded from the definition of employees. Withholding, in addition to being required of domestic corporations, resident trusts, and legal residents of Massachusetts, is required of individuals, corporations, trusts, associations or partnerships (1) having, maintaining, or operating a place of business, warehouse, or agency within Massachusetts, or (2) regularly and systematically engaged in the solicitation of orders within Massachusetts, or (3) regularly and systematically engaged in any activity within Massachusetts which reasonably contributes to the production of their business income.² By federal law enacted during the year, no state withholding may be made on the wages of merchant seamen.³

The State Tax Commission issued withholding tables as well as an alternative percentage formula method. The steps prescribed in the latter method are as follows:

A. Subtract from the employee's wage:

1. The amount deducted for Federal Social Security (FICA);
2. The amount deducted for federal income tax withholding;
3. The amounts for the personal exemption, spouse, and other dependents claimed by the employee.

B. Multiply the difference by .03 (3 percent).

Approval was also given for use of any other formula that would produce substantially the same amount of withholding, provided approval is secured from the Commissioner.⁴ Employees are required to furnish employer's signed exemption and deduction certificates, Form M-4. As a temporary interim measure, the State Tax Commissioner accepted the employees' having filed federal Withholding Form W-4, until April 1, 1959.⁵

Employers are required to pay the tax withheld and file returns, Form M-941, quarterly on or before January 31, April 30, July 31, and October 31 following each calendar quarter. Employers are also required, on or before January 31 of the succeeding year, to furnish each employee with a Form M-2, statement of tax withheld, in duplicate similar to the federal Form W-2. Commercially printed combinations

² Letter from Commissioner of Corporations and Taxation to Commerce Clearing House, Inc., May 25, 1959.

³ 46 U.S.C. §601 (1959 Supp.), added by P.L. 86-263, 73 Stat. 551, approved and effective September 14, 1959.

⁴ Income Tax Withholding System Ruling Number 1959-1, State Tax Commission, February 6, 1959.

⁵ Id. Number 1959-2.

of the W-2 and M-2 forms are permitted.⁶ The employee files one copy of Form M-2 with his tax return. The employer files a copy of the M-2 with a Reconciliation Form M-3 which reconciles the M-2 amounts with the quarterly return amounts.

In the case of employees who are residents of Massachusetts, employers are required to withhold on all wages, wherever earned. Withholding for nonresident employees applies only to that part of the salary earned in Massachusetts. The burden of determining time spent in the state is thus placed upon the employer. When an employer is required to withhold income tax of another state, the District of Columbia, or Canada from a legal resident of Massachusetts, the amount of tax to be withheld for Massachusetts is to be reduced by the foreign tax so withheld.⁷ An employee working for two or more separate employers during the same or overlapping payroll periods may claim his personal exemption and dependency deductions on only one withholding exemption certificate. When the employers are joint or related, however, the withholding may be determined upon the aggregate as if paid by one employer.⁸ The law and regulations provide a fee to the employer for services in withholding. The fee ranges from 3 percent when the quarter's withholding is not over \$50 to \$7.50 plus $\frac{1}{2}$ percent on excess over \$500 when the quarter's withholding exceeds that amount.

The overlap of withholding tax from January 1 and payment of 1958 tax on April 15, 1959, resulted in a "windfall" of much needed revenue for the Commonwealth. It also resulted in two years' state income tax deduction in the 1960 federal tax return for individuals taking itemized deductions. Commentary on the first year of withholding would be remiss if it did not commend the Department and, more particularly, Robert H. McClain, Jr., Chief of the Bureau of Administration and Research, Department of Corporations and Taxation, for an outstanding job in putting the system into smooth operation under a trying time schedule.

§15.3. Declaration of estimated income tax. The system enacted for the declaration of estimated income tax is almost identical with the federal system. The dates for filing, on Form 1-ES, for payment of instalments, and the various tests for avoiding penalty for underestimate are the same as the federal provisions. As in the case of withholding, the system became effective with respect to 1959 income. Declarations are required of all persons expecting to receive Massachusetts taxable income in excess of \$100 not subject to withholding. A regula-

⁶ Letter of Robert H. McClain, Jr., Chief of Bureau of Administration and Research, Department of Corporations and Taxation, June 24, 1959.

⁷ Withholding and Estimated Income Tax Regulations, adopted by the State Tax Commission on September 2, 1959, pursuant to G.L., c. 62; Acts of 1954, c. 681; Acts of 1953, c. 654.

