COMMONWEALTH OF MASSCHUSETTS

APPELLATE TAX BOARD

PAUL S. LOWRY **v.** **COMMISSIONER OF REVENUE**

Docket No. C330919 Promulgated:
May 5, 2020

This is an appeal filed under the formal procedure pursuant to G.L. c. 58A, § 6 and G.L. c. 62C, § 39(c) from the refusal of the Commissioner of Revenue ("Commissioner"[1] or "appellee") to abate personal income tax, interest, and penalties assessed against or paid by Paul S. Lowry ("appellant") for the tax years 2011, 2012, and 2013 (collectively, "tax years at issue").

Commissioner Scharaffa heard this appeal and was joined in the decision for the appellee by Chairman Hammond and Commissioners Rose, Good, and Elliott.

These findings of fact and report are made at the requests of the appellant and the appellee pursuant to G.L. c. 58A, § 13 and 831 CMR 1.32.

John S. Brown, Esq., *George P. Mair*, Esq., *Donald-Bruce Abrams*, Esq., *Darcy A. Ryding*, Esq., and *Adam M. Holmes*, Esq. for the appellant.

Michael P. Clifford, Esq. and *Brett M. Goldberg*, Esq. for the appellee.

[1] These Findings of Fact and Report utilize the masculine pronoun in reference to the Commissioner, irrespective of who held the position at a given time.

FINDINGS OF FACT AND REPORT

This appeal concerns the Commissioner's disallowance of a portion of the credits for taxes paid to other states claimed by the appellant on his 2011, 2012, and 2013 Forms 1, Massachusetts Resident Income Tax Returns ("Returns"). The parties submitted the appeal to the Appellate Tax Board ("Board") for decision based on a Statement of Agreed Facts and briefs in accordance with 831 CMR 1.31.

The parties agreed that the two issues[2] before the Board were: (i) whether the Texas margin tax ("TMT") imposed under Chapter 171 of the Texas Tax Code qualified for the Massachusetts credit under G.L. c. 62, § 6(a) ("§ 6(a)") for taxes paid to other jurisdictions ("Tax Credit Issue"); and, if not, (ii) whether the appellant was entitled to an abatement of the penalties that were imposed by the Commissioner pursuant to G.L. c. 62C, § 35A ("§ 35A") ("Penalties Issue").

Based on the parties' stipulated facts, the Board made the following findings of fact.

I. Introduction and Jurisdiction

At all times relevant to this appeal, the appellant, a certified public accountant, was a partner with KPMG LLP ("KPMG"), an accounting firm doing business in multiple states.

[2] Although the appellant raised issues in his petition relating to the amount of income subject to tax in California and New York, he did not pursue these issues during the course of the proceedings at the Board.

The appellant was a Massachusetts resident during the tax years at issue and filed Massachusetts resident income tax returns for each year.

Because KPMG did business in multiple states, KPMG partners owed taxes in those states based on their distributive share of KPMG's partnership income allocated to those states. For each of the tax years at issue, the appellant received from KPMG a schedule entitled "Schedule of State Income Allocations and Composite Nonresident Income Taxes" ("KPMG schedules"). The appellant attached the KPMG schedules to his Returns to support the § 6(a) credits he claimed on the Returns.

The KPMG schedules reflected the appellant's share of partnership income that KPMG allocated to each of forty-one states and the amount of state income tax, if any, that KPMG paid to those states on behalf of the appellant. The KPMG schedules did not reflect state income taxes that the appellant personally paid to New York and California. These amounts were noted separately on the KPMG schedules that the appellant attached to his Returns. To the taxes he paid directly to New York and California, the appellant added the state income taxes that KPMG paid to the various states on his behalf, to arrive at the total taxes paid to states other than Massachusetts for each of the tax years at issue. The appellant claimed a § 6(a) credit for this total on his Returns.

The KPMG schedules that the appellant received for the tax years at issue did not include the appellant's share of KPMG's partnership income from Texas, or any tax that KPMG paid to Texas. Accordingly, the § 6(a) credit that the appellant claimed on his Returns did not include his share of the TMT that KPMG paid to Texas.

