

“We’ve spent less than \$4 million on the technology and have produced a net gain of more than \$70 million.”



\$70,000,000



To the Honorable Mitt Romney, Governor of the Commonwealth, and the Honorable Members of the General Court of Massachusetts:

It is my pleasure to submit to you the Fiscal Year 2004 Annual Report of the Massachusetts Department of Revenue. FY04 was a year in which we witnessed vast improvement in service and revenues as a result of our investments in technology.

With the implementation of our innovative Discover Tax (DTAX) program and other non-filer project enhancements, DOR generated over \$70 million in collections during FY04. This initiative has extensive value to the Commonwealth. DTAX significantly improves DOR's ability to pinpoint taxpayers and subsequently collect from those who have failed to file tax returns or underreported their tax obligations. As an electronic data warehouse, DTAX also is beneficial in enhancing revenue forecasting, tax policy analysis and refining statistical data mining. Costing less than \$4 million in state funds, we have thus far seen an excellent return on our investment. DTAX is an invaluable tool which continues to provide much needed revenue for the Commonwealth.

The passage of several of DOR's FY04 legislative recommendations resulted in the collection of approximately \$211 million in revenues – welcome news in light of the budgetary challenges facing state government.

In FY04, electronic payments generated \$10.94 billion in accelerated revenue collections, compared to \$7.27 billion in FY03. Electronic funds transfer collections comprised 68 percent of DOR's total FY04 revenue collections of \$15.95 billion.

Use of WebFile for Business (WFB) continues to expand among businesses and professional tax preparers. WFB was responsible for 887,002 returns in FY04 – a 2,308 percent increase over FY03's total of 36,828 returns. In addition, nearly 90 percent of business taxpayers mandated to file electronically are at least partially compliant.

On the Child Support Enforcement front, DOR became eligible for federal incentive funds by passing the annual Federal Data Reliability Audit. We also received systems certification for COMETS from the federal Office of Child Support Enforcement. While COMETS certification and the Data Reliability Audit are important, so too is CSE's mission to protect the economic well-being of children by enforcing the financial responsibilities of parenthood: CSE collected more than \$473 million in child support for Massachusetts families in FY04 — an increase of nearly \$11 million over last year.

In an effort to promote communication between local governments and the Department, the Division of Local Services offered DOR's surplus computers to municipalities for a nominal fee. As more municipal finance business is conducted electronically, many cities, towns and school districts — particularly smaller communities — were able to obtain Internet access.

Like other state agencies, DOR faced many significant internal changes in FY04, including new senior staff in three divisions, our move back to the Saltonstall Building, and the installation of new computers and software for employees. Our employees handled it all with aplomb. I am proud of the way they provided quality service to taxpayers despite the disruptions to their work routines.

DOR has accomplished much, but as always in life, more challenges lie ahead. I look forward to working with you and the taxpayers of the Commonwealth as we strive to reach new goals in the coming year.

A handwritten signature in blue ink that reads "Alan LeBovidge". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Alan LeBovidge, Commissioner of Revenue

Year in Review

Introduction

As a result of the Department of Revenue's commitment to technology, DOR has reached new milestones in service and revenue collections. The Department has continued its long-range plans for streamlining operations and automating processes to make DOR a national model for tax administration.

The following sections highlight DOR's Fiscal Year 2004 achievements in three primary areas of business: tax administration, child support enforcement and local services.

Tax Administration

The Department has thus far seen an excellent return on its investment in DTAX software, a data warehousing system that allows us to identify tax evaders. At the close of FY04, DOR collected more than \$70 million through DTAX from individuals and businesses that failed to file tax returns or underreported their tax obligations. From its immense electronic data warehouse, DTAX interconnects data from multiple sources to identify noncompliant taxpayers, compute the tax due and generate bills accordingly. DTAX not only pinpoints tax evaders, but also has issued refunds to taxpayers who have overpaid. As a result of this automated process, more auditors and collectors are free to focus on projects that are more complex.

In FY04, the Department developed, and the Legislature endorsed, with relatively modest exceptions, a tax loophole package aimed at aligning the Commonwealth's existing tax laws with their original intent. These flaws in the tax code cost the Commonwealth millions of dollars a year in lost revenue by permitting corporations to shelter certain activities that were intended to be subject to taxation. This package led to the collection of roughly \$211 million in FY04, including \$77 million from changes related to corporate transactions without a business purpose (Sherwin-Williams) and \$70 million from changes related to real estate investment trusts (REITs).

DOR implemented several electronic filing mandates in FY04. These mandates required certain businesses to file returns and pay taxes electronically. For example, all new businesses registering to collect taxes in the Commonwealth, businesses collecting \$10,000 or more in trustee taxes and businesses filing zero tax due returns were no longer able to file paper returns or make payments by paper check. As a result of these mandates, DOR realized a 2,308 percent increase in business returns filed electronically over the previous year – 887,002 in FY04 as compared to 36,828 in FY03. The Department collected \$10.9 billion in revenues through electronic payments.

DOR made numerous technological enhancements to its WebFile for Business and Electronic Funds Withdrawal programs to meet the needs of the thousands of new mandated users. DOR employees conducted workshops across the state in an effort to educate the taxpayer community about the mandates and WebFile for Business.

Following the success of WFB, DOR introduced Web Services for Income, a new online service geared toward income tax taxpayers. WSI provides a single point of entry for taxpayers to access a number of online applications for income tax. In this area, taxpayers can make a tax payment or pay a specific bill, apply for a small payment agreement, check their estimated tax payment history and check on the status of a refund. Future enhancements

Year in Review

include applications that will allow taxpayers to apply online for an abatement or a certificate of good standing.

The additional auditors and collectors funded by the FY04 retained revenue account were pivotal in achieving key compliance functions. These new employees generated \$23 million in revenues, exceeding the estimated revenue goal.

As witnessed during the 2004 income tax filing season, e-filing continued to gain in popularity. Of the 3.2 million returns processed, 2.7 million were either electronic returns or 2-Dimensional (2-D) barcoded returns. DOR processed over half a million more returns at the height of the filing season than at the same point in the prior year. This was due in large part to the mandate that all Massachusetts personal income tax returns produced by third party software developers include 2-D barcodes. The increase in the number of 2-D barcoded returns and the corresponding decrease in the number of traditional paper returns resulted in a significant reduction in refund turnaround time: the average refund turnaround time for all filing methods decreased from 23.3 days in 2003 to 9.8 days in 2004.

