

MEMO# 8673

February 27, 1997

MASSACHUSETTS TAXATION OF CAPITAL GAINS

ACTION REQUESTED February 27, 1997 VIA FAX TO: TAX COMMITTEE No. 7-97 RE: MASSACHUSETTS TAXATION OF CAPITAL GAINS

At the last Tax Committee meeting, we briefly discussed that Massachusetts has enacted rules that substantially change the taxation of capital gains for purposes of the Massachusetts personal income tax. Under the new rules, capital gains are taxed at rates that differ based on the holding period of an asset. For gains from capital assets held for more than one year, the tax rate starts at 5% (for capital assets held for more than one year but not more than two years), and decreases by one percentage point for each additional year that the asset is held. Thus, for assets held for more than six years, the tax rate is zero percent. The new rules are effective for the 1996 calendar year, although holding periods are deemed not to begin prior to January 1, 1995. The Massachusetts Department of Revenue issued the attached proposed regulations that explain the application of the new rules. The proposed regulations include, among other things, a special rule for capital gain dividends received from mutual funds (see page seven of the regulations). Under the special rule, a mutual fund may determine the amount of the capital gain dividend that is attributable to each "class" of capital gains under the Massachusetts law, and report such amounts to the taxpayer and Massachusetts by March 1 of the calendar year following the calendar year of the distribution. In this case, Massachusetts shareholders will be able to apply the graduated tax rates applicable to capital gains. If the mutual fund does not provide the additional information, then the capital gain dividend will be subject to the 5% tax rate. Written comments on the proposed regulations are due by March 12, 1997, and a public hearing on the regulations is scheduled for that day. Accordingly, any suggestions for issues that should be addressed in any Institute comment letter regarding the proposed regulations should be sent to the undersigned by Tuesday, March 4. We will keep you informed of developments. Anne M. Barr Associate Counsel - Tax Attachment (in .pdf format)