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Massachusetts Estate Tax Can Now Apply to Out-of-State Trusts

Shaffer v. Commissioner of Revenue

A recent case at the Massachusetts Supreme Judicial Court serves as a reminder that the Commonwealth takes an expansive view of its taxing authority in situations involving taxpayers with connections to multiple states. The stakes can be high because the breadth of taxes imposed on residents of Massachusetts is substantially higher than nonresidents.

For example, Massachusetts residents pay income tax on <u>all</u> their income, wherever earned or received. Conversely, a nonresident of Massachusetts pays income tax to Massachusetts only on income derived from sources within Massachusetts, such as rent from a home they own in the Commonwealth.

Similarly, the estate of anyone who dies while a resident of Massachusetts will pay estate tax to the Commonwealth on all real estate and tangible property located within the state and on all intangible property, such as bank and investment accounts, wherever those are located. The estate of a nonresident pays estate tax only on real and tangible property located in Massachusetts, such as a vacation home and its contents.

In most cases, an individual's residence is easily determined because his or her home, place of employment, and professional, social and religious affiliations are all located in one state. However, in many situations, an individual may have a home in Massachusetts as well as in another state and spend substantial time in both places. And there may be existing social, family, professional and religious affiliations in both states. In these cases, Massachusetts taxing authorities may issue a challenge if the individual or, after death, their estate asserts Massachusetts tax does not apply.

Estate Tax

Massachusetts has aggressively pursued collection of estate tax in situations involving multiple states or countries. For example, in a 2016 case, in which Hemenway & Barnes represented the estate administrator, the Massachusetts Department of Revenue unsuccessfully tried to impose estate tax on real estate owned by a Massachusetts resident at her death but located in a different country.[1] Although it lost that case, the Department of Revenue has given no indication that it will stop trying to collect estate tax from future estates in these circumstances.

Most recently, the Massachusetts Supreme Judicial Court held that the assets of an out-of-state marital trust are subject to Massachusetts estate tax where the trust beneficiary (the

[1] *Dassori v. Commissioner of Revenue* (Middlesex Probate Court MI-14E00-42GC, June 30, 2016).

surviving spouse) had moved to Massachusetts before her death. In this case, *Shaffer v. Commissioner of Revenue*, a husband set up and funded a marital trust while he and his wife were residents of New York. After the husband's death, his wife moved to Massachusetts and although she received distributions of cash from the trust periodically, she never became the owner of the trust's assets. The trust was not subject to Massachusetts income tax because it was not established by a Massachusetts resident. Unfortunately for the taxpayer, the same treatment would not apply for estate tax purposes.

When the wife died, her estate filed Massachusetts and federal estate tax returns reporting the value of her personal assets but did not include the value of the marital trust on her Massachusetts return. The estate's reasoning was that the assets were transferred into a New York trust at the husband's death and remained in that trust throughout the wife's lifetime. So, although the wife became a Massachusetts resident, she never became the owner of the trust assets and, in tax jargon, there was no "taxable transfer" of the trust assets from the wife to any owner that could be subject to Massachusetts estate tax.

The Supreme Judicial Court ruled against the estate, reasoning that the "taxable transfer" occurred at the wife's death because the trust terms required the assets to pass out of the trust to surviving beneficiaries. So, although the wife took no action, and in fact had no power to alter how the assets passed from the trust at her death, the court held that this transfer, which had been set in stone by the husband in New York before there was any connection to Massachusetts, was sufficient to subject the trust assets to Massachusetts estate tax.[2]

The implications of this decision are significant for anyone who is considering moving, or returning, to Massachusetts following the death of a spouse. If the surviving spouse is a beneficiary of a marital trust established at the death of the first spouse while the couple lived in a different state, under this decision the trust's assets will be subject to Massachusetts estate tax. With an estate tax filing threshold of $1 million and a top tax rate of 16%, the surviving spouse's estate may end up with a much higher tax liability than anticipated.

Income Tax

While not an issue in *Shaffer v. Commissioner of Revenue*, it is also important to consider the income tax implications of Massachusetts residency, especially for those who may have moved out of the Commonwealth and established residency elsewhere but continue to visit frequently for family, vacation, medical or other reasons.

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[2] The estate also argued that the definition of Massachusetts gross estate in M.G.L. c 65C § 1(f) did not include assets for which a federal, but not Massachusetts, QTIP election was made, and therefore the QTIP trust property was not taxable in the wife's estate. The Supreme Judicial Court agreed with the Appellate Tax Board that the estate's argument was based on an incorrect reading of the statute.

September 4, 2020

The Massachusetts rule for subjecting a person to its income tax is broader than the rule for subjecting a person's estate to Massachusetts estate tax after death. Both taxes apply to individuals who are "domiciled" in Massachusetts but the income tax can apply even to those who are not domiciled in the Commonwealth.

Focusing first on the concept of domicile, a person can only be domiciled in one state for tax purposes and that is the state where a person's "true, permanent home" is located and to which he or she intends to return even if absent for some period of time. So, for example, someone who is domiciled in Massachusetts but gets transferred by his or her employer to a different state for a few years will still be considered a Massachusetts domiciliary so long as he or she plans on returning. If, while living in the other state, he or she decides not to return, sells the Massachusetts residence, and sets down roots in the new state, that person then ceases being domiciled in Massachusetts.

The taxing authorities will not necessarily believe a taxpayer when he or she states there is no intent to return to Massachusetts, so when reviewing this issue the Massachusetts Department of Revenue will look at the entire fabric of an individual's life, including factors such as voting and automobile registrations, location of family members, professional and personal affiliations, time spent in Massachusetts, and other factors.

If a person is found to be a Massachusetts domiciliary, he or she will be subject to Massachusetts income tax and his or her estate will be subject to Massachusetts estate tax. The Massachusetts income tax, however, can also apply to people who are domiciled elsewhere if they have a "permanent place of abode" in Massachusetts and spend more than 183 days in the Commonwealth. A "permanent place of abode" means a dwelling place continually maintained by a person, whether or not owned by such person, and includes a dwelling place owned or leased by a person's spouse.

Accordingly, those who have moved out of Massachusetts but continue to receive medical care, use a vacation home, or visit family in the Commonwealth need to consider the risk of inadvertently establishing – or reestablishing – residency for purposes of the Massachusetts income tax. A good practice is to keep a diary to track the number of days spent in the Commonwealth and monitor the 183 day threshold to make sure it is not exceeded. This is particularly true in the context of the Coronavirus pandemic where people's normal travel and living patterns have been radically altered in many cases.

Finally, given that people's habits, employment, family and business relationships change over time, it is important to revisit the factors indicative of the location of one's domicile to ensure that they are supportive of the asserted state of residence and that any tax savings associated with being a nonresident of Massachusetts would be upheld.

Additional Resources:

Dassori v. Commissioner of Revenue

Hemenway & Barnes LLP

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Contact Us

If you have questions about how Massachusetts property or residency can impact your income or estate tax, please contact a member of Hemenway & Barnes LLP's Private Client Group, or the authors of this alert:

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