Child Support Enforcement

The Child Support Enforcement Division is charged with protecting the economic well-being of children by enforcing the financial responsibilities of parenthood. CSE provides essential services to families by assisting parents

in establishing paternity and child support orders, collecting child support and asking courts to adjust support orders when circumstances change.

CSE achieved a record \$473 million in collections in FY04, an increase of nearly \$11 million over FY03. This increase can be attributed in part to a growth in collections through employers and the success of the license suspension program. Since becoming a division of DOR in 1987, CSE has collected \$4.7 billion, with \$3.6 billion going directly to families.

In January 2004, employers were required to begin submitting their employees' child support payments electronically. This led to a reduction in errors, improvement of processing and acceleration of payments to families. Electronic payments from employers who withhold child support from employees' wages increased by 44 percent — from \$29.4 million in FY03 to \$42.3 million in FY04.

Revised New Hire Reporting regulations that took effect in January 2004 also increased the number of employers required to file electronically. More than 44,700 employers reported new hires electronically, an increase of 16 percent from FY2003. The number of online reports in FY04 was 2.7 million, compared to the 800,000 received in FY03 — an increase of over 200 percent.

For the second year in a row, CSE passed the federal Data Reliability Audit with no audit findings, making CSE eligible for federal incentive funds on all five performance measures. CSE passed all the line items with an

efficiency rate showing reliability of 95 percent or higher. In addition, CSE completed all federal system certification requirements on COMETS, including the implementation of COMETS FM.

Through these achievements by a dedicated workforce, CSE is helping to improve the lives of hundreds of thousands of children in the Commonwealth by ensuring that they receive the financial support to which they are entitled on time and in full.

Local Services

In addition to administering the tax and child support laws of the Commonwealth, the Department's Division of Local Services has oversight of property taxation and municipal finance for the Commonwealth's 351 cities and towns. The mission of DLS is to help municipalities achieve sound and efficient fiscal management through technical assistance and training.

In FY04 the Division of Local Services issued approximately \$4.8 billion in electronic Cherry Sheet aid and distributed \$4.2 billion in local aid to cities and towns through the quarterly distribution process.

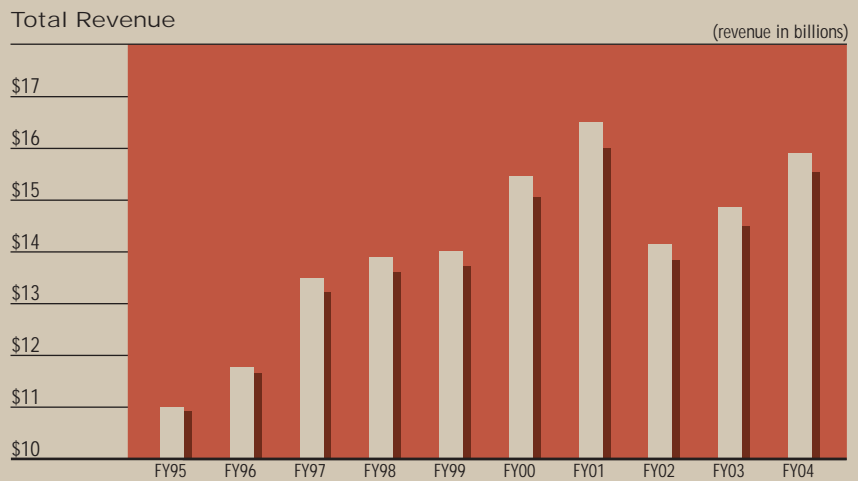
The Division's e-mail distribution list contains more than 6,000 subscribers statewide. Through this service, DLS can electronically disseminate Cherry Sheets, the *City & Town* newsletter, Informational Guideline Releases, Bulletins and other notifications to local officials. This initiative has saved the Commonwealth over \$70,000 in postage costs.

The Division of Local Services continues to implement e-government initiatives to improve internal programs and provide local officials with more convenience and flexibility in working with the state.

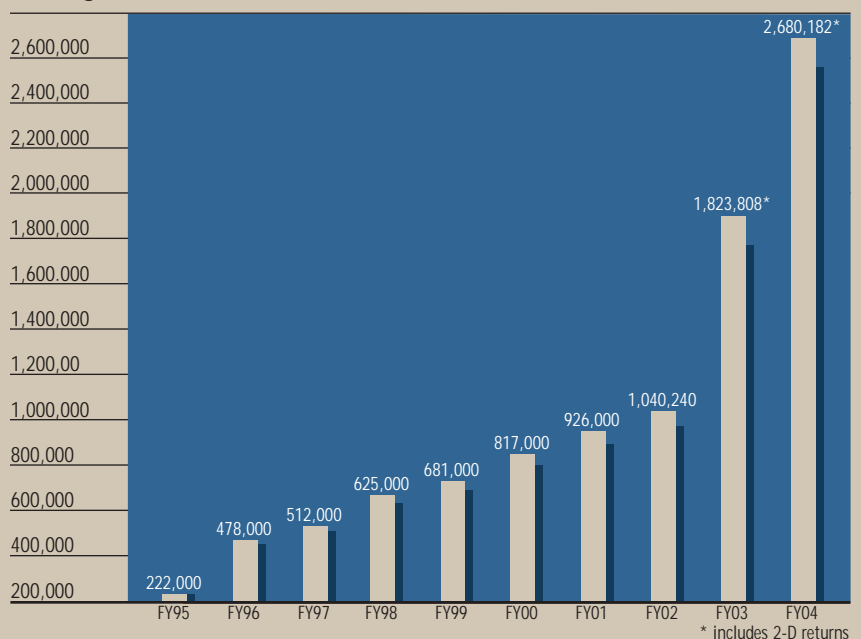
In FY04 DLS completed an online tutorial designed to familiarize new staff and local officials with the various functions of the Division and implemented an electronic examination for Course 101 participants. (All newly appointed assessors and assistant assessors with valuation responsibilities are required by law to pass the Course 101.) The electronic exams provided a new convenience to the officials and those Divisional employees who previously manually corrected the paper exams. In FY04, 160 exams were completed by Course 101 participants.

Additional data is now available online for the benefit of local officials. For example, DLS has published real property sales in a searchable online database for local official query and analysis and established the basis for direct Internet submissions of real estate sales reports by local officials in FY05. DLS also collaborated with MassGIS to create an interactive program where local officials can search for real property sales and locate the results on detailed Internet maps.