⁸ Withholding and Estimated Income Tax Regulations, Commission, September 2, 1959.

tion has been promulgated setting out dates of filing and payment for fiscal year taxpayers.¹

§15.4. **Nontaxable income.** On June 24, 1959, the Appellate Tax Board held that federal old age benefits paid under the Social Security Act are not subject to income tax either as income from professions, employments, trade or business or as retirement allowances subject to tax.¹ In urging a contrary result, the State Tax Commission pointed to the fact of the deduction for social security tax payments on the personal income tax return and various proposals of legislation to accomplish the result reached by the Board. The Appellate Tax Board decision was affirmed by the Supreme Judicial Court after the close of the 1959 SURVEY year.²

§15.5. **Taxable income: Annuities.** Regulations on annuities have been promulgated.¹ They define an annuity as "the right to receive a certain specified sum at regular intervals, usually annually or at shorter intervals, contingent generally on the continued lives of one or more persons, chargeable against a person or corporation neither restricted to nor dependent on earnings or proceeds of a fund or business." Payments to an employee or former employee under an employer's pension or retirement plan, whether contributory or noncontributory, are taxable as business income and not as an annuity, unless the employer buys an annuity and the employee releases the employer in writing from any other obligation. All annuity receipts are taxable at 1½ percent plus the applicable surtax irrespective of the fact that a part of the receipts may be a return of the recipient's own investment or that the annuity was purchased by the annuitant's former spouse to discharge his obligation to support the annuitant. The refund of premium payments provided if the annuitant dies before receiving a designated number of payments is not taxable.

§15.6. **Taxable income: Eminent domain.** The special 50 percent tax on gains from takings by eminent domain by the Commonwealth when the real estate had been purchased within one year was extended by the General Court to cover purchases or takings by other agencies empowered to take by eminent domain.¹ The tax is thereby imposed on real estate purchases or takings by such agencies as the Massachusetts Turnpike Authority, the Massachusetts Port Authority, and the Metropolitan Transit Authority.

§15.7. **Tax-free reorganizations.** The General Court has at last adopted the tax-free corporate organization and reorganization pro-

§15.3. ¹ Withholding and Estimated Income Tax Regulations, Commission, September 2, 1959.

§15.4. ¹ Gray v. State Tax Commission, 1959 A.T.B. Adv. Sh. 5 (1959).

² State Tax Commission v. Gray, 1960 Mass. Adv. Sh. 395.

§15.5. ¹ Annuities Regulations, adopted by the State Tax Commission on April 2, 1959, pursuant to G.L., c. 62; Acts of 1954, c. 681; Acts of 1953, c. 654.

§15.6. ¹ Acts of 1959, c. 461, amending G.L., c. 62, §7A, effective August 13, 1959.

visions of the Internal Revenue Code.¹ Gone is the antiquated provision that the only type of corporate reorganization that does not give rise to taxable income for the noncorporate stockholder is that in which the shares received represent the same interest in the same assets as the shares surrendered in the exchange.² No longer will a well-worked-out tax-free corporate reorganization under the Internal Revenue Code result in taxable income for the individual stockholders who are inhabitants of Massachusetts.

With a few well-chosen words the General Court has incorporated into our law by reference the intricate law of the corporate organization and reorganization provisions of the Internal Revenue Code. Also adopted are the provisions with respect to "boot," basis, and spin-offs. Gain but not loss is recognized when, in addition to the stock or securities permitted to be received without gain or loss, other property or money is received. The gain is recognized only to the extent of the money or other property. Where no gain or loss is recognized on the exchange and no other property is received, the stock or securities received takes the basis of the stock or security surrendered. Otherwise, the basis of the stock or securities received is reduced by the amount of other property received and increased in the amount of gain recognized.

§15.8. Sales and exchanges: Worthless securities. The final regulation on loss from worthless securities was promulgated during the 1959 SURVEY year.¹ Loss sustained from a security becoming worthless during the taxable year is treated as a capital loss from the sale or exchange of intangible personal property, and may be utilized to reduce capital gains. Security means a share of corporate stock, or a bond, debenture, note, certificate, or other evidence of indebtedness to pay a fixed or determinable sum of money, issued by a corporation. As in the case of federal law, proof is required that the security became worthless during the taxable year.

