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830 CMR 62.5A.1 Non-Resident Income Tax

830 CMR: DEPARTMENT OF REVENUE

830 CMR 62:00: INCOME TAX

830 CMR 62:00 is repealed and replaced with the following

(1) *General.*

(a) Massachusetts source income is generally taxable to non-residents. 830 CMR 62.5A.1 sets forth detailed rules for the taxation of this income. Massachusetts source income includes items of gross income derived from or effectively connected with any trade or business, including any employment, carried on by the taxpayer in Massachusetts, whether or not the non-resident is actively engaged in a trade or business or employment in Massachusetts in the year in which the income is received; the participation in any lottery or wagering transaction in Massachusetts; or the ownership of any interest in real or tangible personal property located in Massachusetts. All types of income, including investment income, derived from or effectively connected with the carrying on of a trade or business within Massachusetts are Massachusetts source income. The term may include gain from the sale of a business or of an interest in a business, distributive share income, separation, sick or vacation pay, deferred compensation and nonqualified pension income not prevented from state taxation by the laws of the United States, and income from a covenant not to compete. For rules that apply to non-resident members of professional athletic teams, see 830 CMR 62.5A.2.

Certain types of income received by non-residents from sources within Massachusetts are excluded from taxation, such as non-business-related interest, dividends and gains from the sale or exchange of intangibles that are not derived from or effectively connected with the carrying on of a trade or business, and certain qualified pension income.

Massachusetts source income derived from pass-through entities, such as partnerships, trusts, estates, limited liability companies (LLCs), or S corporations, generally is also subject to Massachusetts income taxation for non-residents. The activities of a pass-through entity are attributed to its owners, including non-resident partners, members, or shareholders. Thus, if a non-resident has an ownership interest in a pass-through entity that is engaged in the conduct of a trade or business in Massachusetts, or derives income from the ownership of real or tangible personal property in Massachusetts, the non-resident is treated as if conducting those activities in his or her individual capacity.

The income of a pass-through entity that derives from or is effectively connected with the conduct of a trade or business or the ownership of real or tangible personal property in Massachusetts retains its character as it passes through a tiered structure of pass-through entities before becoming income to the non-resident. Thus, income that is derived from a trade or business does not convert to non-business-related income as it passes through a series of entities. Similarly, Massachusetts source income of any pass-through entities engaged in a unitary business that conducts a trade or business in Massachusetts is taxable to a non-resident member to the extent it would be taxable if received directly by the non-resident.

In the case of multi-tiered unitary businesses where at least one entity in the structure is engaged in the conduct of a trade or business or the ownership of real or tangible personal property in Massachusetts, and income derived from one or more members of the unitary business is taxable in another state, the group of entities must apportion its income, as determined under this regulation.

When a non-resident earns or derives income from sources both in Massachusetts and elsewhere, only that portion of the income earned or derived from Massachusetts is taxed. The types of deductions and exemptions available to a non-resident with respect to Massachusetts

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source income are generally the same as those granted to a resident.

All transactions involving the taxation of non-residents are subject to the sham transaction rule, as defined in this regulation.

To the extent that any rule in this regulation conflicts with that in another regulation, such as 830 CMR 62.17A.1, "Massachusetts Taxation of S Corporations and their Shareholders," the most recently promulgated rule applies.

(b) 830 CMR 62.5A.1 is organized as follows:

1. General.
2. Definitions.
3. Income Subject to Massachusetts Income Tax.
4. Income Not Subject to Massachusetts Income Tax.
5. Rules for Apportionment of Income for Non-Resident Individuals Working in Massachusetts.
6. Rules for Apportionment of Income to Massachusetts for Non-Resident Members of Pass-Through Entities.
7. Exemptions.
8. Deductions.
9. Estates of Non-resident Decedents.
10. Non-resident Trusts.
11. Returns.
12. Effective Dates.

(2) *Definitions.* Unless the context requires otherwise, for the purposes of 830 CMR 62.5A.1, the following definitions apply:

Code, as defined in G.L. c. 62, § 1, which refers to the federal Internal Revenue Code, with certain modifications.

Corporate trust, any partnership, association, or trust, the beneficial interest of which is represented by transferable shares, which is subject to tax imposed by G.L. c. 62 as a corporate trust

Domicile, the place which is an individual's true, fixed and permanent home, determined by established common law principles and the facts and circumstances in each case.

Entertainer, an individual employee, partner or sole proprietor who receives compensation to perform, entertain, amuse, or inform (as, for example, a lecturer) at one or more discrete events.

Federal Gross Income, gross income as defined under the Code.

Massachusetts Cooperative Housing Corporation, a corporation organized or existing under G.L. c. 157B, or G.L. c. 157, § 3A.

Massachusetts Gross Income, federal gross income as modified by G.L. c. 62, § 2(a).

Massachusetts Source Income, Massachusetts gross income derived from or effectively connected with (1) any trade or business, including any employment, carried on by a non-resident in Massachusetts, whether or not the non-resident is actively engaged in a trade or business or employment in Massachusetts in the year in which the income is received; (2) the participation in any lottery or wagering transaction in Massachusetts; or (3) the ownership of any interest in real or tangible personal property located in Massachusetts.

Massachusetts Timesharing Arrangement, an arrangement under which a taxpayer purchases a right to use accommodations located in Massachusetts for a specific period of less than a year's duration during any given year over a period of greater than three years.

Member, may include a shareholder of an S corporation; a partner in a partnership, including a limited partner in a limited partnership, or a partner in a limited liability partnership; a member of a limited liability company; or a beneficiary of an estate or trust other than a corporate trust.

Non-Resident, any natural person who is not a resident or inhabitant.

Partner, a member of an entity organized as a general partnership, limited liability partnership, or limited partnership, or a member of any business entity subject to tax as a partnership for Massachusetts purposes.

Partnership, an unincorporated association of two or more individuals or entities organized to carry on, as co-owners, a business for profit. A partnership includes any business entity treated as a partnership for Massachusetts tax purposes, such as LLCs that are classified as partnerships for

federal tax purposes. Businesses subject to Massachusetts tax on their income at the entity level, such as a corporate trust or an LLC that elects to be taxed as a corporation for federal tax purposes, are not treated as partnerships for Massachusetts tax purposes.

Part-year resident, a taxpayer who moves to Massachusetts or establishes a permanent place of abode in Massachusetts and becomes a tax resident during the tax year, or a taxpayer who terminates his or her status as a Massachusetts resident and establishes a residence outside of the state during the tax year.

Pass-through entity, includes a limited partnership, limited liability partnership, general partnership, a limited liability company that is treated as a partnership for Massachusetts tax purposes, an S corporation, and a trust not taxed at the entity level, including a grantor-type trust, but not including a corporate trust, and an estate not taxed at the entity level.

Person, an individual, corporation, society, association, partnership or other entity.

Presence for Business in Massachusetts, physical presence in Massachusetts for the purpose of engaging in any activity, the object of which is financial profit, gain, benefit, or advantage, direct or indirect.

Professional Athlete who is Not a Member of a Professional Athletic Team, an individual employee, partner or sole proprietor who receives compensation to compete in athletics (other than as a member of a professional athletic team) at one or more discrete sporting events. For rules that apply to non-resident professional team athletes, see 830 CMR 62.5A.2.

Related business activities, as more fully defined in 830 CMR 62.5A.1(6)(d), include activities where there is a sharing or exchange of value between the segments of a single entity or multiple entities such that the activities are mutually beneficial, interdependent, integrated, or such that they otherwise contribute to one another. The term also includes the short-term investment of capital in a non-unitary business segment or activity, or any other investment that serves an operational function.

Resident or Inhabitant, any natural person domiciled in Massachusetts or any natural person who is not domiciled in Massachusetts but who maintains a permanent place of abode in Massachusetts and spends in the aggregate more than 183 days of the tax year in Massachusetts, including days spent partially in and partially out of Massachusetts.

S corporation, an S corporation as defined in the Code.

Sham transaction, a transaction that does not have (i) a valid, good faith business purpose other than tax avoidance; and (ii) economic substance apart from the asserted tax benefit.

Sham transaction rule, the rule, set forth at G.L. c. 62C, § 3A, that permits the commissioner, in his discretion, to disallow the asserted tax consequences of a transaction by asserting that it is a sham transaction; in such cases the taxpayer has the burden of proving by clear and convincing evidence that it is not a sham transaction, as more fully described in G.L. c. 62C, § 3A.

Trust, a trust as defined under Massachusetts law, but for purposes of this regulation, not including a corporate trust.

Unitary business, a group of related businesses under common ownership that have one or more of the following factors: (1) functional integration; (2) centralization of management; and (3) economies of scale. Evidence of a unitary business includes facts indicating that there is a flow of value among the entities, or that capital transactions among the businesses serve an operational rather than an investment function.

