

Massachusetts Capital Gains Refund Opportunity

By Jim Bailey

There's good news on the capital gains front – particularly for those who got caught in the year 2002 debacle, when the Massachusetts Legislature enacted a law that altered the entire long-term capital gains landscape.

Recently, Governor Mitt Romney signed legislation that cancels retroactive tax hikes on capital gains realized between January and May of 2002. Moreover, the new law authorizes refunds on higher capital gains taxes paid between May and December of 2002.

With that said, let's take a look at what precipitated this opportunity for some to be entitled to a refund.

For several years prior to 2002, Massachusetts had a sliding tax rate scale for long-term capital gains sales, with some sales taxed at very low rates or not at all. Tax rates ranged from 5% of the gain down to 0%, depending on how long the property or stock was held. Long-term holdings are defined as those held for more than a year. Before 2002, properties held more than one year but less than two years were taxed at 5%, decreasing to 4% for properties held more than two years and less than three. Continuing with this sliding scale, property held for more than six years was thereby subject to 0% or no capital gains tax.

That all changed in 2002, when the Legislature passed a law altering the entire mechanism for capital gains sales taking place after April 30 of that year. From that point on, all long-term capital gains were to be taxed at 5.3%, the same rate attached to wages and interest. Therefore, if someone sold an asset on March 1, 2002 for example, he or she would be facing a far different tax scenario than if the sale was transacted on May 1, 2002. The earlier sale, depending on the length of holding period, might be tax free, while the latter sale would definitely incur a 5.3% tax.

What followed was a loud hue and cry from a group of investors who argued that the effective date of the 2002 legislation was unconstitutional as it resulted in a mid-year change in tax rates.

The State Supreme Judicial Court agreed with that argument, and ultimately the effective date implementing the 5.3% rate was established as January 1, 2002. Needless to say, this created a financial hornet's nest for those who sold property on or before April 30, 2002. While not subjected to capital gains tax previously, these individuals now were being "dunned" for 5.3% on the gain of their sale.

Indeed, the Department of Revenue mailed about 21,000 of 48,000 preliminary bills to taxpayers before the Legislature recognized the negative impact of this mid-stream

reversal. At this point, lawmakers wisely changed the effective date of the new capital gains tax to January 1, 2003.

As it now stands, those taxpayers that have already paid taxes based on the preliminary bill will receive automatic refunds. Moreover, individuals that had capital gains sales between April 30 and December 31, 2002 can now apply for an abatement/refund.

The Department of Revenue estimates that 157,000 taxpayers may be eligible for a refund resulting from the 2002 capital gains legislation. Any long-term capital gains transaction conducted after April 30, 2002 and before January 1, 2003 may have refund written all over it.

Individuals that are owners of partnerships or S-Corporations may also be eligible for the abatement if the partnership or S-Corporation entity realized capital gains during this period.

But wait, there's more! If the refund amount is \$1,000 or less, it will be forthcoming from the Department of Revenue in one lump sum. If the abatement is higher than \$1,000 the amount will be paid out over the course of four years in annual installments, with no interest added.

If at all in doubt whether this turn of events affects you, contact your tax preparer to see if you may be eligible for a refund. A few minutes worth of conversation may result in a substantial return.

And take note – abatement claims must be filed prior to July 1, 2006.

For more information and a copy of the abatement application, visit the Department of Revenue's website at www.mass.gov/dor.

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