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Pass through withholding in Massachusetts

September 25, 2008 - Front Section

Recently, the commissioner of the Mass. Dept. of Revenue issued Final Regulation 830 CMR 62B:2.2, titled Pass-Through Entity Withholding. This regulation mandates income tax withholding for non-residents who are shareholders or partners of a Mass. pass-through entity for years beginning on or after January 1, 2009.

Mass. is requiring withholding on the distributive share (cash) of a non-resident's Mass. source income. As such, there is no requirement to withhold on non-Mass. source income, tax exempt income, or distributions to a Mass. resident. After the entity registers as a withholding agent, the withholding is required to be remitted on a quarterly basis. Annually, the pass-through entity is required to file an information return with the Dept. of Revenue identifying payees and amounts. In addition, the withholding information is required to be included on the partner/shareholder information schedule (K-1)

In addition to the above exceptions as to where the withholding applies, there are several entities and situations that are exempt from the withholding requirement.

Investment partnerships whose assets are substantially investment securities, bank deposits and office furniture utilized to carry on the business of the investment partnership are exempt. Also, upper tier pass-through entities that can demonstrate that the withholding was done at a lower tier are exempt. Finally, trusts that are required to withhold under another provision of Mass. law are exempt.

Non-resident may still avoid withholding on Mass. source income if they participate in a composite tax return or file a "certification form." This form basically certifies that the non-resident will file a Mass. tax return and pay quarterly tax estimates based upon the pass-through income. In addition, the non-resident agrees to be bound by the Mass. tax laws and the enforcement procedures existing in the Mass. court system.

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