MEMO# 8729

March 17, 1997

INSTITUTE COMMENTS ON MASSACHUSETTS CAPITAL GAINS TAX REGULATION

1 See Institute Memorandum to Tax Committee No. 7-97, dated February 27, 1997. March 17, 1997 TO: ACCOUNTING/TREASURERS COMMITTEE No. 9-97 TAX COMMITTEE No. 11-97 RE: INSTITUTE COMMENTS ON MASSACHUSETTS CAPITAL GAINS TAX REGULATION ____ As we previously informed you, Massachusetts has enacted personal income tax provisions which generally provide that capital gains are taxed at different rates based on the holding period of an asset.1 Under this law, in the case of gains from capital assets held for more than one year, the tax rate starts at five percent (for assets held 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 Massachusetts Department of Revenue issued proposed regulations on the capital gains provisions, which include special rules for mutual fund investors. The proposed regulations provide that a mutual fund may determine the amount of a 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. In addition, the proposed regulations provide that when an investor sells shares in a mutual fund an accounts for the sale using the average cost basis method for federal tax purposes, then the Massachusetts adjusted basis shall be determined in the same manner, and the Massachusetts holding period for each share shall be averaged in the same manner and the resulting average shall be deemed to be the holding period for all of the shares sold. In the attached comment letter, the Institute addressed the requirement to use an average holding period for shareholders using average cost basis, recommending that this provision be replaced with a provision that permits a mutual fund shareholder to specify which shares are sold, and, in the absence of such specification, the shareholder would be treated as selling those shares that were first acquired. We will keep you informed of further developments. Anne M. Barr Associate Counsel - Tax Attachment (in .pdf format)