The Commissioner selected the Returns for audit. On audit, the Commissioner determined that the appellant failed properly to calculate his § 6(a) credit for the tax years at issue. Under § 6(a), Massachusetts residents are allowed a credit equal to the lesser of: (i) taxes due to other jurisdictions; and (ii) their Massachusetts tax multiplied by a fraction, the numerator of which is income taxed in other jurisdictions and the denominator of which is total income ("Credit Limitation Fraction").

For each of the tax years at issue, the appellant claimed a § 6(a) credit equal to the taxes due to other jurisdictions as reflected on the KPMG schedules attached to his Returns. However, for each year, the Credit Limitation Fraction resulted in a smaller credit than the total shown on the KPMG schedule. Because the appellant failed to use the lesser of the two alternative amounts, the Commissioner issued a Notice of Intent to Assess dated March 6, 2015 ("NIA") that proposed assessments of tax for each of the tax years at issue equal to the amount of the § 6(a) credit that the appellant claimed on his Return less the proper § 6(a) credit using the Credit Limitation Fraction. In addition to the proposed assessments of tax, the Commissioner proposed underreporting penalties pursuant § 35A. These penalties totaled $2,501.40.

The appellant responded to the NIA by letter dated March 8, 2015. In his letter, the appellant did not challenge the Commissioner's determination of the proper § 6(a) credit or the proposed assessments of tax. Rather, the appellant protested the proposed imposition of the § 35A penalties, indicating his belief that his tax underpayments were due to reasonable cause. As support for his challenge to the § 35A penalties, the appellant argued that the TMT was in fact an income tax includable in the calculation of the § 6(a) credit, at least in the case of service businesses. However, the appellant made clear in his letter that: "I don't propose to reopen [the examiner's] calculations, but rather point out the nature of the Texas margin tax . . . to support my belief that there is a reasonable basis for the nonresident tax credit claimed on my originally filed return." Moreover, his letter indicated that he was aware of Department of Revenue ("DOR") Directive 08-7, which reflected the Commissioner's position that the TMT is not an income tax eligible for the § 6(a) credit, and his view that the Commissioner's interpretation was "reasonable" but "not the only way to interpret" § 6(a).

On March 11, 2015 the Commissioner denied the appellant's request for waiver of penalties. The appellant filed an appeal on Form DR-1 with the Commissioner's Office of Appeals on March 28, 2015, requesting a pre-assessment conference. In his appeal, the appellant maintained that the examiner: (i) failed to include, in the numerator of his Credit Limitation Fraction, his distributive share of KPMG's Texas income; and (ii) had incorrectly failed to allow him to claim a credit for his share of the TMT paid by KPMG. Following a May 27, 2015 pre-assessment conference, the Commissioner issued a determination letter on May 27, 2015 that rejected the appellant's position.

The Commissioner issued a Notice of Assessment dated August 25, 2015 and the appellant timely filed an application for abatement on Form CA-6, disputing the additional taxes and penalties assessed, and claiming a § 6(a) credit for his share of the TMT paid by KPMG. The Commissioner denied the appellant's application for abatement by notice dated April 29, 2016. The appellant timely filed a Petition under Formal Procedure with the Board on June 27, 2016.

Based on the foregoing facts, the Board found and ruled that it had jurisdiction to hear and decide this appeal.

II. Tax Credit Issue

During the tax years at issue, the TMT was imposed on the amount of a taxable entity's "taxable margin," or its "total revenue" apportioned to Texas. In general, an entity's taxable margin was based on its total revenue from its entire business less certain deductions. However, entities with total revenue of $10 million or less that elected to use an E-Z computation were taxed at a lower rate on their total revenue apportioned to Texas.