(3) *Income Subject to Massachusetts Income Tax*. The Massachusetts income tax is imposed on the Massachusetts source income earned or derived by non-residents. Massachusetts source income includes the following types of income, but excludes items of income set forth in 830 CMR 62.5A.1(4):

(a) *Income Derived from or Effectively Connected with a Trade or Business, Including Any Employment Carried on in Massachusetts*. This income is defined as the income that is earned by, credited to, accumulated for or otherwise attributable to the taxpayer's trade or business in the Commonwealth in any year or part thereof, regardless of the year in which the income is actually received by the taxpayer and regardless of the taxpayer's residence or domicile in the year it is received. All types of income, including investment income, derived from or effectively connected with the carrying on of a trade or business within Massachusetts are Massachusetts source income. The term may include gain from the sale of a business or an interest in a business, distributive share income, separation, sick or vacation pay, deferred compensation and nonqualified pension income not prevented from state taxation by the laws of the United States, and income from a covenant not to compete.

1. "Trade or business, including any employment."

a. *General Rule.* Subject to the exception that applies to presence for business that is casual, isolated, or inconsequential, described at section 830 CMR 62.5A.1(3)(h), below, a non-resident has a trade or business, including any employment carried on in Massachusetts:

- i. If the non-resident, directly or through representatives or employees, maintains or operates or shares in maintaining or operating any place in Massachusetts where business affairs are systematically and regularly conducted;
- ii. If the non-resident owns an interest in a pass-through entity that, directly or through representatives or employees, or through other pass-through entities, maintains or operates or shares in maintaining or operating any place in Massachusetts where its business affairs are systematically and regularly conducted;
- iii. If the non-resident, directly or through representatives or employees, is present for business in Massachusetts either as an employee or as a sole proprietor or other self-employed individual, or if the non-resident owns an interest in a pass-through entity that, directly or through representatives or employees or through other pass-through entities, is present for business. All activities that are considered a "trade or business," including employment, under Massachusetts and/or federal tax law are subject to taxation in Massachusetts under G.L. c. 62, § 5A. Income from a trade or business generally includes that gross income against which trade or business expense deductions are allowable under sections 62 and 162 of the Code. See G.L. c. 62, § 1(l), IRC §§ 62, 162, Treas. Reg. §§ 1.161-1 – 1.162-29;
- iv. If the non-resident licenses intangibles, including trademarks or patents, directly or through representatives or employees, for use in Massachusetts on an ongoing basis.

2. *Current residence or domicile of a non-resident taxpayer has no effect on the taxability of Massachusetts source income.* All items of income that derive from the conduct of a trade or business or employment in Massachusetts, as those terms are defined in 830 CMR 62.5A.1(3)(a)(1), are Massachusetts source income, even if the taxpayer has not been present in Massachusetts during the year of receipt.

Example (3)(a)(2). Taxpayer is a resident of New Hampshire and works in Massachusetts from 1984 through 2004. Upon retirement in 2004 Taxpayer receives a severance compensation package that includes \$10,000 for severance pay and \$5,000 for unused sick leave. The entire \$15,000 package is derived from and attributable to Taxpayer's employment in Massachusetts. The entire \$15,000 package is thus Massachusetts source income.

(b) *Income from a Pass-Through Entity that is Derived from or Effectively Connected with a Trade or Business, Including Any Employment Carried on in Massachusetts.*

1. *General rule.* The activities of a pass-through entity are attributed to its individual members. A non-resident member of a pass-through entity is therefore engaged in the conduct of the trade or business of the pass-through entity of which it is a member, and thus is taxable on the Massachusetts source income of the entity. The character of any item of income, loss, deduction or credit included in the member's distributive share is determined as if it were realized directly by the member from the source from which realized by the pass-through entity, or incurred in the same manner as incurred by the pass-through entity. The principles in this paragraph shall apply in the case of an ownership chain that runs through multiple pass-through entities. For example, if a non-resident individual is a member of a pass-through entity that, in turn, is a member of a lower-tier pass-through entity that is engaged in a trade or business in Massachusetts, then the non-resident will be taxable on its share of the Massachusetts source income derived from the trade or business conducted by the lower-tier entity.

The income derived by a non-resident limited partner of a Massachusetts limited partnership engaged exclusively in buying, selling, dealing in or holding securities on its own behalf and not as a broker, is not subject to the Massachusetts income tax. See G.L. c. 62, § 17(b). The Massachusetts source income derived by a non-resident general partner of such a

partnership is subject to Massachusetts income tax, provided the partnership is engaged in the conduct of a trade or business in the Commonwealth, or owns or leases real property in the Commonwealth.

2. *Multiple pass-through entities that are not engaged in a unitary business.* In the case of multiple pass-through entities that are not engaged in a unitary business, the pass-through entities must identify the Massachusetts income or loss, reporting that amount to its members, allocated or apportioned as appropriate pursuant to 830 CMR 62.5A.1(6). That income must retain its identity as Massachusetts source income, and be reported as such to members as it passes through multiple pass-through entities, without further apportionment.

Example (3)(b)(2). Florida domiciled LLC ("Florida LLC") has three non-resident members. Florida LLC owns a Massachusetts domiciled LLC ("Massachusetts LLC") that invests in securities on its own behalf and is not engaged in a trade or business. Florida LLC owns a New York domiciled LLC ("New York LLC") that has an office in Boston that offers management services and advice to Massachusetts LLC and receives a fee from Massachusetts LLC based on a percentage of the portfolio value of Massachusetts LLC. Florida LLC also owns Real Estate LLC, commercially domiciled in Utah, but which owns an office tower in Boston and collects rents on that. Real Estate LLC is not engaged in a unitary business with the other members of the group.

Taxation of non-resident members of Florida LLC. The Massachusetts source income of Real Estate LLC, determined pursuant to the allocation and apportionment rules of 830 CMR 62.5A.1(6), is identified and reported to Florida LLC, and is taxable to the non-resident members. It is not subject to further apportionment under 830 CMR 62.5A.1(6) at the level of Florida LLC. Income from Massachusetts LLC is not subject to Massachusetts taxation to the non-resident members, because Massachusetts LLC only invests in securities on its own behalf. The Massachusetts source income derived from New York LLC, determined pursuant to the allocation and apportionment rules of 830 CMR 62.5A.1(6)(a), is taxable because the management company is engaged in the conduct of a trade or business in Massachusetts. The income of the group is not subject to the apportionment provisions described at 830 CMR 62.5A.1(6)(b), below, because the entities subject to Massachusetts taxation are not engaged in a unitary business.

3. *Multiple pass-through entities engaged in a unitary business.* In the case of multiple pass-through entities that are engaged in a unitary business, the income of any entity in the structure that derives from or is effectively connected with the conduct of a trade or business or the ownership of real or tangible personal property in Massachusetts retains its character as it passes through the structure. Thus, business income of a pass-through entity does not convert to non-business income as it passes through a series of pass-through entities engaged in related business activities, as that term is defined in 830 CMR 62.5A.1(2), and is further explained in 830 CMR 62.5A.1(6). Investment income of a pass-through entity that would be taxable as business income if received directly by a non-resident member engaged in business in Massachusetts is treated as taxable income of the non-resident. Note that business income can include investment income that the pass-through entity or entities derives from an operational function.

Example (3)(b)(3). A non-resident is a member of a Nevada LLC. The Nevada LLC sells computer software, and has an 80% ownership interest in a Partnership that develops computer software in Massachusetts. The partnership is treated as a partnership for federal and Massachusetts tax purposes. The income of the Partnership flows through the LLC to non-resident members. The LLC and the Partnership are functionally integrated, and are a unitary business. Subject to the apportionment rules found at 830 CMR 62.5A.1(6), below, the income of the Partnership that is passed through to the non-resident shareholders is Massachusetts source income.

(c) *Specific types of Massachusetts source income.* If a non-resident has a trade or business, including any employment, carried on in Massachusetts, Massachusetts source income includes, among other things:

1. *Compensation for Personal Services.* All types of compensation received for personal services performed in Massachusetts, regardless of where paid, are Massachusetts source income. Personal service compensation includes wages, salaries, commissions, fees, or payments in kind. In the case of compensation for personal services, the taxpayer must report all Massachusetts source income even though the taxpayer does not receive the entire amount of such income. For example, amounts withheld by an employer for federal or state

income taxes, FICA contributions, medical insurance premiums not otherwise excluded from federal gross income, or other similar withholding deductions must be included in Massachusetts source income.