In an effort to encourage Internet access for state-local communication, DLS implemented a program whereby cities and towns, particularly smaller communities, could purchase surplus DOR computers for a nominal fee. Through this program, 300 computers were distributed to 15 communities.



E-Filing Overall Has Increased 8-fold Since 1995



Legislative Review FY2004

An Act Establishing a New Business Corporation Act (St. 2003, c. 127)

This Act creates a new Massachusetts business corporation statute, chapter 156D, which is based on the Model Business Corporation Act. The statute does not directly affect any corporate tax provisions but contains numerous substantive changes to Massachusetts corporate law including the treatment of acquisitions and mergers, corporate conversions and dissolutions, shareholder derivative actions and multiple changes to the methods and structure of share issuance. The Act is effective on July 1, 2004 and applies to domestic corporations having capital stock as were established before July 1, 2004 and which were, on June 30, 2004, subject to chapter 156B of the General Laws. *St. 2003, c. 127, §§ 1–24, amending M.G.L. c. 40D, § 21(h); c. 63, §§ 30, 38C; c. 110D, §§ 1(e), 2, 7, 8; c. 110F, §§ 2, 3; c. 149, §§ 183(i), 184; c. 155, § 1; c. 156, § 2; c. 156A, §§ 13(a), 14; c. 156C, § 59; adding new chapter 156D; amending c. 157A, § 3; c. 175, § 19E; c. 223, § 37; c. 224, § 14.*

An Act Relative to the Taxation of Corporations (St. 2003, c. 136)

This legislation adds a new section to the corporate excise related party provisions which are intended to prevent abusive tax avoidance measures. See TIR 03-19, Effect of the Supplemental Budget (St. 2003, c. 4) on Certain Related Member Interest or Intangible Expenses and Costs and the Commissioner's Interpretation of *The Sherwin-Williams Company v. Commissioner*, 438 Mass. 71 (2002), rehearing denied (Feb. 28, 2003). Under the related party provisions a taxpayer must generally addback to its net income certain payments to related parties for interest and intangibles expenses and costs. There are several exceptions to this rule including when the taxpayer establishes by clear and convincing evidence that the addback is unreasonable. This Act adds a section that provides a new exception for payments made to a related member that is a resident of a nation which has an income tax treaty with the United States. However, the related member must not be a controlled foreign corporation

within the meaning of IRC section 957. Several requirements apply to this exception, including that the amounts are deductible under federal income tax law, the transaction would have been agreed to in an arm's length negotiation and the transaction has a valid business purpose other than the avoidance of tax. This Act was effective upon approval on November 26, 2003. *St. 2003, c. 136, amending M.G.L. c. 63 by adding new section 31K.*

An Act Relative to Investments in Emerging Technologies to Promote Job Creation, Economic Stability and Competitiveness in the Massachusetts Economy (St. 2003, c. 141)

Brownsfield Credit

Prior to the Act, taxpayers subject to tax under M.G.L. c. 62 and 63 were allowed a credit for incurring eligible costs to remediate a hazardous waste site on property used for business purposes and located within an economically distressed area. Net response and removal costs that the taxpayer incurred between August 1, 1998 and January 1, 2007 were eligible for the credit provided that the taxpayer commenced and diligently pursued an environmental response action before August 5, 2003. The Act extends the time for incurring eligible costs that qualify for the credit by changing the environmental response action commencement cut-off date from August 5, 2003 to August 5, 2005. *St. 2003, c. 141, §§ 20, 28.*

Investment Tax Credit

Historically, the Investment Tax Credit has fluctuated between 1 percent and 3 percent of the eligible costs of qualifying property. As of November 26, 2003, the effect of the amendment is to make the Investment Tax Credit's current rate of 3 percent permanent. *St. 2003, c. 141, § 25, amending M.G.L. c. 63, § 31A(k) & (l).*

Jobs Incentive Payment

This Act created a new administrative provision, chapter 62C, § 67D, that authorizes the Commissioner to make a jobs incentive payment to qualifying biotechnology

and medical device manufacturing companies. Qualifying companies must in one calendar year increase their level of Massachusetts employment by at least 10 full-time equivalent eligible jobs over the previous calendar year in order to qualify for a jobs incentive payment. The jobs incentive payment equals 50 percent of the Massachusetts personal income tax rate imposed on the salary attributable to the increase of eligible jobs. The payment is made in equal installments to qualifying companies over a three-year period. A qualifying company may request a jobs incentive payment beginning in calendar year 2005 and through calendar year 2009. The earliest allowed request may be submitted on January 1, 2005 for a jobs incentive payment based on an increase of at least 10 jobs in calendar year 2004 over the qualifying company's weighted average employment in calendar year 2003. *St. 2003, c. 141, §§ 23, 78.*

Domestic and Foreign Manufacturing Corporations and Research and Development Corporations

This legislation made several changes in the qualifications for both domestic and foreign manufacturing corporations and research and development (R&D) corporations. Under the new law, a limited liability company (LLC) which is not classified as a partnership and has elected to be taxed as a corporation separate from its members for federal tax purposes and which is engaged in manufacturing in Massachusetts or R&D in Massachusetts may now be included in the definition of a manufacturing corporation or R&D corporation. The amendments require that a domestic manufacturing corporation be engaged in manufacturing in Massachusetts and that a domestic R&D corporation be engaged in R&D in Massachusetts. In addition, under prior law, to qualify as an R&D corporation one-third of a corporation's receipts must have been from R&D of property "capable of being manufactured in Massachusetts." The legislation repealed that requirement, so that a corporation may now qualify if it has two-thirds of its receipts or expenditures at-

tributable to R&D activity in Massachusetts. Finally, with respect to expenditures, the legislation added a new test for qualification. This test will allow certain entities (e.g., start-up corporations) to qualify without regard to receipts. However, unlike entities qualifying on the basis of their receipts from R&D, entities qualifying solely by virtue of meeting the “expenditures” test may not claim the investment tax credit under M.G.L. c. 63, § 31A. *St. 2003, c. 141, §§ 27, 29, amending M.G.L. c. 63, §§ 38C, 42B.*

One-Day Sales Tax Holiday

The Act provides for a Massachusetts sales tax holiday on August 14, 2004, during which most purchases made by individuals for personal use will not be subject to the Massachusetts sales or use taxes. During the holiday, all non-business sales at retail of single items of tangible personal property costing \$2500 or less are exempt from sales tax. However, all sales of motor vehicles, boats, meals, telecommunications services, gas, steam and electricity do not qualify for the sales tax holiday. *St. 2003, c. 141, §§ 55–59.*

An Act Relative to the Tax Laws of the Commonwealth (St. 2003, c. 143) —

This Act includes tax law changes to tax administration, the corporate excise and the deeds excise.