§15.9. Deductions and credits: Depreciation. Basing his decision on the regulation provision that any reasonable method of depreciation will be accepted, the Commissioner ruled that a taxpayer who is permitted to take the additional 20 percent first-year depreciation under Section 179 of the Internal Revenue Code may have the same treatment on his Massachusetts return.¹

§15.10. Accounting methods: Instalment sales. Regulations have been promulgated on the instalment sales method of reporting income,

¹ Acts of 1959, c. 556, amending G.L., c. 62, §§5(c), 1 and 7, effective with respect to taxable years commencing after December 31, 1958.

² For details on the prior law see 1958 Ann. Surv. Mass. Law §17.5; 1956 Ann. Surv. Mass. Law §16.4.

¹ Adopted by the State Tax Commission on December 4, 1958, in Loss from Securities Regulations.

¹ Income Tax Ruling Number 24, Commissioner of Corporations and Taxation, April 2, 1959.

adopted in 1958 from the Internal Revenue Code.¹ Set out therein are numerous helpful illustrations of the application of the statute. While dealers regularly selling personal property on the instalment plan may use the method without prior approval, as under the federal law, so long as they are not in default in filing returns or paying tax, use of the method for casual sales of personal property for a price in excess of \$1000 and for sales of real property requires prior written approval by the Commissioner and the posting of a bond or other security for payment of the tax.

In general, the regulations follow the federal law. Exceptions occur when the taxpayer leaves the jurisdiction of the Commonwealth or dies. In these cases, the Commissioner may require immediate payment of the entire unpaid tax if he believes collection is in jeopardy, as he may also if the taxpayer sells or otherwise disposes of the instalment obligations. While the federal law requires recognition of gain or loss at the time of disposition of the instalment obligations by sale, death does not affect a disposition of the obligations.²

§15.11. Fraud penalties: Tax practitioners. The statutory criminal penalties for the filing of fraudulent returns have been extended to persons who aid, assist or advise in the preparation of a false or fraudulent return.¹ The provision corresponds to Section 7206(2) of the Internal Revenue Code. The same act imposes criminal penalties upon any person who receives tax money in connection with the preparation of a tax return for another and fails to pay the money over to the Commissioner.

§15.12. Temporary taxes. The so-called temporary taxes (which actually constitute our standard tax rates) were extended for an additional two years for 1959 and 1960, and now for the additional first two months of 1961 in order that the January and February withholding in 1961 might be at the proper rate allowing time for renewal legislation in that year.¹ Prior to the withholding tax there was no need for this additional two-month leeway.

C. TAXATION OF CORPORATIONS

§15.13. Jurisdiction to tax: Interstate commerce. In February, 1959, the United States Supreme Court enunciated a revolutionary change in our conception of the power of states to tax income from interstate business operations. It is no longer necessary that a foreign

§15.10. ¹ Accounting Methods Regulations §4, adopted by State Tax Commission, November 18, 1958; amended by State Tax Commission, Assessing Memorandum 1959-1, January 19, 1959. For discussion of the substance of this law, see 1958 Ann. Surv. Mass. Law §17.8.

² See Lourie and Cutler, *Installment Sales and Purchases—A New Massachusetts Tax Law*, 3 Boston B.J. 13 (May, 1959).

§15.11. ¹ Acts of 1959, c. 315, amending G.L., c. 62, §56, effective August 18, 1959.

§15.12. ¹ Acts of 1959, c. 31, effective February 12, 1959.

corporation be doing business in a state in order to subject a portion of its income to the state's net income tax. The Supreme Court, giving way perhaps to its ideas as to the financial needs of the market states, has drastically cut down the protection formerly afforded by the commerce clause of the Constitution to a foreign business's freedom from taxation in carrying on business among the various states. In *Northwestern States Portland Cement Co. v. Minnesota*¹ and a companion case, *Williams v. Stockham Valves and Fittings, Inc.*, the Court upheld the imposition of state net income taxes on corporations whose sole activity in the taxing state was the maintenance of a leased sales office and the solicitation of sales. In each case the taxpayer had no stock of goods, inventory, warehouse, factory, or other production facilities in the taxing state. Orders could be accepted only at an office outside the taxing state and goods shipped from outside. In the one case, a single salesman occupied the sales office part time, with a full-time secretary. In the other case the office was occupied by five salesmen. The Court found these facts sufficient for imposition of a net income tax under a fair apportionment statute. The sole test is that there be sufficient connection or "nexus" between the corporation and the taxing state.² This will satisfy the due process clause.