2. *Stock options.* A taxpayer must recognize income derived from nonqualified stock options that are connected with employment, or with the conduct of a trade or business, in Massachusetts in the year the income is recognized for federal purposes whether or not the taxpayer is a resident of Massachusetts during the year in which the income is reported and whether or not the taxpayer remains employed by the issuer of the option in the year of recognition of the income. The amount of such income that is taxable to Massachusetts is determined by applying the taxpayer's average Massachusetts apportionment percentage (based on the taxpayer's employment or conduct of business within or without Massachusetts, as described in 830 CMR 62.5A.1(5)) for the period between the option grant date and the option exercise date to the income that derives from the exercise of the option, measured by the share price at exercise minus the option share price, multiplied by the number of shares. A non-resident will generally not be taxable on income that derives from sales of stock acquired pursuant to the exercise of a qualified stock option, namely, an incentive stock option under IRC § 422 or an employee stock purchase plan option under IRC § 423, except in the case of a disqualifying disposition of such stock.

Example (3)(c)(2). Taxpayer works in Massachusetts from 1997 until 2004. Taxpayer lives in Massachusetts in 1997, and then moves to Rhode Island, continuing to work in Massachusetts, with some work days spent in Rhode Island. Taxpayer is granted stock options according to the following schedule

Grant Date	# of shares	Option Price/share	Exercise Date	Price at Exercise/share	Income from exercise
11/19/1997	150	\$14.68	12/9/2004	\$108.5625	\$14,082
11/18/1998	1,200	13.82	5/28/2004	94.0625	96,291
11/17/1999	1,500	25.22	12/9/2004	108.5625	125,014

Taxpayer had the following apportionment percentages for the years during which the options were unexercised:

1997, 100% (taxpayer was a resident during 1997 and worked exclusively in Massachusetts during that year); 1998, 83%; 1999, 93.45%; 2000, 89.36%; 2001, 91.27%; 2002, 95.71%; 2003, 93.47%; 2004, 97.44%.

Calculation of apportioned stock option income is as follows:

- For grant of 11/19/1997. Average apportionment percentage for 1997-2004, the period the option exists and is unexercised, is 92.96%, which represents the sum of the apportionment percentages, 1997 – 2004, divided by 8, the number of years in the period. The calculation is thus: $.9296 * \$14,082$ (income from exercise) = \$13,091 Massachusetts taxable income in 2004.
- For grant of 11/18/1998. Average apportionment percentage for 1998-2004, the period the option exists and is unexercised, is 91.96%, which represents the sum of the apportionment percentages, 1998 – 2004, divided by 7, the number of years in the period. The calculation is thus: $.9196 * \$96,291$ (income from exercise) = \$88,549 Massachusetts taxable income in 2004.
- For grant of 11/17/1999. Average apportionment percentage for 1999-2004, the period the option exists and is unexercised, is 93.45%, which represents the sum of the apportionment percentages, 1999 – 2004, divided by 6, the number of years in the period. The calculation is thus: $.9345 * \$125,014$ (income from exercise) = \$116,826 Massachusetts taxable income in 2004.

The total Massachusetts source income derived from these options in 2004 is \$218,466.

3. *Shares of stock issued by a corporation as compensation.* If a taxpayer obtains an ownership interest in a trade or business as part of the taxpayer's compensation attributable to the period the taxpayer is employed or conducting the trade or business in Massachusetts, the income that the taxpayer recognizes from this element of compensation for federal tax purposes is Massachusetts source income in the year of federal recognition whether or not the taxpayer is a resident of Massachusetts at that time and whether or not the taxpayer continues to conduct a trade or business or be employed in Massachusetts. This rule applies to an ownership interest in any business entity, including a C corporation, S corporation, general partnership, limited liability partnership, limited partnership, or limited liability company.

Example (3)(c)(3). Executive works for C Corporation in Massachusetts in 2003 and is promised one thousand shares of stock as a bonus in 2003, but the stock is not actually issued until 2004, after Executive has been transferred to C Corporation's Boise, Idaho headquarters. The receipt of this stock is attributable to Executive's employment in Massachusetts and is taxable as Massachusetts source income to a non-resident in 2004, the year of federal recognition.

4. *Payments from a covenant not to compete.* Income derived from a covenant not to compete is Massachusetts source income to the extent that it is derived from or effectively connected with any trade or business, including any employment carried on by the taxpayer in Massachusetts.

Example (3)(c)(4). Franchise Owner owns several franchises of a fast food chain in Massachusetts, each of which is a separate corporation. Franchise Owner sells her interest in the corporations and executes an agreement with the purchaser not to open any competing fast food restaurant near the existing stores. The covenant not to compete provides for payments over a period of three years. Franchise Owner moves to another state and never returns to Massachusetts. Since all the income from the covenant not to compete derives both from the Franchise Owner's former conduct of and her sale of a trade or business in Massachusetts, it is Massachusetts source income for the duration of the covenant, notwithstanding Franchise Owner's change in domicile or lack of business activity in Massachusetts for the years of receipt.

5. *Nonqualified pension income.*

a. Nonqualified pension income is Massachusetts source income to the extent that it is derived from or effectively connected with any trade or business, including employment, carried on by the taxpayer in Massachusetts.

Example (3)(c)(5.1). Taxpayer worked in Massachusetts from 1985 through 2002 and retires, moving out of state. A portion of her pension package includes non-qualified benefits that non-domiciliary states are permitted to tax under federal law. Those benefits are paid in 2003 and years thereafter. Because this taxable pension income is derived from Taxpayer's employment in Massachusetts, it is Massachusetts source income taxable to Taxpayer in the year of receipt.

Example (3)(c)(5.2). Same facts as in Example (3)(c)(5.1), but Taxpayer worked for the same company in various states from 1985 through 2002. Taxpayer is allowed to source her non-qualified pension benefits to Massachusetts in the same proportion as her period of Massachusetts employment credited toward her pension bears to the total period of employment credited toward her pension. The apportionment calculation for this example must be based on the entire employment period from 1985 through 2002, assuming that all of those years were credited toward Taxpayer's pension.

6. *Severance and accumulated sick leave.* Severance and accumulated sick leave is Massachusetts source income to the extent that it is derived from or effectively connected with any trade or business, including employment carried on by the taxpayer in Massachusetts.

Example (3)(c)(6). See Example (3)(a)(2).

7. *Deferred Compensation.* Deferred compensation is Massachusetts source income to the extent it is derived from or effectively connected with a trade or business including employment carried on in Massachusetts. For purposes of this regulation, deferred compensation is all compensation for services paid or made available to the taxpayer in a tax year following the year in which the services were performed, but does not include qualified pension income as defined in 830 CMR 62.5A.1(4)(e), nor shall it be deemed to include

income from qualified tax-deferred retirement plans that is exempt from Massachusetts taxation under any other provision of federal or Massachusetts law. A non-resident whose deferred compensation income is derived from or effectively connected with a trade or business or employment carried on by the non-resident both in Massachusetts and elsewhere may apportion the deferred compensation income under 830 CMR 62.5A.1(5).

Example (3)(c)(7.1). LLP is a limited liability partnership that conducts its business out of its Massachusetts headquarters. It consists of twenty partners. In 2002, ten partners withdraw, leaving ten Active Partners and ten Withdrawn Partners. Upon withdrawal, the ten Withdrawn Partners cease to be members of the partnership, and move out of state. The Withdrawn Partners receive annual payments for ten years after withdrawal. Because these payments are attributable to the partners' conduct of a trade or business in Massachusetts, they are taxable Massachusetts source income to the non-residents.

Example (3)(c)(7.2). Same facts as in Example (3)(b)(7.1), except that from 1998 through 2002 the partnership had one or more non-resident individual partners and had income derived from business activities in another state, and that other state had jurisdiction to levy an income tax on the partnership or partners. Five-Year Partner was a partner during the period 1998 through 2002. The partnership should apply the average apportionment percentage of the partnership under 830 CMR 62.5A.1(6) during the period 1998 through 2002 and notify the Five-Year Partner of the Massachusetts source income portion of his annual payments.

8. *Sale of a business or an interest in a business.* Income from a trade or business may include income that results from the sale of a business or an interest in a business. This rule generally applies to the sale of an interest in a sole proprietorship, general partnership, limited liability partnership, a general or limited partner's interest in a limited partnership (subject to the exception in the following sentence), or an interest in a limited liability company. It generally does not apply to the sale of a limited partner's interest in a publicly traded limited partnership, or to the sale of shares of stock in a C or S corporation, to the extent that the income from such gain is characterized for federal income tax purposes as capital gains. Nevertheless, gain from the disposition of a limited partner's interest in a publicly traded limited partnership or the disposition of shares of corporate stock will be considered Massachusetts source income if it is treated as compensation for federal income tax purposes. Such gain may also give rise to Massachusetts source income if, for example, the gain is otherwise connected with the taxpayer's conduct of a trade or business, including employment (as in a case where the stock is related to the taxpayer's compensation for services) or if the organizational form of a business is changed in anticipation of the disposition of one or more interests therein for the purpose of avoiding Massachusetts tax. Depending on the facts and circumstances of the case, gain from the sale of such corporate stock or limited partner's interest in a publicly traded limited partnership will be taxable to non-residents if it is determined that the taxpayer has engaged in a transaction or multiple transactions, the purpose of which is the avoidance of tax upon the gain (e.g. sham or step transaction, or prohibited assignment of income).

