

Effective November 1st, New Massachusetts Withholding Regulations for Real Estate Transactions Primarily Impact Nonresident Individuals, But Create Administrative Burdens for All

As of November 1st, transferors of real estate located in Massachusetts will have to comply with new regulations (830 CMR 62B.2.4) that may require tax withholding at closing. These regulations are just one more step in the recent aggressive audit and collection efforts by the Massachusetts Department of Revenue with respect to taxes paid to Massachusetts by those who are not residents of Massachusetts. Numerous exemptions make the bottom-line impact for most commercial real estate transactions only one of administrative compliance, in the form of a [Transferor's Certification](#), which will be an additional closing document to track in most commercial real estate transactions. Withholding at closing will occur primarily with transactions involving nonresident individuals and certain corporations.

What types of taxpayers are subject to withholding?

The regulations largely focus on the many exemptions to the withholding obligations, which are described below. After parsing through them, it is clear that the primary taxpayers subject to withholding are:

- Individuals who are not Massachusetts residents; and
- Unless they otherwise qualify for an exemption, corporations with (1) no continuing business presence in Massachusetts, either directly or through a combined group, or (2) that are selling all or substantially all of their assets located in Massachusetts.

What types of taxpayers are exempt?

As mentioned, there is a long list of taxpayers that are exempt from these new withholding obligations. The key entities that are exempt are:

- Pass-through entities – i.e., partnerships, LLCs taxed as partnerships, S corporations, estates, and trusts not taxed at the entity level¹;
- Publicly-traded partnerships;
- Corporations:
 - A. With either –
 1. A continuing business presence in Massachusetts or
 2. A membership in a combined group for tax filing purposes where one member of such group has a continuing business presence in Massachusetts; and
 - B. That represent that –
 1. It or a member of its combined group is required to report the transfer on a Massachusetts tax return for the year of the transaction and that it will report the transaction on that return and
 2. It is not selling all or substantially all of its assets in Massachusetts;
- REITS, as long as the proceeds from the sale are distributed to the trust's shareholders in the form of dividends derived from the sale of real estate;
- Certain financial institutions and insurance companies;

¹A disregarded entity for tax purposes – i.e., grantor trusts or single member LLCs – are not considered pass-through entities for these purposes. Disregarded entities are ignored and the status of the owner of the disregarded entity determines the withholding requirements for real estate owned by them.

- 501(c)(3) organizations when the transaction does not produce unrelated business taxable income; and
- Governmental bodies.

These non-commercial taxpayers are exempt:

- Full-year Massachusetts individual residents who will continue to be a resident after closing; and
- Estates of resident decedents or resident trusts.

Where do single purpose entities fit in?

Often real estate is held in single purpose entities such as LLCs (“SPE”). Most sales by SPEs will be exempt under the pass-through entity exemption. LLCs with a sole owner, or member, are ignored for purposes of these rules and the withholding obligation on transfers of Massachusetts real estate owned by these entities is determined by the status of the sole owner or member. For example, if an SPE organized as a single-member LLC transfers real estate and the sole owner of the SPE is a joint venture in the form of an LLC that is taxed as a partnership, there is no withholding obligation. The same would hold true if the sole owner of the SPE fits within another exemption. Similarly, if an SPE has multiple members and is taxed as a partnership, there is no withholding obligation under the pass-through entity exemption.

In these situations, the seller must provide the settlement agent with the Transferor’s Certification to document the exemption.

What types of transactions are exempt?

Even if a taxpayer is subject to withholding on a Massachusetts real estate transaction, there are certain situations where the withholding is reduced, eliminated, or deferred based on the type of transaction. For example, withholding may be reduced or eliminated when the transaction is:

- A like-kind exchange (section 1031 of the Internal Revenue Code (the “Code”))²;
- An installment sale where the full purchase price is not paid at closing³;
- A nontaxable contribution of capital to a corporation (section 351 of the Code);

- A tax-free corporate reorganization (section 368 of the Code);
- An involuntary conversion (section 1033 of the Code);
- A transaction where debt payment obligations prevent a taxpayer from complying with the calculated withholding amount;
- A sale of property located partially in Massachusetts;
- The sale of a taxpayer’s primary residence; or
- A transfer of real estate in connection with a divorce.

How does withholding work?

The responsibility to determine whether withholding is necessary rests with the settlement agent, which is defined in the regulations as the title company, closing attorney, escrow agent, and any other party serving as the settlement agent in connection with a Massachusetts real estate transaction. Specifically, unless an exemption is available, the settlement agent must withhold when:

- The property is located in Massachusetts (fully or partially) and
- The gross sale price (or in certain cases, gross value) is over \$1,000,000.

In these circumstances, the settlement agent must withhold at closing and pay over the funds to the Department of Revenue within 10 days.

How much must be withheld when withholding is required?

There are two calculations available to determine the amount that must be withheld when a settlement agent must withhold:

1. **The Standard Calculation.** The default withholding amount is 4 percent of the gross sale price for each seller. The gross sale price is the sum of cash paid to the seller, the fair market value of any noncash value transferred in the transaction, and any liability assumed by the buyer, or transferee, in the transaction. Income subject to the so-called Millionaire’s surtax is subject to an additional 4 percent withholding.

²The Transferor’s Certification requires a taxpayer to commit to pay any tax, interest, and penalties owed if the 1031 transaction is not completed.

³Withholding must occur on future installment payments in these situations.

2. **The Alternative Calculation.** The seller is allowed to elect to have the amount withheld equal the estimated net gain from the transaction, multiplied by the tax rate applicable to the seller, so that the withholding amount is more closely aligned with the expected tax owed from the transaction. The estimated net gain equals the gross sale price minus the estimated adjusted basis in the real estate and settlement-related expenses. This information needs to be provided on the Transferor's Certification which must be provided to the withholding agent on or prior to closing.

If the amount withheld exceeds the actual tax due, the transferor needs to seek a refund when filing the transferor's tax return.

Please do not hesitate to contact one of the authors or your Nutter attorney with any questions you may have on navigating this process.

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