KPMG paid a TMT for each of the tax years at issue. The statute required KPMG, a partnership whose total revenue exceeded the $10 million threshold, to compute its "total revenue" by: (i) adding its gross receipts or sales, dividends, interest income, gross rents, royalties, net capital gain or loss, and certain other income items reported on its Federal Form 1065; and (ii) deducting, from this sum, bad debts, interest on Federal obligations, and certain other items listed in the statute. To arrive at its "margin," the statute allowed an entity to deduct from its total revenue the largest of three amounts — 30% of total revenue, its cost of goods sold, and its total compensation. The net amount apportioned to Texas ("taxable margin") was subject to tax. During the tax years at issue, KPMG determined its margin by deducting its wages, cash compensation, and employee benefits from its total revenue.

Under § 6(a), a credit is allowed only for taxes imposed by certain taxing jurisdictions other than Massachusetts "on account of any item of Massachusetts gross income." As will be detailed in the Opinion below, the Board ruled that the TMT was not imposed on account of an item of Massachusetts gross income, but instead was imposed on an approximation of the value of the right to do business in Texas. Accordingly, the Board found and ruled that the KPMG schedules and the Returns properly excluded the appellant's share of the TMT paid by KPMG from the calculation of the appellant's § 6(a) credits for the tax years at issue. The Board therefore ruled that the appellant was not entitled to an abatement on the Tax Credit Issue.

III. Penalties Issue

As discussed further in the Opinion below, § 35A imposes a penalty upon taxpayers who underpay their tax liability under defined circumstances unless one of certain limited exceptions applies. The defined circumstances triggering the § 35A penalty include: (i) an understatement of tax that exceeds the greater of ten percent of the amount required to be shown on the return or $1,000 (a "substantial understatement"); and (ii) an underpayment of tax attributable to negligence or disregard of Massachusetts tax law or public written statements issued by the Commissioner. The amount of the underpayment is reduced by any portion attributable to: (i) a return position based on substantial authority; or (ii) a return position adequately disclosed on the return or in a statement attached to the return, for which the taxpayer had a reasonable basis. A taxpayer may avoid the § 35A penalty in its entirety by establishing that there was "reasonable cause" for the position taken on the return, and that the taxpayer acted "in good faith."

The Board found that there was a substantial understatement of tax within the meaning of § 35A. The § 6(a) credits reported on the Returns were excessive because the appellant failed to use the Credit Limitation Fraction. The excessive credits resulted in an understatement of tax that exceeded the $1,000 and ten percent thresholds set out in § 35A for each of the tax years at issue.

As previously noted, the appellant filed his Returns without claiming a credit for his share of the TMT paid by KPMG. Since the appellant did not "disclose" on his Returns the position that he is now claiming — that the TMT should be included in his § 6(a) credit calculations, he must show substantial authority for his position, or that he had reasonable cause and acted in good faith.

The appellant argued that he had substantial authority for treating the TMT as qualifying for the § 6(a) credit, based on: (i) administrative or quasi-judicial determinations in other states; (ii) his view that his position was supported by a well-reasoned analysis of § 6(a); and (iii) Massachusetts authorities whose reasoning was "arguably" contrary to the conclusion reached by the Commissioner in DOR Directive 08-7.

The Board found that the appellant did not have substantial authority for his calculation of the § 6(a) credit on his Returns. As more fully described in the Opinion below, the out-of-state administrative or quasi-judicial determinations on which the appellant relied were not entitled to weight in determining whether the TMT could be included in the appellant's § 6(a) credit calculations. Rather, the Board found that the Texas Supreme Court's and Legislature's interpretation of the TMT, as well as the Commissioner's directives on the issue, represented the appropriate analysis of the TMT with respect to the § 6(a) credit.

Finally, the Board rejected the appellant's argument that he had reasonable cause for claiming the § 6(a) credits shown on his Returns and had acted in good faith. The credits claimed on the Returns were excessive based on the plain wording of § 6(a) and the Commissioner's explicit directives addressing the TMT in the context of the § 6(a) credit. The appellant had no reasonable cause for the credits he claimed on the Returns; he simply improperly used the greater, rather than the lesser, of the alternative amounts permitted under § 6(a). It was only after he was audited that the appellant developed the theory that the claimed credits were justified because the TMT should be considered in the calculation of the § 6(a) credit. However, the appellant's retrospective attempt to justify the erroneous credits on his Returns using out-of-state determinations at odds with relevant Texas and Massachusetts interpretations of the TMT does not rise to the level of reasonable cause.