Example (3)(c)(8.1). Limited Liability Partner, a non-resident, owns a 25% partnership interest in a Massachusetts limited liability partnership that operates a computer consulting business in Massachusetts. Partner contributed funds to the limited liability partnership upon its creation, but took no part in its management or operations. Partner sells his interest in the partnership and recognizes a capital gain for federal tax purposes. Partner is taxable in Massachusetts on the gain.

Example (3)(c)(8.2). Same facts as in Example (3)(c)(8.1), but the partnership had one or more nonresident individual partners, had income derived from business activities in another state, and such other state had the jurisdiction to levy an income tax on the partnership or partners. Non-resident Limited Liability Partner may apportion the gain on the sale of the partnership interest. The proper method for determining apportionment is to use the average of the apportionment percentages under 830 CMR 62.5A.1(6), taken from each partnership Form 3, during the period the partner owned the partnership interest.

Example (3)(c)(8.3). Limited Partner, a non-resident, purchased an interest in a limited partnership that was not publicly traded, but that had Massachusetts source income. After two years, Limited Partner sells her interest. Limited partner is taxable on the apportioned share of gain from the disposition, apportioned by averaging the apportionment percentages of the partnership under 830 CMR 62.5A.1(6) during the two years Limited Partner owned her shares

Example (3)(c)(8.4). Investor is an out-of-state employee of NationalCorp, a C corporation doing business in Massachusetts. Investor works in NationalCorp's Massachusetts offices. Investor purchases stock of NationalCorp as an ordinary investment unrelated in any way to his compensation. The gain on Investor's sale of the stock is not Massachusetts source income.

Example (3)(c)(8.5). Employee works in Massachusetts and is granted a bonus of restricted stock, subject to risk of forfeiture, with vesting conditioned on her employer's reaching certain projected increases in corporate earnings. Employee does not make an election to include the value of the stock in gross income in the year of the transfer under IRC § 83(b). Three years later Employee moves out of state, and sells the stock before it becomes substantially vested, triggering inclusion of the gain in income as compensation for federal income tax purposes. Employee's gain is Massachusetts source income taxable to Employee.

9. Taxable Unemployment Compensation or Disability Income. All unemployment compensation and disability income included in Massachusetts gross income and derived from employment in Massachusetts is Massachusetts source income.

(d) *Income from Ownership of Any Interest in Real or Tangible Personal Property.* All income derived from the ownership of any interest in real or tangible personal property located in Massachusetts is Massachusetts source income. For purposes of this regulation, the ownership of an interest in real property located within Massachusetts includes the ownership of an interest in a partnership to the extent that the partnership holds an interest in real property located in Massachusetts. Income from the ownership of any interest in real or tangible personal property located in Massachusetts includes income and gains derived from the following:

1. *real property located in Massachusetts.* This category includes the ownership of an interest in a partnership, to the extent that the partnership holds an interest in real property located in Massachusetts.

Example (3)(d)(1.1). A Vermont resident owns real estate located in Massachusetts that is sold for a profit. The Vermont resident will be subject to Massachusetts income tax on the net gain derived from the sale.

Example (3)(d)(1.2). A New York resident receiving rental income from real estate located in Massachusetts will be subject to Massachusetts income tax on such income.

Example (3)(d)(1.3). A Connecticut resident owns real estate located in Massachusetts. She sells the property for a gain and as part of the consideration for the sale receives a note from the buyer for 20% of the purchase price. Under the note the buyer will pay principal and interest in installments over the next five years. Both the gain and interest received will be subject to Massachusetts income tax, whether or not the non-resident elects to defer recognition of the income under the installment sale provisions set forth in G.L. c. 62, § 63.

Example (3)(d)(1.4). Texas General Partnership has three non-resident partners. The Partnership owns shares in a REIT that is formed as a corporation that are sold on a secondary market, such as through an investment firm, which it has purchased at arms length. Income from the REIT is not treated as income from real estate, but rather as income from certain intangibles not subject to Massachusetts income tax for non-residents, according to the rule at 830 CMR 62.5A.1(4)(b). As in all cases, such income may be taxable to non-residents under the sham transaction rule.

Example (3)(d)(1.5). MallPartners is a partnership with three non-resident partners that owns malls throughout the country, including a mall in Massachusetts. Income derived from the Massachusetts mall is Massachusetts source income derived from real property, and is taxable to the non-resident partners.

Example (3)(d)(1.6).

Non-resident is a partner in a partnership that owns ten acres of land in Massachusetts. Non-resident sells his interest in the partnership. Non-resident is taxable on the gain from the sale.

a. Like-kind exchanges under Code section 1031. Massachusetts does not tax gain from the sale of real property that is deferred under the like-kind exchange provisions of Code section 1031. However, when the taxpayer subsequently disposes of the property acquired in such an exchange, the amount of the gain that reflects appreciation of Massachusetts real estate is Massachusetts source income.

2. *tangible personal property having a situs in Massachusetts;*
3. *any interest in a Massachusetts cooperative housing corporation;*
4. *any interest in a Massachusetts timesharing or similar arrangement;*
5. *another interest in Massachusetts real or tangible personal property.* This category includes income from extractive rights for timber or minerals.

(e) *Income from Lottery or Wagering Transactions.* All winnings from lottery or wagering transactions within Massachusetts are Massachusetts source income.

Example (3)(e)(1.1). A Maine resident who purchases a Massachusetts lottery ticket and wins a prize will be subject to Massachusetts income tax on the full amount of the winnings.

Example (3)(e)(1.2). A New Hampshire resident visits a horseracing track in Massachusetts, places a bet on a horse and wins. The full amount of the winnings will be subject to Massachusetts income tax.

(f) *Income from Patents, Copyrights and Other Similar Intangibles*

1. *Royalty Income.* Royalty income from the licensing of a patent or copyright, and income from the licensing of a design, idea or other similar intangible, to a person for use in Massachusetts is Massachusetts source income. For this purpose, "royalty income" shall include payments derived from the licensing or sale of an intangible where the amount is contingent on productivity, use, or disposition of the intangible (royalty-type payments) irrespective of whether such transaction may be treated as a "sale" of all substantial rights in the intangible for certain tax purposes.

Example (3)(f)(1). A non-resident scientist develops a formula for a new drug product, patents the formula and grants a license to a pharmaceutical company, which produces the product at its Springfield, Massachusetts plant. The entire income from the licensing agreement is Massachusetts source income to the scientist.

2. *Non-royalty-type Income from Sale or Exchange of Intangible.* Income derived from non-royalty-type payments from the sale or exchange of a patent, copyright, design, idea or other similar intangible by a non-resident is Massachusetts source income if derived from or effectively connected with a trade or business including employment carried on in Massachusetts.

(g) *Other Income.* All other types of income that fall within the definition of Massachusetts source income.

(h) *Presence for Business, Casual, Isolated and Inconsequential for non-resident individuals.* Notwithstanding the provisions of 830 CMR 62.5A.1(3)(a), a non-resident individual does not have a trade or business, including any employment, carried on in Massachusetts if the non-resident's presence for business in Massachusetts is casual, isolated and inconsequential. A non-resident's presence for business in Massachusetts will ordinarily be considered casual, isolated and inconsequential if the non-resident's presence for business in Massachusetts is ancillary to the non-resident's primary business or employment duties performed at a base of operations outside of Massachusetts, as with occasional presence in Massachusetts for management reporting or planning, training, attendance at conferences or symposia, and other similar activities that are secondary to the individual's primary out-of-state duties.

Example (3)(h)(1.1). A former politician, a resident of California, now earns a living speaking at various functions across the country. She spends one day in Massachusetts delivering a speech at a convention in Lowell, Massachusetts and earns \$ 30,000. This non-resident is considered to be carrying on business in Massachusetts because the fee is earned as a direct consequence of the Massachusetts activity, and this activity is not merely ancillary to her business conducted outside of Massachusetts.

Example (3)(h)(1.2). A dentist employed by a health maintenance organization in Portland, Maine, comes to Massachusetts for a paid six-week training course in pediatric dentistry. Her presence for business in Massachusetts is ancillary to her primary employment duties elsewhere and is therefore casual, isolated and inconsequential. She is not considered to be carrying on employment in Massachusetts.

