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FOR YOUR IMMEDIATE ATTENTION

UPDATE FOR CLIENTS AND FRIENDS

THE FOLLOWING TAX AND RELATED DEVELOPMENTS MAY BE OF INTEREST

**Generally – New Mass. Income Tax Withholding Regulations**

Beginning in 2009 “pass through entities” - like S corporations, partnerships, limited liability companies (LLCs) taxed as partnerships, and certain kinds of trusts – are required to withhold Massachusetts income tax from dividends and distributions to stockholders, distributions to partners and LLC members, and certain kinds of trust income and distributions. Note that this is a new and additional withholding requirement – different from the income tax already being withheld from salaries and other compensation.

The most common application of these rules will likely be to S corporations, partnerships and LLCs that maintain an office in Massachusetts and/or conduct business in Massachusetts. The new regulations provide guidance regarding how to calculate and pay over the withholdings.

**Exceptions to Withholding**

Generally, these entities may avoid the new withholding requirement on distributions to stockholders, partners, etc. who (i) are Massachusetts residents by obtaining and keeping on file a “certification”, signed by the stockholder, partner, etc., that he or she is a Massachusetts resident or (ii) are not Massachusetts residents by obtaining and keeping on file a different “certification” signed by the stockholder, partner, etc., agreeing to file required Massachusetts tax returns, make required quarterly estimated tax payments to Massachusetts, and accept personal jurisdiction in Massachusetts state courts. In either case, the certification must be obtained (and then kept on file) by January 31, 2009 (or, if later, within 30 days after the Massachusetts resident becomes a stockholder, partner, etc.). The certification is provided on Form PTE-EX.

## **Exempt Entities**

Certain kinds of “pass through entities” are exempt. The most common of these are “investment partnerships” (and “investment LLCs”), substantially all of whose assets consist of investment securities, bank or other financial institution deposits (or office equipment and office space needed to carry on its investment activities), substantially all of whose income is from interest, dividends and capital gains, provided that the partnership or LLC does not engage in a trade or business in Massachusetts.

## **Trusts**

The application of the new regulations to trusts is most complicated. It appears that “grantor trusts” and perhaps even non-grantor “simple trusts” are subject to the new rules; nominee trusts may also be exposed.

Unfortunately, every trust needs to be studied (some on an annual basis) to determine whether these rules apply. Each trust needs to be analyzed to determine whether it pays income on a mandatory basis, and whether, if there is a non-Massachusetts resident beneficiary, there is “Massachusetts-source” income.

## **A Few Observations**

The new rules may be overkill in certain instances. For example, it would be hard to justify applying the new rules to the case of a “living trust”, created by an individual who is still alive and who retains the right to revoke the trust, and who has transferred all or most of his/her assets into the trust as a probate-avoidance measure. Read literally the new rules would apply to this situation, but in practice the individual is unlikely to treat the trust as a separate entity from him/herself for income tax purposes anyway, and, until the individual dies, the trust may not even have its own taxpayer ID number.

As another example, one may wonder whether the new rules are really intended to reach so-called “simple trusts”. These are irrevocable trusts all of whose net income is required to be paid annually to a beneficiary. In such cases, even if the income is not actually distributed to the beneficiary the beneficiary is required to report the net income on his/her personal income tax return. A common example of a “simple trust” is a marital deduction trust maintained for a surviving spouse. However, in this case, where the trust is required to have its own taxpayer ID number, it may be prudent for the trustee to obtain and retain the necessary beneficiary certifications (unless, for some reason, the beneficiary wants the trustee to withhold Massachusetts income tax).

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In any event, the rules are considerably more complicated than appears at first blush, and more complicated than this brief Update can explain. Consultation with a professional advisor is recommended.

*This Update is intended only to provide generalized information and to alert you to the existence of this new regulation. It is not intended to provide information or advice with respect to specific situations, and specifically may not be utilized to determine how to address the new rules. To address real life, specific situations you should consult appropriate counsel.*

*Under the rules of the Supreme Judicial Court of Massachusetts, this may be considered advertising.*

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