IV. Conclusion

Accordingly, the Board found and ruled that the appellant did not meet his burden of proving that he was entitled to an abatement of either tax or the penalties imposed under § 35A. Having found that the appellant failed to meet his burden of proof on both the Tax Credit Issue and the Penalties Issue, the Board issued a decision for the appellee in this appeal.

OPINION

I. Tax Credit Issue

A. The § 6(a) Credit

Residents of Massachusetts are allowed a credit against their personal income tax liability for income taxes paid to certain other taxing jurisdictions on income that is also taxed in Massachusetts. In relevant part, § 6(a) provides that:

> A credit shall be allowed against taxes imposed by this chapter to a resident for taxes due any other state, territory or possession of the United States, or the Dominion of Canada or any of its provinces on

> account of any item of Massachusetts gross income subject to the following restrictions and limitations: (i) the amount of such taxes due on such income shall exclude interest and penalties; (ii) the amount of such taxes due shall be reduced by any federal credit therefor allowable on the resident's federal income tax return; and (iii) the amount of the credit allowable shall be the lesser of such taxes as reduced by (i) and (ii), or the amount of tax imposed by this chapter multiplied by a fraction the numerator of which is such item of Massachusetts Part A, Part B or Part C income and the denominator of which is the total Massachusetts Part A, Part B or Part C income, as the case may be.

Under this provision, a credit for taxes paid to another state is allowable only if the tax is imposed "on account of any item of Massachusetts gross income." Further, if the total of such taxes exceeds an amount determined by multiplying the taxpayer's pre-credit Massachusetts tax liability by a fraction representing the ratio of the taxpayer's Massachusetts income taxed out of state to the taxpayer's total Massachusetts income (the Credit Limitation Fraction), the § 6(a) credit is limited to the amount determined applying the Credit Limitation Fraction.

Accordingly, to determine whether the TMT is includable in the calculation of the § 6(a) credit, a determination must be made whether the TMT is a tax "on account of" an item of Massachusetts gross income.

B. Nature of the TMT

The Texas Legislature enacted a restructured margin tax in 2006,[3] payable by taxable entities organized or doing business in Texas, including corporations, S corporations, professional corporations, partnerships, limited liability companies, and business associations and, since 2008, limited liability partnerships. *See* Tex. Tax Code § 171.0002(a), as amended by Acts 2007, 80th Leg., Ch. 1282 (H.B. 3928), § 2. The TMT is not imposed, *inter alia*, on sole proprietorships (except for single-member limited liability companies) or on general partnerships owned entirely by natural persons (except for limited liability partnerships). *See* Tex. Tax Code § 171.0002(a) and (b).

For the tax years at issue, entities whose annualized total revenue was equal to or less than $1 million, adjusted for increases or decreases in the consumer price index,[4] were not subject to the TMT. *See* Tex. Tax Code §§ 171.002(d)(2) and 171.006(b). Also, for the tax years at issue, entities with $10 million or less in annualized total revenue using an E-Z computation were allowed to elect to be taxed at a lower rate on a larger amount than other taxable entities. *See* Tex. Tax Code § 171.1016. KPMG had in excess of $10 million in annualized

[3] Texas Tax Code, Title 2, Subtitle F, Chapter 171, Franchise Tax. All references to sections of the Texas Tax Code are to those in effect during the tax years at issue.
[4] The $1 million threshold was increased to $1,030,000 for 2012 and 2013.

total revenue, and therefore was subject to the TMT and was not eligible to use the E-Z computation.

