BALLENTINE PARTNERS

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A Return to Taxachusetts?

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After a years-long process to get the issue on the ballot and a seemingly endless and inescapable media campaign waged by both sides, Massachusetts voters on Tuesday night approved an amendment (Question 1) to the state Constitution to increase the individual tax rate on the highest incomes beginning in 2023. Income greater than $1 million will be taxed at 9% under the new paradigm; all income less than $1 million will be taxed at the current 5% rate. For a state where the "Taxachusetts" moniker has stuck, perhaps unfairly, for decades, the new tax structure firmly places Massachusetts in the handful of states with the highest marginal income tax rate in the country.

Currently (in 2022), besides New Hampshire, which taxes only interest and dividends at the same rate that Massachusetts imposes on *all* income, the Bay State's 5% rate is well below that of its New England neighbors, including Vermont (where the highest tax bracket tops out at 8.75%), Maine (7.15%), Connecticut (6.99%), and Rhode Island (5.99%). With this amendment, Massachusetts joins the ranks of California (13.3%), Hawaii (11%), New York (10.9%), Washington, DC (10.75%), New Jersey (10.75%), Oregon (9.9%), and Minnesota (9.85%) – states with the highest tax rates on its highest earners.

For our clients who are suddenly subject to the new tax structure, the ideas we've discussed over the last several years when the possibility of higher *Federal* tax rates was on the table are all relevant and applicable. However, the age-old strategy of accelerating income and deferring deductions in the face of rising rates, while effective, is easier said than done. Most taxpayers aren't in control of when they get paid, and many of the deductions that taxpayers take on their Federal return have never been available on their Massachusetts return. Trying to squeeze in a home sale or a sale of a business prior to the end of the year can move the needle, if it's even feasible, but should be weighed alongside other non-tax factors as part of a comprehensive plan.

There are, however, some strategies to consider to lessen the impact of higher Massachusetts taxes in the future. Before the passage of Question 1, the most significant development in the Massachusetts tax system set to take effect in 2023 was the implementation of the deduction for charitable contributions.
Passed by voters more than 20 years ago, the charitable contribution deduction has been suspended and delayed due to economic triggers and legislative action. Barring additional activity at the State House, it appears as if it's going to go forward in 2023, which should provide a significant benefit for taxpayers, especially those now subject to the highest 9% tax rate. And while some of the specifics on how the deduction will actually work are still unknown, and we don't want to encourage those to delay their otherwise natural philanthropic tendencies, basic math suggests that donating an extra dollar on January 1, 2023 (for those with incomes exceeding $1 million) may be worth more than doing the same on December 31, 2022. Of course, this comes with the usual caveat that everyone's tax situation has nuances that might make the comparison between one year and the next irrelevant, but the general point holds.

What else can you do? In a year when the stock market has plunged more than 20%, selling securities, booking a tax loss, and staying invested by putting the proceeds back in the market is a tried-and-true way to make tax lemonade out of tax lemons. At Ballentine, we have swapped in and out of securities throughout this volatile year, capturing the tax losses along the way and steering clear of the IRS wash sale rules that can, for some, be a hurdle for effective implementation. These losses can be used in future years to offset eventual gains; with the highest earners now subject to higher rates, this strategy, known as “tax loss harvesting,” is even more valuable.

Finally, in what can only be described, perhaps, as the ultimate tax-tail-wagging-the-dog strategy, changing one’s tax residency (also called “domicile”) can be a consideration. As we’ve discussed with many clients over the years, changing domicile is not for the faint of heart. And the days of thinking that you can effectuate a domicile change by shifting your voting registration and living in Florida for 183 days are antiquated. To do the domicile change right and to have the facts on your side for a possible (and eventual?) audit defense, be prepared to commit to a life outside of Massachusetts and be able to document it. But for those who have been contemplating such a move and can show that they have good answers when the Department of Revenue says, “Prove It,” the passage of Question 1 might be the impetus to begin those conversations in earnest.

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Adam is a Partner, Senior Client Advisor, and Chief Wealth Advisory Officer at the firm. While responsible for multiple areas of wealth management, he has a particular expertise in income tax planning for high net worth individuals. He keeps abreast of tax developments and informs the firm of changes in legislation and implications for the firm’s clients. Before joining the firm in 2007, Adam was a tax supervisor at Levine, Katz, Nannis & Solomon, P.C., an accounting firm in Needham, MA, where he provided tax planning and compliance, financial statement preparation, and other accounting services to high net worth individuals and privately held companies. Prior to that, he worked at KPMG Consulting (now part of Deloitte), where he helped the United States Department of Defense improve and streamline various finance and accounting processes. Adam also spent nearly 10 years as an economist and policy analyst for the U.S. Departments of Labor and Education. Adam received a Masters in Taxation from Bentley University, his Certificate in Accounting from the University of Virginia, and a Bachelor of Arts in Economics and Communications from the University of Michigan. He is a Certified Public Accountant (CPA). Adam is on the Finance Committee of Jewish Family and Children’s Service. During his free time, Adam enjoys playing golf and tennis, following New England sports, and planning his family’s next vacation. He lives with his wife, Eve, and their two teenagers in Newton, MA.