Planning with the Massachusetts Millionaires Tax

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Wealth Planning Insights

This article explores a few planning ideas to potentially decrease the impact of the Massachusetts Millionaires Tax which went into effect in 2023.

Who wants to be a millionaire? Although higher household income is often something families strive for, with the passage of the Massachusetts Millionaires Tax (MMT) in November 2022, having taxable income in excess of $1 million became less attractive for 2023 and beyond. While it is estimated that only 0.6% of households are impacted by the new tax annually, some households could find themselves subject to the tax as the result of a one-time event such as a significant Roth conversion or the sale of a home or business.

Beginning in 2023, if the taxable income on your Massachusetts income tax return is over $1 million, you pay an additional 4% tax on the income exceeding the $1 million threshold. This is in addition to the other state tax, usually 5%, on income.

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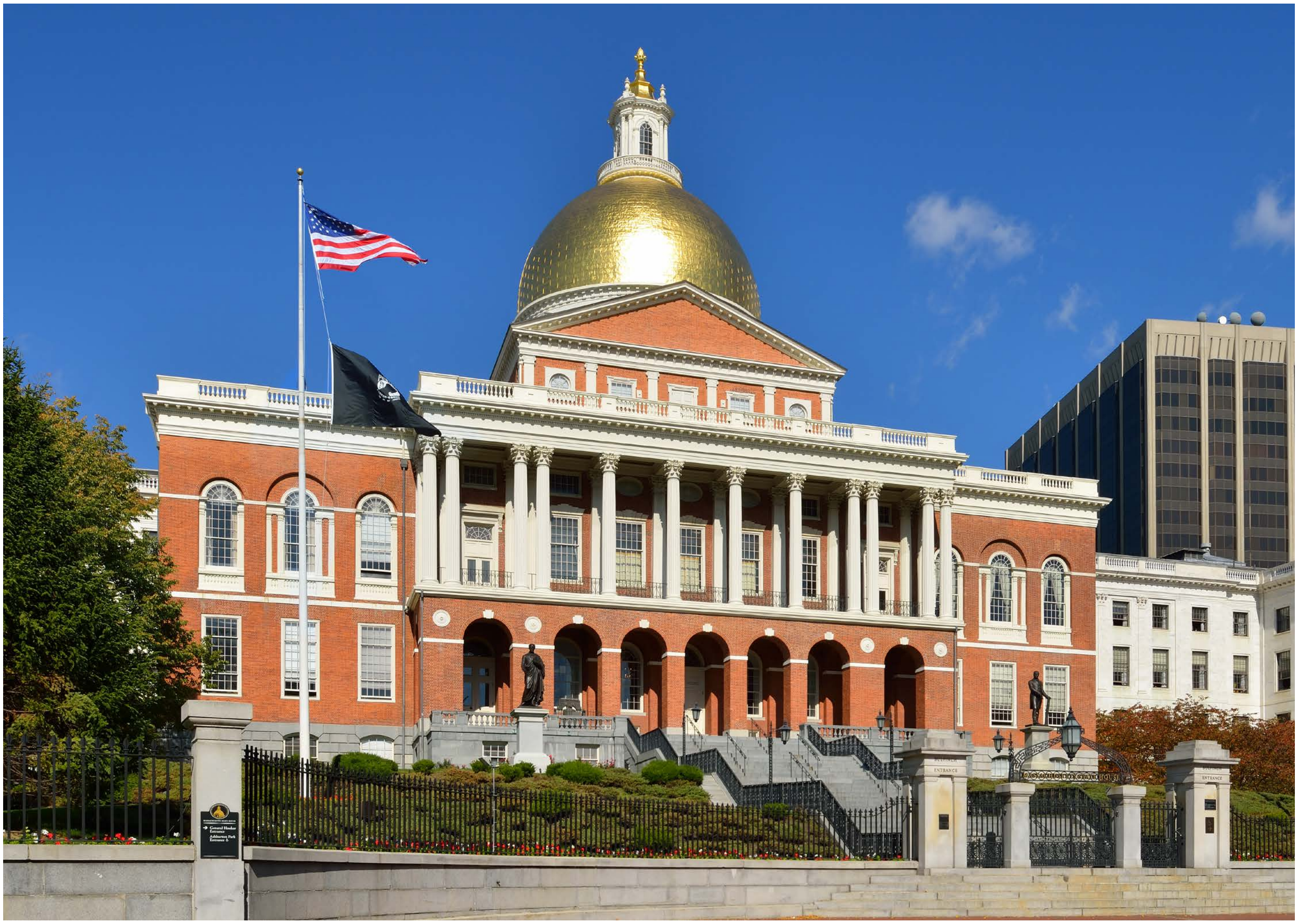

Roth IRA does not have required minimum distributions (RMDs)

The following are a few planning ideas to potentially decrease the impact of the new tax.