Example (3)(h)(1.3). A New York attorney, practicing law as a sole practitioner primarily in New York City, is retained by a Massachusetts business in connection with a pending lawsuit in a Massachusetts court. All of the trial preparation occurs in New York but the attorney appears in

court in Massachusetts every day for four weeks. This non-resident is considered to be carrying on business in Massachusetts while in the Commonwealth because the duties performed in Massachusetts are not merely ancillary to his primary business outside Massachusetts.

(4) *Income Not Subject to Massachusetts Income Tax.* The following types of income earned or derived by non-residents are not subject to Massachusetts income tax:

(a) *Duty in the armed forces.* Compensation paid by the United States of America to its servicemembers for services rendered on active duty, including members of the Army, Navy, Air Force, Coast Guard and Marines who are assigned to a military airbase, naval station, or any facility, public or private, in Massachusetts, to which they must report under service orders.

(b) *Income from certain intangibles.* Income from annuities, interest, dividends, and gains from the sale or exchange of intangibles, when purely of a passive investment character, not related to the operational functions of a business, and not related to employment or business activity in Massachusetts or to the sale or exchange of Massachusetts real or tangible personal property or of an interest in a business, and not related to a partnership interest in a partnership to the extent the partnership holds an interest in real property located in Massachusetts.

(c) *Certain income of foreign citizens.* Massachusetts source income received by a non-resident who is a citizen of a foreign country, which income is excluded from federal gross income under an income tax treaty or convention to which the United States is a party. Massachusetts source income not excluded from federal gross income by the treaty or convention and that is included in federal gross income is subject to Massachusetts income tax.

(d) *Certain Pension income.* Income from any contributory annuity, pension, endowment or retirement fund of the United States Government or the Commonwealth or any political subdivision thereof, to which the employee has contributed.

(e) *Qualified pension income,* as set forth in 4 U.S.C. § 114, or other provision of federal law that would preclude such income from being subject to Massachusetts tax, which includes any distribution received by the taxpayer from:

1. a qualified trust under section 401(a) of the Code that is exempt from taxation under section 501(a) of the Code;
2. a simplified employee pension as defined in section 408(k) of the Code;
3. an annuity plan described in section 403(a) of the Code;
4. an annuity contract described in section 403(b) of the Code;
5. an individual retirement plan described in section 7701(a)(37) of the Code;
6. an eligible deferred compensation plan as defined in section 457 of the Code;
7. a governmental plan as defined in section 414(d) of the Code;
8. a trust described in section 501(c)(18) of the Code;
9. any plan, program, or arrangement described in section 3121(v)(2)(C) of the Code, under the conditions provided in 4 U.S.C. § 114.

(f) *Federal preemption.* Any other income that is the subject of federal preemption on state taxation. This includes income of: certain seafarers and fishers, as set forth at 46 USC § 11108, or its successor; certain employees of interstate rail carriers, as set forth at 49 USC, § 11502, or its successor; certain employees of motor carriers, as set forth at 49 USC § 14503, or its successor; certain employees of air carriers who regularly perform duties on an aircraft, as set forth at 49 USC, § 40116, or its successor.

(5) *Rules for Allocation or Apportionment of Income to Massachusetts for Non-Resident Individuals Working in Massachusetts.* When a non-resident earns or derives income from sources both within Massachusetts and elsewhere, the taxpayer must either allocate or apportion the income to determine the amount of Massachusetts source income, using the following apportionment provisions. These rules apply to non-resident individuals working in Massachusetts. Non-resident members of pass-through entities use the rules at 830 CMR 62.5A.1(6).

(a) *Employees Compensated on an Hourly, Daily, Weekly or Monthly Basis.* When a non-resident employee is able to establish the exact amount of pay received for services performed in Massachusetts, that amount is the amount of Massachusetts source income. When no exact determination of amounts earned or derived in Massachusetts is possible, the income of employees who are compensated on an hourly, daily, weekly or monthly basis must be apportioned to Massachusetts by multiplying the gross income, wherever earned, by a fraction, the numerator of which is the number of days spent working in Massachusetts and the denominator of which is the total working days. The result is the amount of the non-resident's

135 (total working days)

2. *Other situations – Three factor apportionment.* If none of the formulas described in 830 CMR 62.5A .1(5)(a) – (c) is applicable to the apportionment of a non-resident's trade or business income, then the amount of Massachusetts source income is determined based upon the three-factor formula for apportioning a corporation's income under G.L. c. 63, § 38 and the definitions applicable to that formula. The following three factors must be determined:

- a. *Property factor.* The average value of the taxpayer's real and tangible personal property owned or rented, and used in the taxpayer's business in Massachusetts, divided by the average value of all the taxpayer's real and tangible personal property owned or rented everywhere, and used in the taxpayer's business during the tax year. The average value of property is determined by averaging the values at the beginning and at the end of the tax year.
- b. *Payroll factor.* The total wages, salaries and other personal service compensation paid during the tax year to employees in connection with the trade or business carried on within Massachusetts divided by the total of such wages and compensation wherever earned and paid.
- c. *Sales factor.* The gross sales in Massachusetts, or gross receipts derived from activities in Massachusetts, divided by the total gross sales or charges everywhere.

The above three factors must be carried out to four decimal places. The apportionment percentage is a fraction, the numerator of which is the property factor plus the payroll factor plus twice the sales factor, and the denominator of which is four. The resulting figure is then multiplied by the entire net income of the trade or business, wherever derived. The result is the Massachusetts source income.

d. In a case where only two of the foregoing three factors are applicable, the Massachusetts source income is determined by multiplying the entire net income of the business by a fraction, the numerator of which is the remaining two factors with their respective weights and the denominator of which is the number of times that such factors are used in the numerator. If only one of the three factors is applicable, the Massachusetts source income is determined solely by that factor. A factor will not be deemed to be inapplicable merely because the numerator of the factor is zero. A factor will not be applicable if the denominator of the factor is less than ten percent of one third of the entire net income or if it is otherwise determined to be insignificant in producing income.

(e) *Entertainers and Professional Athletes not Members of a Professional Athletic Team.* The Massachusetts source income of non-resident entertainers and professional athletes who are not members of a professional athletic team is the entire amount received for performances, engagements or events that occurred in Massachusetts. If the entertainer or athlete is not paid separately for each Massachusetts event, then the following apportionment formula must be used. The income earned and subject to the Massachusetts income tax is the total annual compensation derived from performances, engagements, or events multiplied by a fraction, the numerator of which is the number of performances or events the entertainer or athlete performed (or was available to perform, as, for example, with understudies) in Massachusetts, and the denominator of which is the total number of performances or events that the entertainer or athlete was obligated to perform during the tax year.

Example (5)(e)(1.1). A non-resident entertainer performs for three evenings at Symphony Hall in Boston and earns \$ 100,000. The entire \$ 100,000 is income subject to Massachusetts income tax.

Example (5)(e)(1.2). A non-resident professional dancer earns an annual salary of \$50,000. She dances in all 40 of her dance company's performances during the tax year, 20 of which took place in Massachusetts. The income subject to tax in Massachusetts is \$ 25,000, calculated by multiplying \$ 50,000 by 20/40.

Example (5)(e)(1.3). A non-resident professional tennis player plays in one tournament in Massachusetts during the tax year. She spends six days in Massachusetts and earns \$75,000 in winnings from the tournament. The entire \$ 75,000 income is subject to Massachusetts income tax.

(f) *Allocation and Apportionment for non-residents who have income attributable to a period of Massachusetts residence.* Non-residents who have income attributable to a period during which they were residents are taxable only on income from sources within Massachusetts, which includes items of gross income derived from or effectively connected with any trade or business, including any employment carried on by the taxpayer in Massachusetts. Because taxpayers were residents and thus subject to 100% allocation of income during the period to which the current income is attributable, the non-resident receiving such income may allocate or apportion it according to 830 CMR 62.5A.1(5) if the income was attributable to more than one jurisdiction during the year it was earned. A taxpayer asserting this right must document all factors used in calculating the Massachusetts source income under 830 CMR 62.5A.1(5). In the absence of such documentation, the presumption will be that 100% of the income for that year is allocated to Massachusetts. For allocation and apportionment rules for income derived from the sale of a business or an interest in a business, see Example (3)(c)(8.2).

Example (5)(f)(1).

Taxpayer lived in Massachusetts in 2005 and worked for a single corporation in both Massachusetts and Connecticut during that year. In 2006, Taxpayer moved to Florida. In 2008, Taxpayer receives income that is attributable to her work for that corporation in 2005. Taxpayer has no apportionment percentage available for 2005, because Taxpayer was a resident and subject to 100% allocation of income. Taxpayer is unable to establish the exact amount of pay received for services performed in Massachusetts. Taxpayer can, however, prove through documentation that she worked 50% of her working days in Massachusetts and 50% in Connecticut. The Massachusetts source income is the amount of the payment attributable to 2005 multiplied by the resulting apportionment percentage of 50%.

