

The Commonwealth of Massachusetts



THE COMMONWEALTH OF MASSACHUSETTS
EXECUTIVE DEPARTMENT
STATE HOUSE • BOSTON 02133

MICHAEL S. DUKAKIS
GOVERNOR

May 9, 1986

To the Honorable Senate and House of Representatives:

I am filing herewith for your consideration legislation which would grant to shareholders of qualifying small business corporations substantially the same treatment under Massachusetts tax laws as they already receive under the Internal Revenue Code and the laws of thirty-six other states. This has been a priority item for small businesses in the Commonwealth.

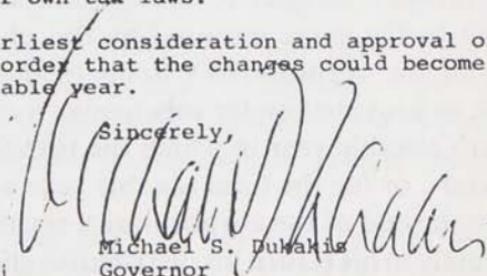
Small business corporations with no more than thirty-five shareholders and which also meet other qualifying requirements may elect, with the consent of the shareholders, to become S corporations for federal tax purposes; and, by so doing, cause the business entity to be treated more as a partnership for income tax purposes than as a corporation.

There are some difficulties to be encountered in moving totally from the corporation excise to the personal income tax under our state laws. But, nonetheless, this proposed legislation would allow the income portion of the corporation excise to be replaced for the shareholders of these corporations by the personal income tax. Thus, the shareholders' distributive share of any income, loss, deduction or credit would be taxed to the shareholder under personal income tax laws rather than to the corporation. This would usually mean a tax at 5% rather than at 9-1/2%. Other parts of the legislation would address the treatment of different classes of income, undistributed accumulated earnings, and shares of non-residents.

This legislation, by introducing conformity with Internal Revenue Code and the laws of thirty-six other states, will not only contribute to a more competitive environment for the formation of small business in the Commonwealth, it will also simplify and improve the administration of our own tax laws.

I recommend your earliest consideration and approval of the attached legislation in order that the changes could become effective for the current taxable year.

Sincerely,


Michael S. Dukakis
Governor

The Commonwealth of Massachusetts

In the Year One Thousand Nine Hundred and Eighty-Six.

AN ACT CONFORMING THE TAXATION OF CERTAIN SMALL BUSINESS CORPORATIONS TO THAT PROVIDED UNDER THE FEDERAL INCOME TAX LAW.

Be it enacted by the Senate and House of Representatives in General Court assembled, and by the authority of the same, as follows:

1 SECTION 1. Paragraph (1) of subsection (a) of section 2 of
2 chapter sixty-two of the General Laws, as appearing in the 1984
3 Official Edition, is hereby amended by striking out subpara-
4 graph (E).

1 SECTION 2. Paragraph (2) of said subsection (a) of said sec-
2 tion 2 of said chapter sixty-two, as appearing in the 1984 Official
3 Edition, is hereby amended by striking out subparagraph (B).

1 SECTION 3. Subsection (d) of section 2 of said chapter sixty-
2 two, as appearing in the 1984 Official Edition, is hereby amended
3 by striking out paragraph (4).

1 SECTION 4. Said chapter 62 is hereby further amended by
2 inserting after section 17, as appearing in the 1984 Official Edition,
3 the following section: —

4 Section 17A. (a) An inhabitant of the commonwealth who is a
5 shareholder of an S corporation, as defined under section thirteen
6 hundred and sixty-one of the Code and whether or not such S
7 corporation is subject to tax under chapter sixty-three, shall be
8 subject to the taxes imposed by this chapter on his distributive
9 share of the corporation's items of income, loss, deduction or
10 credit, as provided under subchapter S of the Code, for the share-
11 holder's taxable year in which the taxable year of the S corpora-
12 tion ends, or for the final taxable year of a shareholder who dies
13 before the end of the corporation's taxable year. He shall include
14 separately in his return his distributive share of the S corporation's

15 income or loss from sources taxable under this chapter and of any
16 item of deduction or credit.