Roth IRA Conversions: If you have an interest in Roth IRA conversions, reviewing your income on an annual basis and making numerous smaller conversions may be your best approach. When you convert a traditional IRA to a Roth IRA, you include the conversion amount in current income, but then enjoy tax-free growth on amounts inside the Roth IRA. In addition, a Roth IRA does not have required minimum distributions (RMDs). Converting amounts that keep your income below the MMT tax today may be more attractive than conversions after the scheduled increase to the top federal income tax rate effective January 1, 2026, and avoid the MMT on any future RMDs that might push your income over the $1 million mark.

Charitable Planning:

- *Qualified Charitable Distributions (QCDs):* If you are over age 70½, in 2024 you can gift up to $105,000 from your traditional IRA to a qualified charity as a QCD. Done properly, the QCD amount will count towards your RMD and you will not recognize income on the amount gifted directly to the charity. For those with philanthropic goals, using a QCD can be another option for lowering taxable income.
- *Charitable Deductions:* Beginning in 2023, Massachusetts once again allowed charitable deductions against taxable income. If you are pushing up against the MMT and charitably inclined, making charitable contributions may be attractive. Coupling that with using appreciated securities for the donation can be a double benefit by getting a full fair market charitable deduction and avoiding recognition of the embedded capital gains on the security gifted. If you will be subject to the MMT due to a one-time income event, such as a significant Roth IRA conversion or the sale of your home or company, you may wish to consider establishing a donor advised fund (DAF) and deduction bunching by gifting multiple years' worth of charitable gifts to the DAF currently, in order to offset your current income event. You could then request that the gifts be distributed to charities over multiple years in line with your charitable goals.

Bond Investments: If you will be subject to the MMT, changing your municipal bond strategy to be Massachusetts focused will exclude that income from Massachusetts taxable income. In addition, the interest from U.S. Treasuries is not taxable in Massachusetts.

Commercial Real Estate and 1031 Exchanges: If you are thinking of selling and replacing a commercial real estate holding, you should explore utilizing a Section 1031 exchange that allows you to exchange the properties and delay any gain recognition until the ultimate disposition of the property.

Qualified Opportunity Funds: Before January 1, 2027, capital and qualified Section 1231 gains can be deferred by investing the gain amount in a Qualified Opportunity Zone utilizing a Qualified Opportunity Fund. Under this provision, gains must be properly reinvested within 180 days of the realization event.

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New Hampshire Trusts: Depending on your situation, there may be an opportunity to establish irrevocable New Hampshire trusts and avoid state income tax on ordinary income or capital gains, but not on Massachusetts-sourced income. Placing an income-producing investment or a business interest prior to a liquidity event in the trust may avoid the MMT. However, this only works if the ordinary income in a particular year is not withdrawn from the New Hampshire Trust.

Wealth Transfer: If your wealth plan goals include wealth transfer to your family, you have assets you do not anticipate needing during your lifetime, and your children or trusts for their benefit will not be subject to the MMT, you may wish to consider gifting assets sooner rather than later. This may help to both remove any future appreciation from your taxable estate and avoid the MMT.

Changing Domicile: Most income will not be taxable in Massachusetts if the taxpayer is not domiciled here. For an individual, changing your domicile is not easy, but there are plenty of families that have successfully moved their domicile to Florida or New Hampshire, two states without an income or estate tax. It is likely that the MA DOR will continue to be aggressive in verifying that a change in domicile is legitimate, so this is not one to be undertaken lightly.[1]

Married Filing Separately (MFS): With the passage of the Massachusetts tax reform package in October 2023, for 2024 and beyond a married couple must use the same tax filing status for Massachusetts as they do for their federal return. As such, married couples cannot reduce income subject to the MMT by filing separately for Massachusetts while filing a joint federal return.

Planning to avoid the additional MMT may be time well spent. It is important to consult with your tax and wealth advisors to help ensure you make the decisions in this area that best fit your individual circumstances and fulfill your objectives. ■

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[1]Although New Hampshire does have an interest and dividends tax

Disclosure: The opinions expressed in this article are as of the date issued and subject to change at any time. Nothing contained herein is intended to constitute investment, legal, tax, or accounting advice, and clients should discuss any proposed arrangement or transaction with their investment, legal or tax advisors.

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