Tax Administration

Change to Final Determination for Purposes of Federal Changes

Under M.G.L. c. 62C, § 30, when the federal taxable income of certain taxpayers is finally determined by the federal government to be different from that originally reported, the “federal change” must be reported to the Massachusetts Department of Revenue. Taxpayers who must report changes are those with incomes taxable under M.G.L. cc. 62 or 63 (personal income tax or corporate excise, respectively), or with federal taxable estates subject to Massachusetts estate tax under M.G.L. c. 65C. If as a result of the federal change a taxpayer owes additional tax to Massachusetts, the tax must be paid, with interest,

when the federal change is reported. If as a result of a federal change, a taxpayer believes that a lesser Massachusetts tax is due, an abatement application may be filed with the Department of Revenue within one year from the date of notice of a final determination of change by the Internal Revenue Service.

The Act provides that a change in federal taxable income resulting from a closing agreement, an offer in compromise or any similar agreement constitutes a final determination of a change by the federal government. An agreement may constitute a final determination whether or not any audit or other review is complete with respect to issues not addressed in the agreement. Such an agreement need not result from a formal deficiency assessment against the taxpayer. Taxpayers must report changes resulting from those agreements to the Department of Revenue. The Act is applicable to closing agreements, offers in compromise, or similar agreements executed on or after January 1, 2004. *St. 2003, c. 143, § 1, amending M.G.L. c. 62C, § 30. See TIR 04-13.*

Failure to File, Report or Pay as Prescribed

The Act authorizes the Commissioner to impose a penalty on taxpayers that fail to conform any filing, data transfer or payment with the method prescribed by the Commissioner. A taxpayer that does not comply with the prescribed method for filing, data transfer, or payment will not be considered to have made the required filing or the required payment. The Act permits the Commissioner to impose a penalty of up to \$100 for each improper return, document or data transmission, and for each improper payment. Penalties may be imposed for nonconforming returns, data transfers, or payments due for tax years beginning on or after January 1, 2005. Penalties may be waived or abated in whole or in part if the filer shows that the failure to properly file or pay is due to reasonable cause and not to willful neglect. *St. 2003, c. 143, § 2, amending M.G.L. c. 62C, § 33. See TIR 04-12.*

Limitations on Payment of Refunds

The Act limits the payment of refunds on certain late filed returns. The new limitations apply to returns filed on or after December 4, 2003. Generally, applications for refunds filed more than three years from the due date of the return, without regard to extensions, or two years from the date the tax was paid, whichever is later, will be denied. If the refund is denied pursuant to the Act's new statutory provisions, there will be no credit applied to other tax periods either before or after the period for which the refund is claimed and no offsets for other liabilities of the taxpayer, including child support. A taxpayer may not voluntarily contribute a denied refund. Where no tax return is required to be filed for a particular tax type, e.g., deeds excise under M.G.L. c. 64D or gasoline excise under M.G.L. c. 64A, applications for refunds filed later than two years from the date the tax was paid will be denied. The new limitations on refunds do not affect the statute of limitations for filing an abatement under M.G.L. c. 62C, § 37. However, any refund resulting from the abatement will be subject to the new limitations. The new limitations do not apply to applications for refunds following a federal change pursuant to M.G.L. c. 62C, § 30. The new limitations also do not apply to refunds of motor fuel tax under IFTA. *St. 2003, c. 143, § 2A, amending M.G.L. c. 62C, § 36. See TIR 04-03.*

Corporate Excise

Change in Definition of Financial Institution

The Act changes the definition of “financial institution” subject to the financial institution excise in M.G.L. c. 63, § 1. The term now excludes “a diversified savings and loan holding company unless it satisfies the definition of a financial institution” elsewhere in § 1. The legislation ensures that ordinary business, manufacturing, and other corporations are eligible to invest in thrifts without necessarily subjecting themselves to the financial institution excise. The Act is effective December 4, 2003. *St. 2003, c. 143, § 3, amending M.G.L. c. 63, § 1. See TIR 04-9.*

Dividends Received by Certain Corporations

The Act clarifies that dividends received directly or indirectly from a Regulated Investment Company (RIC) by a financial institution or a corporation are excluded from the definition of dividends eligible for the dividends received deduction. The Act also clarifies the treatment of dividends from RICs where the financial institution owns 15 percent or greater of the voting stock of the RIC. The “directly or indirectly” language in the Act ensures that if the ultimate source of a dividend is a RIC, whether or not that dividend passes through a subsidiary or affiliate of the taxpayer, the amount of the RIC distribution may not be included in the dividends received deduction at any level.

Under federal and state law, distributions from REITs are ineligible for inclusion in the dividends received deduction for financial institutions and corporations. The Act clarifies this rule by excluding all dividends received by a financial institution or a corporation from a REIT whether received directly or indirectly. The “directly or indirectly” language ensures that if the ultimate source of a dividend is a REIT, whether or not that dividend passes through a subsidiary or affiliate of the taxpayer, the amount of the REIT distribution may not be included in the dividends received deduction at any level.

The Act applies to taxable years beginning on or after January 1, 2004. *St. 2003, c. 143, § 9. St. 2003, c. 143, §§ 4–5, amending M.G.L. c. 63, § 1 and 30.4. See TIR 04-10.*

Deeds Excise

The Act allows the Register of Deeds to refuse to register any deed, instrument or writing, which does not have stamps required for payment of the deeds excise affixed to the deed, instrument or writing or to the vellum, parchment or paper upon which it is written or printed. *St. 2003, c. 143, § 6, amending M.G.L. c. 64D by adding new section 6B.*

An Act Making Appropriations for the Fiscal Year 2003 to Provide for Supplementing Certain Existing Appropriations and for Certain Other Activities and Projects (St. 2004, c. 65) —

This Act includes tax law changes to the personal income tax, tax administration and the corporate excise.