(6) *Rules for Allocation or Apportionment of Income to Massachusetts for Non-Resident Members of Pass-Through Entities.* A pass-through entity that earns or derives income from sources both within Massachusetts and elsewhere must either allocate or apportion the income to determine the amount of Massachusetts source income of its non-resident members, using the following allocation and apportionment provisions. These rules apply to pass-through entities with non-resident members that have Massachusetts source income. Non-resident individuals use the rules at 830 CMR 62.5A.1(5).

(a) *General.* A pass-through entity that has income that is taxable both within and outside of Massachusetts must report the member's apportioned share of income to the member. To arrive at the apportioned income figure, the pass-through entity must multiply its taxable net income by the apportionment percentage determined under G.L. c. 63, § 38(c)-(g) and 830 CMR 63.381. For Massachusetts purposes, the pass-through entity's income subject to apportionment is its entire net income derived from its related business activities, as that term is defined at 830 CMR 62.5A.1(2), and further described at 830 CMR 62.5A.1(6)(d), within and outside of Massachusetts. The entity's income subject to Massachusetts tax is its apportioned net income derived from its related business activities, plus any other income subject to the tax jurisdiction of Massachusetts. Guaranteed payments made to pass-through entity members are treated as other income of the pass-through entity is treated, and are subject to the apportionment rules in this paragraph.

(b) *Treatment of multiple pass-through entities engaged in a unitary business.* If a pass-through entity has Massachusetts source income and is related to one or more other pass-through entities in a unitary business, including non-Massachusetts businesses that are in a unitary relationship, the entire income derived from the related activities of the members of the unitary business is subject to Massachusetts apportionment. The method of apportionment is to take the pro rata share of the factors of each entity in the unitary structure, and to aggregate the result for the entire group, according to the method in the following example. The non-resident members will report as Massachusetts source income their apportioned share of income of the entire unitary business.

Example (6)(b)(1.1). General Partnership (General) has a 50% interest in Subsidiary Partnership (Subsidiary); the entities are engaged in a unitary business. General has the following apportionment factors attributable to Massachusetts, presented as a fraction of Massachusetts activity divided by activity everywhere: Property, 25/100; Payroll, 50/100; Sales, 100/10,000. General has income of \$1,000. Subsidiary has the following apportionment factors, presented as a fraction of Massachusetts activity divided by activity everywhere: Property, 10/100; Payroll, 50/100; Sales, 1000/10,000. Subsidiary has a loss of \$500. The Massachusetts income of the unitary group is calculated as follows: Income = \$1,000 (General's income) - \$250 (representing half the loss of Subsidiary; half because General has a 50% interest in Subsidiary) = \$750. The \$750 income figure must be multiplied by the blended apportionment factors. The blended factors are determined by adding the full factor of General to half the value of Subsidiary's factors

(again, because of the 50% ownership). Thus the blended property factor is $(25 + 5)/(100 + 50) = 30/150$; the blended payroll factor is $(50 + 25)/(100 + 50) = 75/150$; the blended sales factor (to be counted twice according to the double weighted sales factor rule) is $[(1000 + 500)/(10,000 + 5,000)] = 1,500/15,000$; the sum of these factors is then divided by four to yield the following result: $.2 + .5 + .1 + .1 = .9 / 4 = .225$.

(c) *Treatment of income derived from unrelated activities.* If the unitary business subject to Massachusetts apportionment has income derived from unrelated business activities, as determined under 830 CMR 62.5A.1(6)(d), these items of income will be excluded from the taxpayer's taxable net income and will not be apportioned to Massachusetts if Massachusetts does not have jurisdiction to tax the items of income under the Constitution of the United States. Income derived from unrelated business activities will be allocated to Massachusetts when the entity's commercial domicile is Massachusetts. The unitary business must report to the non-resident taxpayer, and the non-resident taxpayer must disclose on his or her return, the nature and amount of any item of income that is derived from unrelated business activities and is excluded from (or is excludable from) taxable net income. The taxpayer must also disclose and exclude expenses allocable in whole or part to such unrelated business activities. Any property, payroll, or sales derived from unrelated business activity are excluded from the taxpayer's apportionment factors.

Example (6)(c)(1). Massachusetts LLC owns a commercial real estate property that it leases, both to its parent, a Partnership that gives investment advice to clients, and to other unrelated tenants. The Partnership, in turn, is owned by three Owner LLCs, all of which have a commercial domicile in other states. The Owner LLCs own the interests in the Partnership, as well as other business ventures, such as a manufacturing corporation in South Carolina and a public utility corporation in North Dakota. The manufacturing corporation and the utility corporation are not in a unitary business with other entities, nor do they have any contacts with Massachusetts. The Massachusetts LLC and the Partnership have centralization of management and a flow of value between the entities, and comprise a unitary business. In determining the Massachusetts source income of the Owner LLC members, the Massachusetts LLC and the Partnership must combine their taxable net income and calculate the Massachusetts apportionment percentage based on their combined property, payroll, and sales. The unitary business will exclude the income of the manufacturing corporation and the public utility corporation from this determination, and will not take into account any of the property, payroll, or sales of the two corporations in calculating the Massachusetts apportionment percentage of the unitary business.

(d) *Related Business Activities.*

1. *Definition.*

i. *General Rule.* Related business activities are activities where there is a sharing or exchange of value between the segments of a single entity or multiple entities such that the activities are mutually beneficial, interdependent, integrated, or such that they otherwise contribute to one another, as generally described under the discussion of the unitary business principle in *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768 (1992). The rules that apply to corporations, found at 830 CMR 63.38.1(4), generally apply to pass-through entities as they are applicable, with certain modifications set forth in this regulation. In general, any two segments or activities of a single pass-through entity are related business activities unless the two segments or activities are not unitary. In addition, the following activities are related business activities notwithstanding the absence of a unitary relationship:

- a. the short term investment of capital in a non-unitary business segment or activity; and
- b. any other investment of capital that serves an operational function.

ii. *Income from Cash, Cash Equivalents, and Short-Term Securities.* Interest or other income from cash deposits, cash equivalents, and short-term securities is considered related business income if such capital serves or performs an operational function. Without limitation, examples of operational functions include: the use or holding of funds as working capital or reserves; the use or holding of funds to maintain a favorable credit rating (e.g. by maintaining a strong current or quick asset ratio); the use or holding of funds to self-insure against business risks; and the interim investment of funds pending their future use in the taxpayer's business.

2. *Burden of Proof.* Except as provided in 830 CMR 62.5A.1(6)(d)(3) (relating to

pass-through entity limited partners), all income of a single pass-through entity (whether derived directly or through representatives, or other pass-through entities) is presumed to be income from related business activities until the contrary is established. Either the taxpayer or the Commissioner may assert that an item of a taxpayer's income is derived from unrelated business activities. The party making such an assertion must prove by clear and cogent evidence that the business activities do not reasonably warrant a finding that the business activities are related. To demonstrate that income from cash, cash equivalents, or short-term securities is derived from unrelated business activities, a taxpayer must prove by clear and cogent evidence that the underlying assets and their acquisition, maintenance, and management were, in fact, unrelated to the pass-through entity's business activities in the Commonwealth.

3. *Presumption of Unrelated Business Activity of Pass-Through Entity Limited Partners.* In cases where a pass-through entity limited partner owns no more than 50% of the capital interests of a partnership, income that the pass-through entity limited partner derives from the holding or disposition of its limited partnership interest is presumed to be unrelated to the pass-through entity's other business activities unless the Commissioner or the taxpayer rebuts this presumption, as provided (and applicable) in 830 CMR 63.39.1(8)(f). If the business activities of the pass-through entity limited partner and the limited partnership are unrelated, then the pass-through entity limited partner must separately account for its limited partnership income and its other business income and must separately apportion to Massachusetts income from each unrelated activity (to the extent that Massachusetts has jurisdiction to tax income from each such activity), using only the apportionment factors applicable to that activity.

Example (6)(d)(3.1). Texas LLC owns a minority limited partnership interest in Partnership A. Partnership A conducts business in Massachusetts. Apart from this partnership holding, Texas LLC does not conduct business in Massachusetts. Texas LLC does conduct business in other jurisdictions, either directly or through ownership of other pass-through entities. Neither Texas LLC nor the Commissioner rebuts the presumption that the business activities of Texas LLC and Partnership A are unrelated. Texas LLC must separately apportion to Massachusetts income from the holding or disposition of its interest in Partnership A, using the apportionment factors derived from the partnership's activity. Income from Texas LLC's other activities is not subject to Massachusetts tax jurisdiction and is excluded from the Massachusetts source income that it reports to its members.