A few weeks later the Supreme Court refused the opportunity to review the decision of the Louisiana Supreme Court which had upheld the imposition of tax when there was no sales office in the taxing state but merely "missionary men" helping the making of sales by wholesalers, followed by shipment of goods into the state.³

Swift and concerted activity by industry and the Congress resulted in the enactment of Public Law 86-272 in September, 1959. This is our first and only law decreasing the taxing jurisdiction of the states. The act leaves standing the Supreme Court holding that a state income tax may be applied to the income of an out-of-state corporation solely on the basis of its having a sales office in the state. The act prevents states from taxing the out-of-state corporation solely on the basis of visits by salesmen to solicit orders so long as the orders are sent outside the state for approval and are filled by delivery of the product from outside the state. The maintenance of an office, stock of goods, or the performance of services in the state would permit the state to impose tax.

An office maintained in a state by an independent contractor, such as a manufacturers' representative, will not be sufficient to permit imposition of tax on the independent contractor's principal, provided two conditions are met: (1) the independent contractor, or manufacturers' representative, must represent and must hold himself out as representing more than one principal in the regular course of his

§15.13. 1 358 U.S. 450, 79 Sup. Ct. 357, 3 L. Ed. 2d 421 (1959).

² See the excellent collection of articles in 12 Tax Executive No. 1 (Oct. 1959).

³ *Brown-Forman Distillers Corp. v. Collector of Revenue*, 234 La. 651, 101 So.2d 70 (1958), *appeal dismissed and cert. denied*, 359 U.S. 28, 79 Sup. Ct. 602, 3 L. Ed. 2d 625 (1959).

business; (2) the activities of the contractor, or manufacturers' representative, on behalf of the principal must be limited to making sales or soliciting orders for sales of the principal's products.

The act leaves some areas of doubt. If the order is filled by delivery from out of state but the delivery is made in the vendor's own truck rather than by common carrier, it is possible that tax could be applied. It would appear that advertising in the state should not permit the imposition of tax.⁴ It is possible that residence of a salesman in the state might subject the company to tax. Company telephone listing to the salesman's home and payment of rent should be avoided.

The Massachusetts Corporate Excise is a "privilege" tax, not an income tax. In *Northwestern States*, the Supreme Court made it clear that a privilege tax as opposed to a net income tax may not be levied on solely interstate business, citing its earlier opinion in *Spector Motor Service v. O'Connor*.⁵ It also cited with approval *Alpha Portland Cement Co. v. Massachusetts*,⁶ coming to the same conclusion under the Massachusetts Corporate Excise Tax, as it existed in 1924. It would, therefore, appear that the *Northwestern States* case does not extend the jurisdiction of the corporate excise tax inasmuch as the character of the tax has not appreciably changed since 1924. A non-tax case decided by the Supreme Judicial Court during the year, *Remington Arms Co. v. Lechmere Tire and Sales Co.*,⁷ enunciates the basic formerly understood rule of what constitutes "doing business" in the Commonwealth.

On the other hand, prior to the *Northwestern States* case, the Commonwealth has taken the position that when a domestic corporation's activities in another state were purely interstate commerce there was no jurisdiction of the other state to tax and, therefore, no allocation of income was permitted in determining the Massachusetts tax. This view has had to be changed since other states now do have jurisdiction and allocation must be permitted under the Massachusetts formula. This problem never existed for foreign corporations since it has always been recognized that their state of incorporation, if none other, had jurisdiction to tax.

§15.14. Allocation of income: Gross receipts fraction. In order to determine what part of a multi-state corporation's income is to be taxed here, the so-called Massachusetts three-fraction formula is applied to all net income¹ except interest, dividends, and gains from the sale of capital assets, these items being directly allocated to Massachusetts.² The formula fractions are Massachusetts tangible property over total tangible property, Massachusetts wages and salaries over total wages and salaries, Massachusetts gross receipts over total gross re-

⁴ *Miller Brothers v. Maryland*, 347 U.S. 340, 74 Sup. Ct. 535, 98 L. Ed. 744 (1954). But changes in the composition of the Court leave doubts.

⁵ 340 U.S. 602, 71 Sup. Ct. 508, 95 L. Ed. 573 (1951).