Personal Income Tax

The Act amends *St. 2003, c. 141, §§ 22, 24* (which added new *M.G.L. c. 62, § 6J* and *M.G.L. c. 63, § 38R*). The Historic Rehabilitation Tax Credit provides \$10 million a year over five calendar years beginning in 2005, for the rehabilitation of qualified historic structures in Massachusetts. Both corporate excise and personal income tax taxpayers can qualify for the tax credit. The Massachusetts Historic Commission will administer the application and certification process for determining qualified rehabilitation projects. The Commission is responsible for allocating the annual \$10 million among one or many chosen projects, subject to the limitation that the maximum credit allowed for a chosen project is 20 percent of its qualified rehabilitation expenditures. The Act also contains provisions for the allowance of a five-year credit carryforward, the ability of taxpayers to sell or transfer their credits to any corporate excise or personal income tax taxpayer, and the calculation of a recapture tax if the taxpayers sell their interest in the rehabilitation project within five years of qualifying for the credit. *St. 2004, c. 65, §§ 5–9, 13–18, 54, amending St. 2003, c. 141, §§ 22, 24. See 830 CMR 63.38R.1.*

Tax Administration

Legislation was passed to allow any city or town within the counties of Barnstable, Nantucket, Bristol, and the county of Dukes County to impose an embarkation fee of 50 cents (\$.50) per passenger per departing trip upon all passenger ferry (boat) trips. *St. 2003, c. 55, § 11.* After a majority of voters in a designated city or town (“port

town”) approve the fee imposition the fee shall take effect on January 1st of the following calendar year. The legislation requires that the fee be collected from each passenger departing from a port town and that the fees collected be remitted to the Commissioner along with related records. The Commissioner is required to disburse the fees remitted to him, along with any related proceeds, back to the port towns according to a statutory formula.

In 2004, new legislation added language to the statute making it clear that only tickets actually used were to be subject to the fee. In addition the revised statute expressly allows the operators to retain “any unclaimed fees not redeemed by purchasers of unused tickets . . . to offset the costs incurred by ferry operators attributed to the implementation of this section.” Finally, the Act changed the filing requirement so that returns are due “not later than the twentieth day of the month following the last day of each calendar quarter.” *St. 2004, c. 65, §§ 44–47, amending St. 2003, c. 55, § 11. See TIR 04-18.*

Corporate Excise

Manufacturing and Research and Development Corporations

The Act clarifies prior law under *M.G.L. c. 63, §§ 38C and 42B* in a number of ways. First, a corporation organized under or subject to *M.G.L. c. 156D*, (*c. 156B* until July 1, 2004) and a limited liability company (LLC) organized or chartered under *M.G.L. c. 156C* (or an entity organized under laws other than those of the Commonwealth as a foreign corporation or LLC) which is not classified as a partnership and has elected to be taxed as a corporation separate from its members for federal income tax purposes and which is engaged in manufacturing in Massachusetts or research and development in Massachusetts may now qualify as a manufacturing corporation or R&D corporation, for purposes of chapter 63.

Second, the Act clarifies that a domestic manufacturing corporation be engaged in

manufacturing in Massachusetts. Similarly, a domestic research and development corporation must be engaged in research and development in Massachusetts. This clarification conforms to the existing requirement in M.G.L. c. 63, § 42B that foreign manufacturing corporations and research and development corporations be engaged in such activities in Massachusetts.

Third, the requirements for qualification as an R&D corporation have significantly changed. A corporation may now qualify if it has a sufficient level of either receipts or expenditures attributable to R&D activity in Massachusetts. With respect to receipts, the Legislature repealed one of the two former tests. That test required a corporation to derive one-third of its receipts from research and development of property capable of being manufactured in Massachusetts. The remaining “receipts” test under former law (i.e., requiring an entity to derive more than two-thirds of its receipts attributable to Massachusetts from research and development) remains in force.

With respect to expenditures, the Act added a new test for qualification. This test will allow certain entities (e.g., start-up corporations) to qualify based on expenditures without regard to receipts. However, unlike entities qualifying on the basis of their receipts from R&D, entities qualifying solely by virtue of meeting the “expenditures” test may not claim the investment tax credit (ITC) under M.G.L. c. 63, § 31A. *St. 2004, c. 65, §§ 11–12, amending St. 2003, c. 141, §§ 27, 29 and M.G.L. c. 63, § 38C. See TIR 04-15.*

Historic Rehabilitation Credit
(see Personal Income Tax, above).

Royalty and Interest Expenses and Costs

The Act clarifies that the provisions of M.G.L. c. 63, § 31K shall be in effect for tax years beginning on or after January 1, 2002. In addition, the Act provides that nothing in section 31K shall restrict any authority the Commissioner had prior to November 26, 2003 (when section 31K was originally

enacted) to adjust taxpayer transactions due to lack of adequate business purpose or other grounds. *St. 2004, c. 65, amending M.G.L. c. 63, § 31K.*

An Act Making Appropriations for the Fiscal Year 2005 for the Maintenance of the Departments, Boards, Commissions, Institutions and Certain Activities of the Commonwealth, For Interest, Sinking Fund and Serial Bond Requirements and For Certain Permanent Improvements (St. 2004, c. 149) — This Act includes tax law changes to the personal income tax, tax administration, the club alcohol excise, and the sales and use tax.

Personal Income Tax

Effective for tax years beginning on or after January 1, 2002, the Legislature enacted changes regarding the income tax treatment of capital gains and losses under chapter 62. *St. 2002, c. 186, and St. 2002, c. 364.* This legislation set May 1, 2002, as the effective date for the provision changing the rate of taxation on long-term capital gains. Subsequently, the Supreme Judicial Court held that the May 1, 2002, effective date violated article 44 of the Amendments to the Massachusetts Constitution. *E. Joel Peterson, et al. v. Commissioner of Revenue*, 441 Mass. 420 (2004). In the Peterson case, the Court ruled that the uniformity requirement of article 44 requires that “a single tax rate must be applied to income from the same class of property received during the period specified by the legislature for measuring income.” May 1, 2002, was stricken as the effective date, and the case was remanded for a determination of whether the effective date of the rate change should be January 1, 2002, or January 1, 2003.

