Massachusetts Tax Reforms Under the Economic Development Act

2010-08-11

On August 5, 2010, Governor Deval Patrick signed into law an economic development bill (the "Economic Development Act" or the "Act"). In addition to the much-publicized Massachusetts sales tax holiday, the Act contains several significant tax reforms for Massachusetts.

Net Operating Loss Carryforwards

Before enactment of the Act, net operating losses ("NOLs") sustained in any taxable year could not be carried forward more than five years. Pursuant to the Act, this rule now applies to only those losses sustained in taxable years prior to January 1, 2010. Losses sustained in any taxable year beginning on or after January 1, 2010 may be carried forward for up to 20 years.

Qualified Small Business Stock

Under U.S. federal tax rules, noncorporate investors in "qualified small business stock", as defined in Section 1202 of the Internal Revenue Code ("QSBS") may generally exclude a portion of the gain realized on the sale or exchange of QSBS held for five years. Under the Act, and effective January 1, 2011, Massachusetts adopts a similar rule. The Act provides that income derived from the sale of investments which (1) are in a corporation which (a) is domiciled in Massachusetts; (b) is incorporated on or after January 1, 2011; (c) has less than $50 million in assets at the time of investment; and (d) complies with certain of the "active business" requirements of Section 1202 of the Internal Revenue Code and (2) are held for three years or more, are taxed at a rate of 3% instead of 5.3%. In order to qualify for the 3% rate, investments must be made within five years of the corporation's date of incorporation and must be in stock that generally satisfies the definition of QSBS under Section 1202 of the Internal Revenue Code, other than the requirement that the stock be stock of a C corporation.

Property Exempt from Taxation

Generally, all property—other than real estate, poles and underground conduits, wires and pipes—owned by a manufacturing corporation or a research and development corporation (an "R&D corporation") is exempt from taxation.

Effective for tax years beginning on or after January 1, 2011, the Act extends this exemption to a limited liability company ("LLC") that (1) has its usual place of business in Massachusetts; (2) (a) is engaged in manufacturing in Massachusetts and whose sole member is a manufacturing corporation or (b) is engaged in research and development in Massachusetts and whose sole member is an R&D corporation; and (3) is a disregarded entity. The new law makes clear that in determining whether the sole member of the disregarded LLC is either a manufacturing corporation or an R&D corporation, the attributes and activities of the LLC are taken into account by the member along with the member's other attributes and activities. Furthermore, for purposes of R&D corporations or LLCs whose sole members are either manufacturing corporations or R&D corporations, the provision takes effect only upon its acceptance by the city or town in which the real estate, poles and underground conduits, wires and pipes are located.

Combined Reporting

The Act amends existing Massachusetts law to clarify that where a combined group determines its taxable net income or loss on a water's edge basis, an item of income of a non-U.S. corporation that is a member of the combined group is not included in the combined group's taxable income to the extent that the item is exempt from U.S. federal income tax by virtue of a federal income tax treaty. The Act provides that this provision applies to taxable years beginning on or after January 1, 2009. By making this amendment, the Act brings Massachusetts law in line with federal income tax law.

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