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Directive 08-6: Credit for Taxes Paid to Another Jurisdiction

The Department of Revenue has recently been presented with several questions regarding the G.L. c. 62, § 6(a) credit and the extent to which it applies to entity-level taxes paid in another state by a pass-through entity. In issuing this Directive 08-06 the Department restates the rules regarding the availability of the credit to resident taxpayers who as sole proprietors pay an income tax in another jurisdiction, and also states and amplifies the rules that apply when such income taxes are paid by an S corporation, partnership or other pass-through entity. However, these rules do not extend to taxes that are not imposed on net income, including gross receipts-based taxes. See Directive 08-07 for the treatment of such gross receipts-based taxes (e.g., as recently enacted in Texas and Ohio) under the Massachusetts personal income tax and the corporate excise.

I. Issue

Whether a Massachusetts resident taxpayer who is a sole proprietor or a shareholder, partner or member of a pass-through entity is entitled to a credit against Massachusetts income tax under G.L. c. 62, § 6(a) for income taxes paid by the sole proprietor or the entity to another jurisdiction?

II. Directive

Generally, yes. A Massachusetts resident taxpayer who is a sole proprietor or a shareholder, partner or member of a pass-through entity is entitled to a credit against Massachusetts income tax under G.L. c. 62, § 6(a) for taxes paid by the sole proprietor or the entity to another jurisdiction if the requirements of § 6(a) are met, as further discussed herein.

III. Discussion

A. Massachusetts Personal Income Tax Credit Allowed for Income Taxes Paid to Another Jurisdiction

1. G.L. c. 62, § 6(a) Credit; General Rule

Under the Massachusetts personal income tax, specifically Massachusetts General Laws chapter 62, § 6(a), a credit is allowed against taxes imposed by this chapter to a resident^[1] for taxes due any other state, on account of any item of Massachusetts gross income. See G.L. c. 62, § 6(a). An “item of Massachusetts gross income” is an item of income that is taxable under the Massachusetts personal income tax after applicable adjustments and deductions. See G.L. c. 62, §§ 2 and 3 (defining Massachusetts gross income, adjusted gross income, taxable income, and related terms).

For example, Letter Ruling 94-8 involved the issue of whether the District of Columbia

Unincorporated Business Franchise Tax (UBT) could be credited against the Massachusetts individual income tax under G.L. c. 62, § 6(a). The letter ruling stated that the credit is allowed for an income tax. See also LR 77-10. The credit is not allowed for other types of taxes, such as excise or property taxes or for franchise taxes not in the nature of an income tax. See LR 94-8. The UBT computation started with gross income as defined for federal income tax purposes under IRC § 61. The UBT was based on a net income figure rather than a gross receipts amount, and the Commissioner determined that the UBT was essentially an income tax. Therefore, the letter ruling concluded that payment of the UBT could be credited against the Massachusetts personal income tax under G.L. c. 62, § 6(a).

2. General Rule for Entity-Level Income Taxes Paid by an S Corporation or other pass-through entity in Another State

The Massachusetts regulation for S corporations and their shareholders provides that a Massachusetts shareholder of an S corporation may claim the credit afforded by G.L. c. 62, § 6(a) for a taxable year if the S corporation pays or is obligated to pay a tax during the shareholder's taxable year and all of the following additional conditions apply:

- (1) The tax is imposed by another state, territory, or possession of the United States, or the Dominion of Canada or its provinces;
- (2) The tax is measured by income earned by the S corporation, the distributive share of which is required to be included in the shareholders' Massachusetts gross income;
- (3) The S corporation does not deduct any portion of the tax from its income in computing net income available for distribution to shareholders; and
- (4) The tax is otherwise allowable as a credit under the provisions of G.L. c. 62, § 6(a).

830 CMR 62.17A.1(5)(e) (emphasis added).

Whenever an entity-level tax is paid in another state, for instance where an S corporation pays a C corporation income tax because it did not elect S corporation treatment or it elected out of such treatment, or in states that tax S corporations on income at the entity level when they have a certain level of income, a § 6(a) credit will be allowed to the Massachusetts shareholders if certain criteria are met. For the credit to be allowed, the tax paid by the S corporation must be an income tax based on an item of Massachusetts gross income or the tax must be an income tax in nature and imposed on net income of the entity that flows through to the Massachusetts shareholders, subject to all other requirements and limitations described in G.L. c. 62, § 6(a) and 830 CMR 62.17A.1(5)(e), as noted above.

Similarly, where an entity-level income tax based on an item of Massachusetts gross income is paid in another state by a partnership or other pass-through entity and meets these same conditions, a credit will be allowed to the Massachusetts partners or members under G.L. c. 62, § 6(a).^[2] The § 6(a) credit is not allowed for taxes paid to another jurisdiction if those taxes are in the nature of excise, property or franchise taxes and are not imposed on net income. See DOR Directive 08-07.

IV. Conclusion

A Massachusetts resident taxpayer who is a sole proprietor or a shareholder, partner or member of a pass-through entity is entitled to a credit under G.L. c. 62, § 6(a) for taxes paid by the sole proprietor or the pass-through entity to another jurisdiction if the requirements of § 6(a) are otherwise satisfied.

/s/Navjeet K. Bal
Navjeet K. Bal
Commissioner of Revenue

NKB:MTF:wm

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[\[1\]](#) The credit is not available to nonresidents because they are only taxed by Massachusetts on Massachusetts source income. See G.L. c. 62, § 5A.

[\[2\]](#) For example, in Letter Ruling 87-10, the question for the Department was whether Massachusetts partners of a Massachusetts partnership investing in a New Hampshire partnership could credit against their personal income taxes their distributive shares of the New Hampshire partnership's payment of the New Hampshire Business Profits Tax (BPT). The letter ruling concluded that the Massachusetts partners were required to include in their gross incomes their distributive shares of the Massachusetts partnership's income from the New Hampshire partnership's sale of property. Therefore, a credit was allowed against the Massachusetts partners' income taxes under G.L. c. 62, § 6(a) for taxes due in New Hampshire on account of an item of Massachusetts gross income.