As part of chapter 149 of the Acts of 2004, the Legislature enacted provisions to address the effective date of the tax rate change for long-term capital gains. These amendments shift the effective date back to January 1, 2002. However, the law also provides that the Commissioner of Revenue

will not adjust the tax liability with respect to capital gains for the period January 1, 2002 to April 30, 2002 for any taxpayer who, before the effective date of the Act, paid that liability in full for capital gains realized between January 1, 2002 and April 30, 2002, inclusive. The Legislature’s response to the *Peterson* ruling is being considered in pending litigation. The original plaintiffs in the Peterson case are contesting the constitutionality of sections 413 and 414 of chapter 149 under the Massachusetts and U.S. Constitutions. These matters have not yet been resolved. *St. 2004, c. 149, §§ 413, 414.*

Club Alcohol Excise

The Act excludes social clubs on a Massachusetts army or air national guard base from the definition of “taxpayer” for purposes of the club alcohol excise, thereby exempting such clubs from the excise. *St. 2004, c. 149, § 119, amending M.G.L. c. 63A, § 1.*

Sales and Use Tax

The Act exempts meals sold on the premises of social clubs on a Massachusetts army or air national guard base from the sales tax. *St. 2004, c. 149, § 123, amending M.G.L. c. 64H, § 6(cc).*

The Taxes FY 2004

TYPE OF TAX	MEASURE	RATE ¹	RETURN DUE
Personal income and fiduciary income	Net capital gains ²	5.3–12%	On or before April 15 for calendar year filings.
	Dividends, interest, wages, other income	5.3% ³	The 15th day of the 4th month for fiscal year filings.
Nonresident	Massachusetts source income		
Estimated tax	Liability in excess of \$200		Due quarterly on or before the 15th day of April; June, September and January.
Withholding	Wages	5.3%	Varies depending on amount of tax withheld in calendar year. If annual withholding: up to \$100 — annual filing; \$101–1,200 — quarterly filings; \$1,201–25,000 — monthly filings; over \$25,000 — quarterly filings, weekly payments.
Estate	Federal taxable estate	0.8%–16% ³	Within 9 months after date of decedent's death.
Nonresident	Massachusetts real and tangible property		Within 9 months after date of decedent's death.
Alcoholic beverages	Malt (31-gal. bbl.)	\$3.30	Monthly, on or before the 20th day of the month.
	Cider 3%–6% (wine gal.)	\$.03	
	Still wine 3%–6% (wine gal.)	\$.55	
	Sparkling wine (wine gal.)	\$.70	
	Alcoholic beverages 15% or less (wine gal.)	\$1.10	
	Alcoholic beverages more than 15%–50% (wine gal.)	\$4.05	
	Alcoholic beverages more than 50% or alcohol (proof gal.)	\$4.05	
Cigarettes	20-count package	\$1.51	Monthly, on the 20th day of the month. Unclassified acquirers must file upon importation or acquisition.
	Smokeless tobacco (percentage of price paid by licensee)	90%	Quarterly, on or before the 20th day following the close of the tax period.
	Cigars and smoking tobacco (percentage of price paid by licensee)	30%	
Marijuana and controlled substances tax	Weight of marijuana	\$3.50 per gram	Payment due immediately upon acquisition or possession in Massachusetts by dealer. Payment evidenced by stamps purchased from the Commissioner.
	Weight of controlled substance	\$200 per gram	
	Dosage unit of controlled substance	\$2,000 per 50 dosage units	
Deeds	Sales price (less mortgage assumed) of real estate	\$2.28 ⁴ per \$500	Monthly, on or before the 10th day of the month (filed by Registers of Deeds).
Motor fuels	Gasoline and diesel fuel per gallon	\$.21	Monthly, on or before the 20th day of the month.
	Propane, liquified gas, etc. (no minimum)	19.1%	
	Aviation (10¢ minimum)	7.5%	
	Jet fuel at local option (5¢ minimum)	5%	
Room occupancy	Transient room occupancy	5.7%	Monthly, on or before the 20th day following the close of the tax period.
	At local option, up to	4.0%	
	Convention Center Financing Fee	2.75%	
	(Boston, Cambridge, Springfield, Worcester, Chicopee and West Springfield)		

¹ Tax rates as of August 1, 2003.

² As of August 1, 2003, gains from the sale or exchange of capital assets (except collectibles) held for more than one year are taxed at 5.3%, but only for transactions completed on or after May 1, 2002. Short-term capital gains, as well as long-term capital gains arising from the sale of collectibles and gains on pre-1996 installment sales are taxed at 12%.

³ Resident rate is equal to federal credit for state death taxes. Nonresident rate is equal to Massachusetts proportionate share of federal credit for state death taxes.

⁴ In Barnstable County, the rate is \$5.70 per \$1,000.

Sales and use tax	Sale, rental or use of tangible personal property, including cigarettes, telecommunication services and certain fuel.	5%	On or before the 20th day following the close of the tax period. If annual liability: up to \$100 — annual filing; \$101–1,200 — quarterly filings; over \$1,200 — monthly filings
Sales tax on meals, prepared food and all beverages	All “restaurant” food and on-premises consumption of any beverages in any amount.	5%	Monthly, on or before the 20th day following the close of the tax period.
Business and manufacturing corporations	Net income Tangible property or net worth Minimum	9.5% ⁵ \$2.60 per \$1,000 \$456	On or before the 15th day of third month after close of taxable year.
Estimated tax	Liability in excess of \$1,000		Due quarterly as follows: 15th day of 3rd (40%), 6th (25%), 9th (25%) and 12th (10%) months of taxable year. ⁶
Security corporation			
Non-bank holding co.	Gross income	1.32%	Same as business corporations.
Bank holding company	Gross income	0.33%	
	Minimum	\$456	
Financial institutions	Net income Minimum	10.50% \$456	Same as business corporations.
Public utilities	Net income	6.5%	Same as business corporations.
Ship excise tax	Value (equity interest) of the corporation's interest in a ship or vessel engaged in interstate or foreign trade.	0.379%	Same as business corporations.
Insurance company			
Domestic life	Premiums	2.0%	On or before March 15.
	Massachusetts net investment income	4.8%–14.0%	
Foreign life	Premiums	2.0%	On or before May 15.
Domestic casualty	Premiums	2.28%	
	Gross investment income	0.2%–1.0%	
Foreign casualty	Premiums	2.28%	
Ocean marine	Underwriting profit	5.7%	
Preferred provider arrangements	Premiums	2.28%	On or before March 15.
Motor vehicle garaged outside Massachusetts	90% to 10% of manufacturer's list price	\$25 per \$1,000	On or before 30 days from issuance of tax bill.
Boston sightseeing tour	Ticket purchase price of any water- or land-based sightseeing tourist venue or entertainment cruise or trolley tour originating or located in Massachusetts and conducted partly or entirely in Boston.	5%	Quarterly, on or before the 20th day following the close of the tax period.
Boston vehicular rental transaction surcharge	Each vehicular rental transaction contract executed in Boston.	\$10	Quarterly, on or before the 20th day following the close of the tax period.
Parking facilities surcharge in Boston, Springfield and/or Worcester	Parking facilities built in conjunction with or as part of a project authorized by the Convention Center Financing Act in Boston, Springfield or Worcester.	\$2 per vehicle per day	Quarterly, on or before the 20th day following the close of the tax period.