⁶ 268 U.S. 203, 45 Sup. Ct. 477, 69 L. Ed. 916 (1925).

⁷ 1959 Mass. Adv. Sh. 717, 158 N.E.2d 134.

§15.14. ¹ G.L., c. 63, §§38, 41(a)-(d).

² Id. §§37, 41(d).

ceipts. Inasmuch as Massachusetts interest, dividends, and gains from the sales of capital assets are directly allocated and taxed, they are not included in the numerator of the gross receipts fraction. Since these items are not included in the numerator, they are likewise not to be included in the denominator of the fraction. Both the numerator and the denominator include only sales, rents, and royalties. The Commission has so stated in a ruling published during the 1959 SURVEY year.³ The ruling applies both to domestic and foreign corporations. It is applicable to all open years, having been published without an effective date, for the reason that it states a rule which the State Tax Commission has always followed.

§15.15. Federal "small business corporations." The federal "Technical Amendments Act of 1958" permits so-called "small business corporations" to elect not to be subject to the federal corporation income tax.¹ In order to explain the effect of this election on the Massachusetts personal income tax and corporate excise tax, the State Tax Commission has issued two detailed rulings.² Epitomized, the rulings provide: Election under the federal law not to be taxed as a corporation does not permit the corporation not to file its Massachusetts corporation excise tax return. The State Tax Commission will determine the reasonableness of salaries to avoid permitting the payment of dividends as salaries with resulting lower Massachusetts tax rate. Since no federal corporate income tax will be paid, the corporation will lose this item as a reduction of its book income in Schedule B. The enlarged federal income tax will be allowed as a deduction on personal income tax returns. The undistributed dividend will not be taxed as dividend income of the individual nor as business income.

§15.16. Consolidated returns. The Supreme Judicial Court has modified the State Tax Commission's position as to the circumstances under which consolidated returns may be filed. General Laws, c. 63, §34, permits the filing of a Massachusetts consolidated return by domestic corporations which are filing a federal consolidated return. Section 39 extends the same privilege to foreign corporations doing business in Massachusetts. In *Felt Process Co. v. State Tax Commission*,¹ the Supreme Judicial Court permitted a Massachusetts consolidated return by five domestic corporations which had filed a federal consolidated return with two foreign corporations. The rule thereby established is that the Massachusetts consolidated return may be filed by less than the entire group joining in the federal consolidation. This reverses the long standing position of the Department. Pursuant to this opinion the Commission permits a consolidated domestic return

³ Corporation Excise Ruling 1959-1, State Tax Commission, January 16, 1959.

§15.15. ¹ Int. Rev. Code of 1954, §§1371-1377.

² Massachusetts Income Tax Ruling Number 22, State Tax Commission, November 6, 1958; Massachusetts Corporation Excise Ruling 1958-9, State Tax Commission, November 7, 1958.

§15.16. ¹ 1959 Mass. Adv. Sh. 1279, 162 N.E.2d 76.

by domestic corporations forming a part of a federal return consolidated group and a consolidated foreign return, on Form 355-B, by foreign corporations doing business in Massachusetts and forming a part of a federal return consolidated group. Domestic corporations, however, may not file a Massachusetts consolidated return with foreign corporations doing business in Massachusetts even though all joined in the filing of a federal consolidated return. The *Felt Process* decision did not reach this issue. The Court rested its opinion upon legislative history involving the deletion of statutory language in 1933 which had required separate returns for corporations filing a mixed federal consolidated return. Consolidation is permitted for the income portion of the return only, not for the corporate excess measure.

§15.17. **Abatements and refunds.** Under Commissioner Capeless the practice has been adopted of notifying corporations of the amount of the Bureau's assessment, with the result that the corporation that has overpaid its tax is made aware of the fact and amount of overassessment, and is enabled to make application for refund. Further, by administrative action, the 1958 legislation making the return itself an application for abatement¹ was extended to make the return a claim for refund when the corporation files its return on or before the due date, pays its tax in full, and the Bureau thereafter assesses a lesser tax. The return is also treated as an automatic claim for refund when an advance payment exceeds the amount shown due on a timely correct return, or exceeds the amount of the Bureau's assessment after a timely incorrect return. No interest is paid on such automatic refunds.

§15.17. ¹ See 1958 Ann. Surv. Mass. Law §17.19.