KPMG was required to file a Texas Franchise Tax Report listing its gross receipts or sales, dividends, interest income, gross rents, royalties, net capital gain or loss, and certain other income items reported on its Federal Form 1065, from which it could exclude only certain amounts, including bad debts and interest on Federal obligations, to arrive at its "total revenue." *See* Tex. Tax Code § 171.1011(c)(2). KPMG's "margin" shown on its Franchise Tax Report was the least of three amounts: (i) 70 percent of total revenue; (2) total revenue minus its cost of goods sold as determined under Tex. Tax Code § 171.1012, including certain indirect or administrative overhead costs; and (iii) total revenue minus its compensation as determined under Tex. Tax Code § 171.1013, including employee benefits. *See* Tex. Tax Code § 171.101(a)(1). KPMG was taxed on its margin to the extent apportioned to Texas (its "taxable margin"), determined by applying a single-factor formula described in the statute. *See* Tex. Tax Code §§ 171.101(a)(2) and 171.106. During the tax years at issue, KPMG determined its margin by deducting the amount of its wages, cash compensation, and employee benefits from its total revenue.

After enactment of the restructured margin tax in 2006, the Texas Supreme Court addressed two constitutional challenges to the TMT. First, a limited partnership subject to the TMT argued it constituted a tax on the net income of its natural-person limited partners and hence violated the Texas Constitution. ***In re Allcat Claims Serv., L.P.***, 356 S.W. 3d 455 (Tex. 2011). The Texas Supreme Court disagreed, stating:

> The Bullock Amendment [to the Texas Constitution] does not preclude the taxation of business entities for the privilege of doing business in Texas and taking advantage of the option to limit the liability of the owners of a business as Allcat does by means of the limited partnership structure. We conclude that the franchise tax constitutes a tax on Allcat as an entity . . . .

Id. at 470.

In the second matter, the Texas Supreme Court addressed a challenge to the constitutionality of the TMT brought by a corporation with limited business operations in Texas. The corporation argued that because the TMT "[bore] no reasonable relationship to its object, the value of the privilege of doing business in Texas," it violated the mandate in the Texas Constitution requiring "equal and uniform" taxation. ***In re Nestle USA, Inc.***, 387 S.W.3d 610, 612 (Tex. 2012). In its decision, the Texas Supreme Court pointed to the provisions of Article VIII, §§ 1(c) and 2(a) of the Texas Constitution, indicating that the Legislature could impose taxes on the privilege of doing business that were equal and uniform upon the same class of subjects. ***Id.*** at 619, 621. The Court concluded that, notwithstanding the exemptions and special deductions allowed in computing the TMT, the structure of the revised TMT statute was reasonably related to its object of taxing the privilege of conducting business in Texas. ***Id.*** at 623-24.

In reaching its conclusion in the second matter, the Texas Supreme Court addressed the nature of the TMT in the following way:

> "The granting of the privilege to transact business in this state confers economic benefits, including the opportunity to realize gross income and the right to invoke the protection of local law. The Texas franchise tax is a tax on the value of this privilege [citing to ***Bullock v. National Bancshares Corp.***, 584 S.W.2d 268, 270 (Tex. 1979)]." The Tax Commission responsible for developing the 2006 amendments to the franchise tax confirmed that purpose by stating: "The clear intention of the law's original framers — that the franchise tax should be imposed in exchange for the state's liability shield — remains the guiding light for the Commission's recommendation."

Id. at 622. *See also* ***Combs v. Newpark Res., Inc.*** 422 S.W.3d 46, 47 (Tex. App. – Austin 2013) (in which the Texas Court of Appeals, citing ***In re Nestle***, described the TMT is "a tax on the value and privilege of doing business in Texas").