⁵S corporations: 4.5% if total receipts \$9 million or more; 3% if total receipts are \$6 million or more but less than \$9 million.

⁶30%, 25%, 25% and 20% for corporations with fewer than 10 employees in their first full tax year.

Revenue Collections FY 2004

In thousands	FY00	FY01	FY02	FY03	FY04	FY03-04 % change
STATE TAXES COLLECTED BY DOR						
Tax on personal income						
TOTAL	\$ 9,041,936	\$ 9,902,677	\$ 7,912,934	\$ 8,026,148	\$ 8,830,334	10.0
Taxes on business						
Corporations	\$ 1,130,544	\$ 945,253	\$ 586,743	\$ 799,450	\$ 997,602	24.8
Insurance companies	306,018	322,551	347,645	344,626	373,721	8.4
Public utilities	82,983	86,726	88,486	40,621	64,733	59.36
Commercial banks ¹	92,451	180,057	134,431	347,833	238,740	(30.7)
Savings institutions ¹	375	(453)	2,597	(3,293)	00	—
TOTAL	\$ 1,612,371	\$ 1,534,134	\$ 1,159,902	\$ 1,529,237	\$ 1,674,796	9.5
Taxes on commodities sold						
Motor fuels	\$ 652,597	\$ 659,873	\$ 666,751	\$ 676,426	\$ 684,912	1.3
Cigarettes	279,945	270,512	274,997	451,044	425,421	(5.7)
Alcoholic beverages	63,146	64,168	65,356	66,298	67,902	2.4
Sales and use ²	3,108,430	3,273,817	3,194,989	3,196,044	3,211,197	0.5
Sales on meals	436,184	482,021	500,885	512,025	532,014	3.9
TOTAL	\$ 4,560,954	\$ 4,750,391	\$ 4,702,978	\$ 4,901,837	\$ 4,921,446	0.4
Other taxes						
Estate & inheritance	\$ 166,511	\$ 203,381	\$ 200,547	\$ 181,295	\$ 194,706	7.4
Room occupancy excise	137,005	149,617	123,306	119,991	120,178	0.2
Deeds excise ³	81,426	91,425	97,782	105,091	132,625	26.2
Club alcoholic beverage excise	621	625	571	657	621	(5.5)
Motor vehicle excise	151	105	86	72	51	(29.2)
Controlled substances	0	0	0	0	0	—
Convention Center surcharge	12,594	13,235	10,502	9,934	9,804	(1.3)
Community preservation trust	—	15,989	42,451	53,503	50,520	(5.6)
TOTAL	\$ 398,308	\$ 474,377	\$ 475,245	\$ 470,543	\$ 508,505	8.1
Total state taxes collected by DOR	\$15,613,569	\$16,661,579	\$14,251,059	\$14,927,765	\$15,935,081	6.8

¹All bank tax transactions (both savings and commercial) appear in the Commercial Bank Excise category.

²Include sales and use tax on motor vehicles.

³Due to different accounting methods, amounts reported for the deeds excise differ from those amounts reported by the comptroller.

Because of rounding, detail may not add to Totals.

The figures contained herewith are DOR figures pending the Comptroller's Fiscal Year 2004 Statutory Basis Annual Financial Report.

	FY00	FY01	FY02	FY03	FY04	FY03-04 % change
LOCAL TAXES COLLECTED BY DOR ON BEHALF OF COMMUNITIES						
Urban redevelopment	\$ 42,765	\$ 44,580	\$ 46,824	\$ 47,083	\$ 48,729	3.5
Local option airplane jet fuel	15,650	17,861	12,914	12,846	12,541	(2.4)
Local option room occupancy	78,119	85,559	70,953	69,617	68,484	(1.6)
Local rental vehicle (Convention Center 10%)	1,286	1,290	1,028	962	945	(1.8)
Embarkation fees	—	—	—	—	72	—
Total local taxes collected by DOR on behalf of communities	\$ 137,820	\$ 149,290	\$ 131,719	\$ 130,508	\$ 130,771	0.2
OTHER REVENUE						
Utility and insurance assessments	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	0.0
Department fees, licenses, etc.	7,911	4,819	6,475	7,166	8,043	12.2
County Correction Fund — deeds	11,713	5,587	6,121	6,605	8,343	26.3
County recording fees				17,954	60,384	236.3
Abandoned deposits — bottle	29,684	31,422	37,109	36,205	36,422	0.6
Total other revenue	\$ 49,308	\$ 41,828	\$ 49,705	\$ 67,930	\$ 113,192	66.6
STATE TAXES COLLECTED BY OTHER AGENCIES						
Horse and dog racing	\$ 7,829	\$ 7,542	\$ 6,856	\$ 6,547	\$ 5,697	(12.9)
Beano and boxing	3,180	3,043	3,066	2,793	2,591	(7.2)
Raffles/bazaars	925	881	846	889	965	(8.6)
Special insurance brokers	8,182	10,348	13,030	21,805	26,042	19.4
UI surcharge	20,435	23,674	22,198	21,394	20,451	(4.4)
Deeds, Secretary of State	34,496	38,029	39,721	42,704	54,418	27.4
Total state taxes collected by other agencies	\$ 75,047	\$ 83,517	\$ 85,717	\$ 96,132	\$ 110,164	14.6
TAXES ON PROPERTY COLLECTED BY LOCAL GOVERNMENT						
Real estate	\$ 6,755,186	\$ 7,174,441	\$ 7,651,814	\$ 8,126,933	\$ 8,607,527	5.91
Personal property	348,372	345,612	352,104	367,088	407,777	11.08
Motor vehicles	534,082	583,165	597,915	645,125	605,090	(6.2)
Total taxes on property collected by local government	\$ 7,637,640	\$ 8,103,218	\$ 8,601,833	\$ 9,139,146	\$ 9,620,394	5.3
TOTAL ALL TAXES	\$23,513,384	\$24,949,432	\$23,120,033	\$24,361,481	\$25,909,602	6.4

Because of rounding, detail may not add to Totals.

The figures contained herewith are DOR figures pending the Comptroller's Fiscal Year 2004 Statutory Basis Annual Financial Report.