(e) *Special apportionment rules for the gain on the sale of an ownership interest in a partnership that holds real property in Massachusetts.*

1. *Partnerships that are carrying on a trade or business in Massachusetts.* A non-resident partner who sells an interest in a partnership that both holds an interest in real property in Massachusetts and is carrying on a trade or business in Massachusetts is subject to the general rule at 830 CMR 62.5A.1(3)(c)(8), particularly as illustrated at 830 CMR 62.5A.1, *Example (3)(c)(8.2).*

2. *Partnerships that are not carrying on a trade or business in Massachusetts.* A non-resident partner who sells an interest in a partnership that holds an interest in real property in Massachusetts but is not carrying on a trade or business in Massachusetts should apply the following rule. The non-resident partner selling his or her interest in the partnership must multiply the gain by a fraction, the numerator of which is the value of the Massachusetts real property and the denominator of which is the total value of the partnership. The value of real property to be used in the fraction is the current fair market value of the property reduced by the value of any lien or encumbrance remaining thereon at the time the partner sells his or her interest in the partnership.

Example (6)(e)(2). Non-resident is a partner in LandHold, a partnership that purchases land in several states and holds the land for subsequent sale to developers. The partnership was formed with an initial capital contribution from its partners, but was not engaged in the conduct of a trade or business in Massachusetts during the year that Non-resident sells his interest in the partnership. The Massachusetts source income derived from the sale is the total gain from the sale, multiplied by fraction set forth in 830 CMR 62.5A.1(6)(e)(2).

(7) *Exemptions.*

(a) *General.* A non-resident is entitled to the same exemptions under G.L. c. 62 as those granted to a resident, found at G.L. c. 62, § 3(B)(b), with exceptions that apply to participants in a

composite return, set forth at 830 CMR 62.5A.1(11)(f), below.

(b) *Deduction and Exemption Ratio.* The non-resident's applicable exemption amounts must be totaled and apportioned to Massachusetts. The total exemption amount must be pro-rated by the "deduction and exemption ratio" of the taxpayer's Massachusetts source income to his or her total income. The deduction and exemption ratio is a fraction, the numerator of which is the non-resident's Massachusetts source income and the denominator of which is the non-resident's Massachusetts gross income for the tax year determined as if the taxpayer had been a Massachusetts resident. For more detail, see the instructions to Form 1 NR/PY.

Example (7)(b)(1.1). Taxpayer, an unmarried full year resident of New Hampshire, is over 65 and earns \$ 20,000 in Massachusetts source income and \$ 10,000 in New Hampshire during the tax year. Taxpayer is entitled to a personal exemption of \$3,300 and an additional exemption of \$700 for having attained the age of 65 before the close of the tax year. He may claim an exemption amount of \$2,667, calculated on the following basis:

\$3,300 (personal exemption) + \$700 (age 65 exemption) = \$4,000;
 $\$4,000 \times \$20,000 \text{ (Massachusetts source income)} / (\$20,000 + \$10,000) \text{ (total income from all sources)} = \$2,667.$

Example (7)(b)(1.2). Husband and Wife are full year residents of Maine during the tax year. Husband has \$24,000 of Massachusetts source income. Wife earns \$25,000 in Maine and \$1,000 in Massachusetts. They have one dependent child. They are entitled to claim an exemption of \$3,800, calculated on the following basis:

\$6,600 (personal exemption) + \$1,000 (dependent child exemption) = \$7,600;
 $\$7,600 \times (\$24,000 + \$1,000) \text{ (Massachusetts source income)} / (\$24,000 + \$25,000 + \$1,000) \text{ (total income from all sources)} = \$3,800.$

(c) *Rules that Apply to a Taxpayer who is both a Non-Resident and Part-Year Resident during a tax year.* If during a single tax year an individual changes status from that of resident to that of non-resident, or vice versa, the individual will be required to file one Form 1-NR/PY as both a non-resident and part-year resident. To calculate exemption amounts applicable for the period when the individual was considered a non-resident, refer to the instructions for Form 1-NR/PY.

(8) *Deductions.*

(a) *General.* A non-resident is entitled to the same deductions under G.L. c. 62 as those granted to a resident, with exceptions that apply to participants in a composite return, set forth at 830 CMR 62.5A.1(11)(f), below.

Example (8)(a)(1). A non-resident earned \$10,000 in Massachusetts and \$20,000 in Connecticut in 2000. He may deduct only that FICA amount withheld from the \$10,000 earned in Massachusetts.

(b) *Apportionment of Deductions.* Where a particular deductible item is not directly traceable to Massachusetts source income, as may be the case for certain employee business expenses, the non-resident's applicable deduction amounts must be totaled and apportioned to Massachusetts using the applicable rules for apportionment of income set forth in 830 CMR 62.5A.1(5), (6). Deductions for alimony paid and for employment related expenses for the care of a child under age 13, disabled dependent or disabled spouse, and for a dependent member of the household under age 12 at year end must be apportioned to Massachusetts using the deduction and exemption ratio set forth in 830 CMR 62.5A.1(7)(b).

(9) *Estates of Non-resident Decedents.* The estate of a decedent who was a non-resident at the time of death, or the taxable beneficiaries of the estate, are subject to Massachusetts income taxation on the Massachusetts source income of the estate.

(10) *Non-resident Trusts.* A non-resident trust deriving Massachusetts source income, or taxable beneficiaries of the trust, are subject to Massachusetts income taxation on the Massachusetts source income of the trust.

(11) *Returns.*

General note.

All returns may be subject to electronic filing requirements, subject to change over time, according to the rules set forth on the Department of Revenue's Web site. See www.mass.gov/dor for current requirements.

(a) *Individuals.*

1. *General.* An individual non-resident whose Massachusetts source income exceeds \$8,000 or the personal exemption to which the non-resident is entitled after apportionment, whichever is the lesser, is required to file with the Commissioner a return on Form 1-NR/PY.
2. *Married Individuals.* If the Massachusetts source income of one or both spouses exceeds the minimum filing amount, each spouse whose income exceeds that amount must file a Form 1-NR/PY. However, a married individual may file Form 1-NR/PY jointly with his other spouse provided that they are both non-residents and that their tax years begin on the same day and either end on the same day or end on different days solely because of the death of either or both.
3. *Failure to File.* The Massachusetts income tax will be assessed on the entire Massachusetts source income of a non-resident who fails to file a return. The Commissioner will determine the non-resident's Massachusetts source income according to his best information and belief and may assess the tax with penalties and interest, and without allowance for deductions or exemptions, in addition to any other penalties allowed by law.

(b) *Partnerships.* Any partnership having a usual place of business in Massachusetts and federal gross income in excess of \$100 during the tax year must file with the Commissioner on or before the 15th day of the fourth month following the close of the tax year, an information return, sworn to by a member of the partnership, on Form 3 and its schedules. The return must include the partnership's income or losses from Massachusetts sources; any deductions or credits attributable thereto; the names and addresses of the resident and non-resident partners; their distributive shares of the various classes of the partnership's income, losses, deductions or credits apportioned to each, and other information as required by Form 3 and its schedules. In general, a partnership must maintain an office or other place of business in the state (which may include an office that is neither owned nor rented by the partnership, but is provided by another party) in order for it to have a "usual place of business" in Massachusetts. It is not necessary that the place of business maintained in Massachusetts be the principal place of business of a partnership in order for it to be a usual place of business.

(c) *Estates of Non-Resident Decedents.* An executor or administrator of a non-resident decedent's estate deriving Massachusetts source income that meets other filing requirements must file with the Commissioner a return on Form 2, Fiduciary Income Tax Return, and all other required forms.

(d) *Non-Resident Trusts.* The trustee of a non-resident trust deriving Massachusetts source income that meets other filing requirements must file with the Commissioner a return on Form 2, Fiduciary Income Tax Return, and all other required forms.

(e) *Payor's Information Returns.* Every individual or entity doing business in Massachusetts must file information returns (such as the federal form W-2 or form 1099) with the Commissioner, on or before June 1st of each year, for each non-resident deriving income in Massachusetts to whom it has paid any income subject to Massachusetts income taxation. All returns must report the name and address of the non-resident recipient(s), the total amount paid to him or her during the preceding calendar year, the amount of Massachusetts source income, and the amount of Massachusetts tax withheld. See 830 CMR 62B.2.1(6). This requirement applies to payments to any entity, as described in 830 CMR 62B.2.1.