More recently, the Texas Court of Appeals, in a decision affirmed by the Texas Supreme Court, ruled that the TMT was not an "income tax" for purposes of the Multistate Tax Compact and, therefore, the Texas single-factor formula was required for apportionment. ***Graphic Packaging Corp. v. Hegar,*** 471 S.W.3d 138 (Tex. App. – Austin 2015) ("***Graphic I***"), *aff'd*, 538 S.W.3d 89

(Tex. 2017) ("***Graphic II***"). In reaching its conclusion, the Texas Court of Appeals noted that the TMT could be imposed even in the absence of net income and that the deductions allowed under the TMT were not the same as deductions from gross income typical of an income tax. ***Graphic I***, 471 S.W.3d at 144 & 144, n.3; *see* ***Graphic II***, 538 S.W.3d at 95. The Texas Court of Appeals also noted that the Texas Legislature, in adopting the 2006 amendment to the TMT, specifically stated that the "franchise tax imposed by [the TMT], as amended by this Act, is not an income tax" and that "Pub. L. No. 86-272[5] does not apply to the tax." ***Graphic I***, 471 S.W.3d at 146 & 146, n.4; *see* ***Graphic II***, 538 S.W.3d at 95 and Acts 2006, 79th Leg., 3rd C.S., Ch. 1 (H.B.3), § 21.[6] In affirming the decision of the Texas Court of Appeals, the Texas Supreme Court found it unnecessary to reach the question whether the TMT was an income tax for purposes of the Multistate Tax Compact, holding instead that the Texas single-factor formula was required for apportioning the TMT derived from multi-state business, notwithstanding the provisions of the Multistate Tax Compact. ***Graphic II***, 538 S.W.3d at 106. However, the Texas Supreme Court expressly

[5] Public Law 86-272 prohibits a state from imposing a net income tax on income derived within a state under certain circumstances. By stating that the TMT was not subject to Public Law 86-272, the Texas Legislature underscored its intention that the TMT was not an income tax.

[6] The Texas nexus regulations also state that Public Law 86-272 does not apply to the Texas franchise tax. Texas Administrative Code, Title 34, § 3.586(e), effective January 1, 2008. Section 3.586, as amended effective December 29, 2019 to expand businesses subject to the franchise tax, retains this provision as re-lettered subsection (i).

recognized "the Legislature's stated intent not to create an income tax . . . ." ***Graphic II***, 538 S.W.3d at 95.

The interpretation of the TMT by the highest court of Texas is entitled to weight. *See, e.g.,* ***Elmendorf v. Taylor***, 23 U.S. (10 Wheat.) 152, 159 (1825), relied upon by the Massachusetts Supreme Judicial Court in ***Hill v. Boston***, 122 Mass. 344, 380 (1877). In the ***Elmendorf*** decision, Supreme Court Chief Justice Marshall wrote:

> This Court has uniformly professed its disposition, in cases depending on the laws of a particular state, to adopt the construction which the courts of the state have given to those laws. This course is founded on the principle, supposed to be universally recognized, that the judicial department of every government, where such department exists, is the appropriate organ for construing the legislative acts of that government.

Elmendorf, 23 U.S. at 159.

In addition to the Texas judicial and legislative determinations that the TMT is a franchise tax and not an income tax, the Commissioner has similarly expressed the same view in public written statements. In DOR Directive 08-6, the Commissioner allowed partners to claim a credit for income taxes paid to another state by a partnership, but stated that (i) this rule does not apply to taxes that are "not imposed on net income, including gross receipts-based taxes . . . (e.g., as recently enacted in Texas . . .)," and (ii) no § 6(a) credit will be allowed for taxes "in the nature of excise, property or franchise taxes."

Simultaneously with the issuance of DOR Directive 08-6, the Commissioner issued guidance stating that the TMT was not the type of tax for which a § 6(a) credit is allowed. *See* DOR Directive 08-7. The Commissioner noted in DOR Directive 08-7 that the TMT did not allow deductions generally allowed by a net income tax and that the Texas Legislature made clear that the TMT was not an income tax. The Commissioner observed here that the TMT was due whether or not a business was profitable.

The Commissioner's determination in DOR Directive 08-7, finding that the TMT was not creditable under § 6(a) because it was a franchise tax imposed for the privilege of doing business in Texas, is entirely consistent with taxpayer-specific conclusions reached by the Commissioner in two private letter rulings on which the appellant relied. The New Hampshire business profits tax addressed in DOR Letter Ruling 87-10 was an income tax in nature, imposed on a Massachusetts partner's share of gain that a New Hampshire limited partnership realized from selling its real estate. The business profits tax was imposed on the partner's share of the gain, which was an item of Federal and Massachusetts gross income. Accordingly, the partner was allowed a § 6(a) credit.