17 (b) A nonresident of the commonwealth who is a shareholder of
18 an S corporation, as so defined, which is subject to tax under
19 chapter sixty-three shall be subject to the tax imposed by section
20 five A on his distributive share of the income realized by the S
21 corporation as would be subject to taxation under section five A if
22 realized by a nonresident. The net income derived from business
23 carried on within the commonwealth shall be determined under
24 the provisions of section thirty-eight and forty-two of chapter
25 sixty-three. The shareholder shall include separately in his return
26 his distributive share of such income or loss and of any item of
27 deduction or credit relating thereto.

28 (c) The character of any item of income, loss, deduction or
29 credit included in a shareholder's distributive share shall be deter-
30 mined as if such item were realized or incurred directly by the
31 shareholder from the source from which realized by the corpora-
32 tion or incurred in the same manner as incurred by the corporation.

33 (d) Where a corporation had elected to be an S corporation for
34 federal income tax purposes prior to the effective date of this
35 section; has accumulated and undistributed earnings and profits as
36 of the first day of the first taxable year commencing after nineteen
37 hundred and eighty-five; and such earnings and profits were pre-
38 viously includible in the gross income of its shareholders for
39 federal income tax purposes, each shareholder of such S corpora-
40 tion shall also be subject to tax on his distributive share of such
41 earnings and profits in the shareholder's taxable year in which
42 such first taxable year of the S corporation ends. If the shareholder
43 is a nonresident of the commonwealth, he shall be subject to the
44 tax imposed by section five A on his distributive share of such
45 earnings and profits and the amount thereof derived from business
46 carried on within the commonwealth shall be determined under
47 the provisions of sections thirty-eight and forty-two of chapter
48 sixty-three. The commissioner shall, by regulation, provide for the
49 manner in which the accumulated and undistributed earnings and
50 profits and the distributive shares shall be determined under this
51 section.

52 The shareholder may elect to pay the tax imposed by this
53 subsection in three equal installments in such taxable year and the

54 two succeeding taxable years. Where the commissioner determines
55 that payments of the tax imposed by this subsection over a three-
56 year period creates an undue hardship for the shareholder, the
57 commissioner may, upon application of the shareholder, extend
58 the period of payment up to a maximum of six years, provided that
59 the tax due is paid in equal installments in each taxable year of the
60 extended period. The tax imposed by this subsection shall be con-
61 sidered due and payable, for purposes of section thirty-two of
62 chapter sixty-two C, at the time when each installment is required
63 to be paid.

1 SECTION 5. Chapter 63 of the General Laws is hereby amended
2 by inserting after section 32C, as appearing in the 1984 Official
3 Edition, the following section: —

4 Section 32D. Any domestic business corporation or foreign
5 corporation subject to tax under section thirty-two or thirty-nine,
6 which is an S corporation, as defined under section thirteen
7 hundred and sixty-one of the Federal Internal Revenue Code, as
8 amended and in effect for the taxable year, for federal income tax
9 purposes for any taxable year, shall determine the net income
10 measure of the excise imposed under section thirty-two or thirty-
11 nine by taking into account the provisions of Subchapter S of said
12 Code in computing “gross income” and “net income” under para-
13 graph five of section thirty. The modifications or adjustments to
14 gross and net income set forth in said paragraph shall continue to
15 apply. Income shall be includible in the net income measure only to
16 the extent that such income is taxed to the S corporation and not
17 passed through to its shareholders under the provisions of said
18 Subchapter S.

1 SECTION 6. The provisions of this act shall apply to taxable
2 years commencing after December thirty-first, nineteen hundred
3 and eighty-five; provided, however, that the provisions of chapter
4 sixty-two of the General Laws in effect prior to amendment by this
5 act shall continue to apply to an S corporation having a taxable
6 year commencing prior to nineteen hundred and eighty-six.