(f) *Composite returns.*

1. *General rule.* A pass-through entity may file a composite return on behalf of qualified electing non-residents reporting and paying income tax on the non-residents' pro rata or distributive shares of Massachusetts source income of the pass-through entity.
 - a. *Person responsible for filing.* Qualified electing non-residents must authorize a single person to act as their agent (the "filing agent") in filing a composite tax return and estimated tax payments. The filing agent must sign the composite tax return, and shall accept all notices from the Department of Revenue on behalf of any and all qualified electing non-residents.
 - b. *Qualified electing non-residents.* A non-resident who meets all of the following criteria is a qualified electing non-resident:
 - i. the person must be an individual, or an entity that is taxed under the Code as an individual, such as an electing small business trust (ESBT), or the estate or trust of

- a deceased non-resident;
 - ii. the person must be a non-resident for the entire tax year;
 - iii. the person must have no Massachusetts source income other than that reported on one or more composite returns, nor may the person's spouse have other Massachusetts source income, if they are filing jointly;
 - iv. the person must elect to be included in the composite return by signing, either as individual or as trustee, the statement required under 830 CMR 62.5A.1(11)(f)2. A person filing a separate return in Massachusetts cannot participate in the filing of a composite return; and
 - v. the person must waive the right to claim deductions, exemptions, and credits allowable under G.L. c. 62, § § 3, 5, and 6.
- c. Special rule for trusts that are not taxed under the Code as individuals. Trusts that are not taxed as individuals under the Code may be qualified electing non-residents if each beneficiary of the trust that receives Massachusetts source income would qualify to join in the filing of a composite return under 830 CMR 62.5A.1(11)(f)(1)(b)(i – v). In addition to other requirements under 830 CMR 62.5A.1(11)(f), the trust must file a statement with the composite return that contains the name and social security number of each beneficiary of the trust that receives Massachusetts source income. The statement must affirm that each beneficiary meets the requirements of 830 CMR 62.5A.1(11)(f)(1)(b)(i – v).
- d. Withholding requirement. To the extent applicable, a pass-through entity is subject to the withholding requirements at 830 CMR 62B.2.1.

2. *Filing Statement.* Each person participating in the filing of a composite return must sign under penalties of perjury a statement affirmatively stating the person's qualifications and election to file a composite return. The person will submit this filing statement to the filing agent, who will retain the statements in his or her records. The statement must include the following information:

- a. the name and taxpayer identification number of the pass-through entity;
- b. the person's taxpayer identification number and the exact address of the person's principal place of residence;
- c. an acknowledgment of the person's obligation to file a return, make estimated tax payments if required, and pay his or her pro rata share of any penalty and interest due for any underpayment of estimated taxes;
- d. a statement of waiver of the right to claim any deductions, exemptions, and credits allowable under G.L. c. 62, § § 3, 5, and 6; and
- e. a power of attorney authorizing the filing agent to represent the qualified electing non-resident in making, executing, and filing the composite return, tax payments, and estimated tax payments, and authorizing the filing agent to receive notices from the Department of Revenue on behalf of the non-resident. Attaching a properly completed Massachusetts Power of Attorney Form M-2848 to the qualified electing non-resident's statement will fulfill the power of attorney authorization requirement.

3. *Composite Return filing requirements.* The filing agent will file a return on Form 1-NR/PY, attaching the composite Massachusetts Schedule E-NR/PY. The filing agent will note that it is a "Composite Return" at the top of each form or schedule. The total Massachusetts gross income reported on the composite Form 1-NR/PY shall be the sum of all the qualified electing non-residents' Massachusetts source income. Persons included in the composite return filing must have the same tax year.

4. *Attachments.* The filing agent shall attach to the composite return:

- a. a statement signed by the filing agent under penalties of perjury, certifying that each non-resident included in the composite return has executed the statement required by 830 CMR 62.5A.1(11)(f)2, and that those statements are on file at the principal office in Massachusetts of the pass-through entity, the address of that office, or if there is no Massachusetts office the address of the pass-through entity, and that the filing agent signing the composite return is authorized to act as such under power of attorney;

- b. a schedule of each qualified electing non-resident's name, tax identification number, and distributive share of Massachusetts source income of the pass-through entity;
- c. a copy of the Massachusetts income tax forms and attachments of the pass-through entity for any tax year that ended during the qualified electing non-residents' tax year that is reported on the composite return.

5. *Composite Payments of Estimated Tax.* The filing agent shall make payments of estimated tax on Form 1-ES. The filing agent shall note that it is a "Composite estimated tax payment" on the form.

Estimated tax payments made by individuals cannot be credited against tax due with the composite return. Individuals who have made such payments with respect to a tax year and desire to participate in a composite return filing for that year may request a refund of their individual estimated tax payments. The request must be made according to current instructions found at the Department of Revenue web site, www.mass.gov/dor. The request must state that the taxpayer is electing to participate in a composite filing for the tax year. The entity filing the composite form must be clearly identified by name, address and federal identification number. The application will not be considered complete until the composite return is filed with the Department. A copy of the composite return should be attached to the refund request where available.

6. *Extension of Time to File.* The filing agent may request an extension of time to file the composite return. The request must include a schedule of qualified electing non-residents and their tax identification numbers. The filing agent shall note at the top of the form that it is an "Application for Extension of Time to File a Composite Income Tax Return." If granted, the extension of time to file shall apply only to qualified electing non-residents who were included in the request and are then included in the composite return.

7. *Due Dates.* The following due dates apply to 830 CMR 62.5A.1(11)(f):

- a. A qualified electing non-resident must file the filing statement with the pass-through entity before the due date, without any extensions, of the composite return.
- b. A composite return is due on the same date that the return of an individual would be due, and may be allowed the same extensions granted individuals under G.L. c. 62C, § 19.
- c. Composite payments of estimated tax are due on April fifteenth of the tax year, June fifteenth of the tax year, September fifteenth of the tax year, and January fifteenth of the following tax year.

8. *Filing Instructions.* The filing agent shall mail the composite return and composite payments of tax in accordance with the filing instructions for Form 1-NR/PY Form 1-ES. For current instructions, including electronic filing requirements, see the Department of Revenue web site, www.ma.gov/dor.

9. *Special Rules.* The following special rules apply to composite returns and composite payments of estimated tax:

- a. The filing of the composite tax return and composite payments of estimated taxes will be treated as satisfying the obligation of each qualified electing non-resident to file a tax return and to make estimated tax payments under G.L. c. 62C, § 6, and G.L. c. 62B, § 13.
- b. The filing agent is merely an agent for the qualified electing non-residents and each qualified electing non-resident is personally responsible for timely filing of returns and payment of his or her tax liabilities. Non-residents are subject to the same requirements for filing tax returns and the same penalties for failure to file or failure to pay their tax as other taxpayers.
- c. A non-resident taxpayer has the right to file an individual amended return. The Commissioner retains the right to require the filing of an individual non-resident personal income tax return by any of the qualified electing non-residents. This ordinarily will not affect the validity of the original composite return for the tax year to which the individual return required by the Commissioner relates.
- d. A pass-through entity may file an amended composite return on behalf of electing non-residents only if it timely filed an original composite return on their behalf.

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(g) *Composite Returns for Tiered Pass-through entities.* A tiered group of pass-through entities may file a single composite return on behalf of its non-resident members if each entity and individual taxpayer is otherwise eligible to participate in the filing of a composite return. The following additional requirements must also be met:

1. Each of the pass-through entities must join in the filing of a single composite return on behalf of its qualified electing non-residents, and the filing agent of each entity must sign the return.
2. A schedule must be attached to the composite return indicating each qualified electing non-resident's distributive share of Massachusetts source income from each pass-through entity, and the total amount of Massachusetts source income received by each taxpayer from all the pass-through entities combined.
3. A statement must be attached to the composite return, preferably including an organizational chart, disclosing the structure, identity, (including the names, addresses and federal identification numbers), the nature and extent of ownership interests, and the identity of each partner or member of all of the related entities from which participating non-residents directly or indirectly derive Massachusetts source income.
4. The words "Tiered Entity Composite Return" must be clearly indicated on the face of the return.

(12) *Effective Dates.*

General. This regulation repeals and replaces the prior version of 830 CMR 62.5A.1 as of the date of promulgation. The prior version of 830 CMR 62.5A.1 is effective for all periods prior to that date. The provisions in this regulation generally shall apply to tax years beginning on or after January 1, 2006, except to the extent that a provision (i) is subject to a specific effective date provided herein, (ii) is subject to a specific effective date created by legislation, or (iii) reflects a position appearing in a prior public written statement or other Department of Revenue publication, including electronic publication. All rules that antedate this regulation, whether appearing in a prior public written statement or other Department of Revenue publication, continue in force and effect except to the extent any such rules are revised or altered by this regulation. These general rules notwithstanding, for periods prior to the promulgation of this regulation, the Commissioner reserves the right to assert a position reflected in this regulation that is not inconsistent with a prior public written statement, and that otherwise is consonant with the law in effect at that time.

REGULATORY AUTHORITY

830 CMR 62.00: M.G.L. c. 62; c. 14, § 6(1); M.G.L. c. 62C, § 3.

New Regulation Promulgated: 7/14/06