Similarly, the District of Columbia Unincorporated Business Franchise Tax considered in DOR Letter Ruling 94-8 qualified for the § 6(a) credit because, despite its label, computation of the tax began with federal gross income and was reduced by exclusions and deductions commonly found in personal income tax provisions. In addition, the Commissioner found "most compelling" the case law construing the tax as an income tax, particularly the decision of the highest court in the District of Columbia.

None of the out-of-state determinations construing the TMT cited by the appellant addressed language similar, or comparable, to that in § 6(a). Rather, they addressed the particular wording of non-Massachusetts statutes using non-Massachusetts law to inform their analysis. Decisions in other states addressing another state's laws shed little light on the interpretation of a specific and distinct Massachusetts statute. *See* ***Macy's East, Inc. v. Commissioner of Revenue***, 441 Mass. 797, 807 (2004) ("The law in other jurisdictions . . . cannot serve as a source for interpreting the Massachusetts . . . provision and corresponding regulation."); ***Borofsky's Case***, 411 Mass. 379, 381 (1991) ("Cases from other jurisdictions which tend to favor [an appellant] are not helpful because they have been decided under statutes which are dissimilar to ours."); ***Commonwealth v. Jones***, 382 Mass. 387, 392, n.8 (1981) ("The defendant points to decisions in other jurisdictions finding . . . an implied repeal [of a statutory provision] . . . . The decisions all turn on the particular wording of the . . . statutes involved, however, and are not very helpful to us here.”). On the other hand, as noted above, cases from the highest court of Texas construing its own state law are instructive. *See, e.g.,* ***Hill***, 122 Mass. at 380; ***Elmendorf***, 23 U.S. at 159.

Moreover, the appellant’s argument that the TMT had been determined to be an income tax for financial accounting purposes by certain accounting firms and the Financial Accounting Standards Board is not relevant to the matter before this Board. How a specific item is treated for book and financial accounting purposes does not determine its tax treatment. *See* ***Bayer Corp. v. Commissioner of Revenue***, Mass. ATB Findings of Fact and Reports 2000-543, 560, *affirmed* per Rule 1:28, 68 Mass. App. Ct. 1101 (2007).

The fact that the TMT was based on certain items which enter into the computation of income subject to Federal and Massachusetts income tax did not change the character of the tax. In a different context, the Supreme Judicial Court recognized that the measure of a state-imposed tax is not determinative of its character. In two decisions involving the insurance excise imposed on the gross investment income of domestic insurance companies under G.L. c. 63, § 22A, the court ruled that the tax was a franchise tax or other nonproperty tax imposed on the value of the privilege of doing business in Massachusetts, such that the measure of the tax could constitutionally include interest earned on Federal obligations. *See* ***Commissioner of Revenue v. Massachusetts Mutual Life Insurance Co.***, 384 Mass. 607, 612 (1981) ("The fact that the measure of the tax mentions 'gross investment income' as reported in the annual statement [filed by an insurance company] does not divest the tax of its excise character. . . . The tax at issue is imposed on the insurers for the privilege of doing business in the Commonwealth. . . . Section 22A does not impose a limited income tax. Rather, it sets out a workable measure, a yardstick to calculate the value of the privilege of doing business in Massachusetts."); ***Liberty Mutual Insurance Co. v. Commissioner of Revenue***, 405 Mass. 352, 356 (1989)("We . . . continue to adhere to our conclusion that § 22A is a franchise or other nonproperty tax."). Like the tax imposed on the gross investment income of domestic insurance companies under § 22A, the TMT in effect during the tax years at issue was in substance, form, and purpose a franchise tax on the privilege of doing business — not an income tax.

