# Who wants to be a millionaire? - by Kyle Kadish

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As voters headed to the polls last November, Massachusetts residents approved a constitutional amendment officially called “The Fair Share Amendment”. Selling real estate might subject investors to an additional tariff in their year of sale. However, the tax code offers ample opportunities to defer or mitigate tax liabilities; strategic planning often allows investors to keep more capital at work for the time being. Even with additional attempts to redistribute wealth, investors can make the best use of their own money, determining how and when (if ever) the tax liability is created.

With the support of nearly 52%, voters across the Commonwealth passed the Mass Millionaires tax. The passage created an additional tax liability of 4% on any income over the $1 million threshold. The added revenue benefits the state education and transportation budgets - with legislators on Beacon Hill determining the annual allocations. In addition, an inflation indexing component should increase the threshold annually.

Tufts University’s Center for State Policy Analysis estimates that nearly 21,000 residents would be subject to this additional tariff - even though only about one-third of the income for these million-dollar households is from salaries and paychecks. Instead, the more significant allocation of earnings for a million-dollar household comes from capital gains and business income. So here is the warning for Massachusetts real estate investors: capital gains on a property sale could push you over the millionaire threshold.

A January report from The Center for State Policy Analysis warned of migration by over 500 families per year out of Massachusetts, moving primarily to friendlier tax jurisdictions. Similarly, a recent survey conducted by the Massachusetts Society of CPAs found tax policy changes as the leading reason why residents are relocating and domiciling out of state. Data suggests New Hampshire and Florida are the early winners of Massachusetts refugees; however, if leaving property behind, that property will still be subject to Commonwealth tax policy when sold.

Moving is only sometimes an option. Some residents will remain within Massachusetts’ borders and endure the additional tax. For those unwilling or unable to move, the Internal Revenue Code still has many strategies allowing for deferral on real estate transactions - which will also prevent the millionaire threshold from triggering. A few deferral possibilities might include conducting a 1031 Exchange, pursuing a 721 Exchange, structuring an installment sale, or exploring the benefits of a Qualified Opportunity Zone. A general summary of each possibility follows.

1031 Exchanges have existed in some form or fashion for over 100 years. The seller defers taxes (gains and recapture) when reinvesting proceeds from investment real estate into other investment real estate. For example, investors looking to move out of Massachusetts can avoid the millionaire tax by exchanging for property in other states. Under current law, investors can continue exchanging property(ties) repeatedly. The ultimate deferral occurs when heirs receive property with a step-up in basis.

Another exchange option is the 721 Exchange. A current owner contributes property to the operating partnership (OP) of a real estate investment trust (REIT). The tax-free contribution immediately diversifies the taxpayer's holdings into a larger, professionally managed portfolio. The investor realizes a tax upon converting the OP units; these conversions could be at a volume to engineer tax liabilities and keep the taxpayer at the most favorable rate.

Often utilized through seller-carried financing, the seller's tax liability is only recognized when the seller receives principal payments on an installment note. Thoughtful planning allows the installment rules to utilize an independent entity to structure the installment; the seller holds the promissory note, and the buyer fully funds the independent entity - unlocking capital otherwise tied up. Consideration of the promissory note's terms provides extensive flexibility for taxpayers to determine their future tax liabilities for any year.

This column discussed Qualified Opportunity Zones (QOZs) on these pages in November 2022. The federal law allows the deferral of capital gains through 2026 when the taxpayer reinvests the gain in designated census tracts. The longer-term benefit allows QOZ investors to exit QOZ investments tax-free after a 10-year hold period. Massachusetts' Department of Revenue published a Technical Information Release in 2019 confirming the state decoupled from federal law; only corporations can utilize QOZs to defer Massachusetts taxes.

Some policy groups brought additional awareness of what they call a loophole in the millionaire tax. Specifically, the Massachusetts Budget & Policy Center quickly pointed out how the Millionaire threshold can be gamed; married couples filing jointly cross the $1 million threshold while filing singly at the state level allows each spouse $1 million.

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