C. Conclusion

Accordingly, the Board determined that the appellant's share of the TMT paid by KPMG for each of the tax years at issue was not creditable under § 6(a), such that the amount subject to that tax was not properly includible in the numerator of the appellant's Credit Limitation Fraction. The TMT paid by KPMG was not imposed "on account of" an item of Massachusetts gross income;[7] rather it was a franchise tax imposed on account of an approximation of the value of being able to conduct business in Texas and derive revenues from business activities in Texas.

II. Penalties Issue

Under § 35A, the Commissioner is authorized to assess a penalty equal to twenty percent of the amount of tax required to be, but not, shown on a return if there is a "substantial understatement" of tax, defined as an understatement exceeding the greater of $1,000 or ten percent of the tax required to be shown on the return. G.L. c. 62C, § 35A(a), (b)(2), and (c). The § 35A penalty can also be imposed if there is an underpayment of tax attributable to negligence or disregard of the tax laws of the Commonwealth or of public written statements issued by the Commissioner. Negligence includes "any failure to make a reasonable attempt to comply with the laws or public

[7] In fact, unlike the Massachusetts income tax, the restructured TMT was based on gross revenue, including cost of goods sold not includible in either Federal or Massachusetts gross income.

written statements," and disregard includes "any careless, reckless, or intentional disregard." G.L. c. 62C, § 35A(a), (b)(1), and (c).

The statute reduces the amount of understatement on which the § 35A penalty can be imposed by the portion attributable to:

> (i) the tax treatment of any item by the taxpayer if there is or was substantial authority for the treatment; or
>
> (ii) any item if the relevant facts affecting the tax treatment of the item are adequately disclosed in the return or in a statement attached to the return, and there is a reasonable basis for the tax treatment of the item by the taxpayer.

G.L. c. 62C, § 35A(d).

Another statutory provision further limits the scope of the penalty provisions by stating:

> A penalty shall not be imposed under section 35A with respect to any portion of an underpayment if it is shown that there was reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.

G.L. c. 62C, § 35B(a)("§ 35B(a)").

In the present appeal, the appellant's understatement of tax resulting from the excessive § 6A credit claimed on his Returns constituted a substantial understatement for purposes of § 35A. The Board found that the appellant did not establish that any of the conditions for penalty avoidance or reduction described in § 35A(d) applied. Because the appellant did not disclose his position on his Returns for the tax years at issue,

§ 35A(d) required that he establish "substantial authority" for his position to avoid or limit the § 35A penalty. The Board ruled that the appellant did not have "substantial authority" for the position taken on his Returns. The Board gave no deference to his cited out-of-state administrative or quasi-judicial determinations or to his analysis of the applicable statutory provision, particularly in light of the definitive conclusions reached by the Texas Supreme Court and Texas Legislature and the Commissioner's public written statements that the TMT was not an income tax.

In addition, the reasonable cause and good faith conditions for penalty avoidance under § 35B(a) were not met. The appellant's submissions to the examiner and the Office of Appeals in response to the Commissioner's NIA indicate that the appellant purposely claimed a § 6(a) credit on his Returns based either on an interpretation of the Credit Limitation Fraction that he knew to be different from the Commissioner's interpretation, or on his failure to apply any Credit Limitation Fraction at all. In either case, the action of the appellant, a partner with an accounting firm, did not evidence reasonable cause and good faith.

III. Conclusion

The Board found and ruled that the appellant's share of the TMT paid by KPMG for each of the tax years at issue was not creditable under § 6(a), and that therefore the amount subject to that tax was not properly includible in the numerator of the appellant’s Credit Limitation Fraction.

The Board further found and ruled that none of the conditions for penalty avoidance or reduction described in § 35A(d) were satisfied, and that the reasonable cause and good faith conditions for penalty avoidance under § 35B(a) had not been met.

Accordingly, the Board issued a decision for the appellee in this appeal.

THE APPELLATE TAX BOARD

By: *Thomas W. Hammond, Jr.*
Thomas W. Hammond, Jr., Chairman

A true copy,

Attest: *William J. Doherty*
Clerk of the Board