Offers in Final Settlement FY2004

Under M.G.L. c. 62C, sec. 37A, the Commissioner of Revenue has the authority, under specific conditions, to accept less than full payment as a final settlement for a state tax liability. The statutory condition for such settlement is "serious doubt" as to collectibility of the tax due or the taxpayer's liability for it. The Commissioner must also determine that the taxpayer or responsible person has acted without intent to defraud. The settlement must be recommended to the Commissioner by at least two deputy commissioners.

The written agreement, signed by all parties and including the reasons for settlement, is a public record. In cases where the liability is reduced by more than half, or by \$20,000 or more, the Attorney General of the Commonwealth must review the settlement and has the authority to object to it.

The law requires that a listing of all settlements entered into during the fiscal year be included in the Commissioner's annual report. In Fiscal Year 2004, 52 settlements were made. All 52 were reviewed by the Attorney General.

The cases approved were as follows:

NAME	TOTAL TAX, INTEREST & PENALTIES	AMOUNT PAID IN SETTLEMENT	AMOUNT ABATED
Duarte, Irene	\$3,666.20	\$900.00	\$2,766.20
Mattaliano, Catherine	\$6,628.04	\$3,888.00	\$2,740.04
White's Corner Restaurant, Inc.	\$163,636.38	\$30,000.00	\$133,636.38
Tarcy, Brian W.	\$2,460.68	\$1,150.00	\$1,310.68
DiGirolamo, Angelo RP 2nd Offer	\$31,793.64	\$15,000.00	\$16,793.64
Todd, John	\$1,873.85	\$1,200.00	\$673.85
Hicks, Quintin	\$45,043.16	\$10,000.00	\$35,043.16
Waters, Raymond d/b/a	\$49,833.16	\$6,000.00	\$43,833.16
Bragaglia, Anthony (2nd Offer)	\$26,567.12	\$13,000.00	\$13,567.12
Frykholm, Richard RP	\$13,125.56	\$4,200.00	\$8,925.56
Lecce, Lucio	\$23,130.01	\$5,000.00	\$18,130.01
Karakostas, George RP	\$29,107.07	\$10,000.00	\$19,107.07
Buck, Robert A.	\$384,609.56	\$170,000.00	\$214,609.56
Holyoke Pasta & Pizza, Inc.	\$21,994.86	\$6,750.00	\$15,244.86
Northshore Wholesale Marketplace, Inc. (3rd Offer)	\$398,118.21	\$205,000.00	\$193,118.21
Guptill, Earl	\$28,185.70	\$3,000.00	\$25,185.70
Skamarycz, Valerie RP	\$10,791.83	\$1,100.00	\$9,691.83
Gladrich, Inc.	\$146,314.58	\$15,000.00	\$131,314.58
Barton, Mark and Tracey	\$6,386.10	\$500.00	\$5,886.10
Casey, John and Mary Ellen	\$16,276.85	\$5,000.00	\$11,276.85
Cimorelli, Peter	\$13,900.53	\$3,250.00	\$10,650.53
Custom Kitchen Designs, Inc	\$58,529.25	\$20,000.00	\$38,529.25
Gremo, Thomas d/b/a	\$19,658.85	\$2,800.00	\$16,858.85
Andrews, Marcel	\$20,128.66	\$3,000.00	\$17,128.66
MacDonald, Margaret A. (R/P)	\$46,238.02	\$16,852.00	\$29,386.02
Angelo's Ristorante Inc.	\$135,256.22	\$20,000.00	\$115,256.22
Hammond, Barbara d/b/a	\$29,179.34	\$1,500.00	\$27,679.34
Estate of Georgette M. Colin	\$27,932.99	\$6,977.00	\$20,955.99
Nunez, Hector	\$35,134.53	\$3,500.00	\$31,634.53
Quinn, Nathaniel & Kellie	\$6,197.00	\$720.00	\$5,477.00
Touchette, Denise	\$1,716.57	\$175.00	\$1,541.57
Steele, Richard & Joanne (R/Ps)	\$26,152.22	\$1,000.00	\$25,152.22
Zeng, Chun Ling	\$110,480.76	\$7,500.00	\$102,980.76
Kelly, William & Mary (2nd Offer)	\$84,480.24	\$40,000.00	\$44,480.24
Nevalsky, Steven M. (2nd Offer)	\$52,617.03	\$32,600.00	\$20,017.03
Burns, Edward F.	\$12,640.69	\$5,680.50	\$6,960.19
Dimino, Vincent d/b/a	\$11,871.55	\$6,000.00	\$5,871.55
B & D Management, Inc. (2nd Offer)	\$375,410.66	\$18,045.00	\$357,365.66
Gomez, Prudencio RP (2nd Offer)	\$35,189.82	\$3,000.00	\$32,189.82
Sollosy, Brian (2nd Offer)	\$20,312.07	\$7,938.60	\$12,373.47
Correa, Carlito & Da Silva, Zenaide	\$10,513.49	\$1,200.00	\$9,313.49
Nordstrom, Daniel	\$43,384.83	\$24,436.00	\$18,948.83
Farah, John	\$11,358.63	\$1,500.00	\$9,858.63

Offers in Final Settlement continued

NAME	TOTAL TAX, INTEREST & PENALTIES	AMOUNT PAID IN SETTLEMENT	AMOUNT ABATED
Egan, Thomas F. (Deceased)	\$7,807.82	\$3,261.13	\$4,546.69
Higgins, Helen R. (2nd Offer)	\$50,658.81	\$2,000.00	\$48,658.81
Silvia, Diane E. (3rd Offer)	\$9,462.55	\$2,000.00	\$7,462.55
Dicarlo, Robert M.	\$5,900.36	\$3,000.00	\$2,900.36
Color Shed, Inc. (2nd Offer)	\$34,060.69	\$15,000.00	\$19,060.69
Furtado, Patricia Kelley d/b/a	\$154,093.23	\$12,000.00	\$142,093.23
Ventura, Daniel & Deidre (2nd Offer)	\$13,060.49	\$5,000.00	\$8,060.49
Greenfield Lodge 997 (2nd Offer)	\$164,244.66	\$90,000.00	\$74,244.66
Sullivan, Bruce D. (2nd Offer)	\$32,386.23	\$9,500.00	\$22,886.23
TOTAL	\$3,069,501.35	\$876,123.23	\$2,193,378.12

Because of rounding, detail may not add to Totals.

The figures contained herewith are DOR figures pending the comptroller's Comprehensive Annual Financial Report.

Collection Agencies FY2004

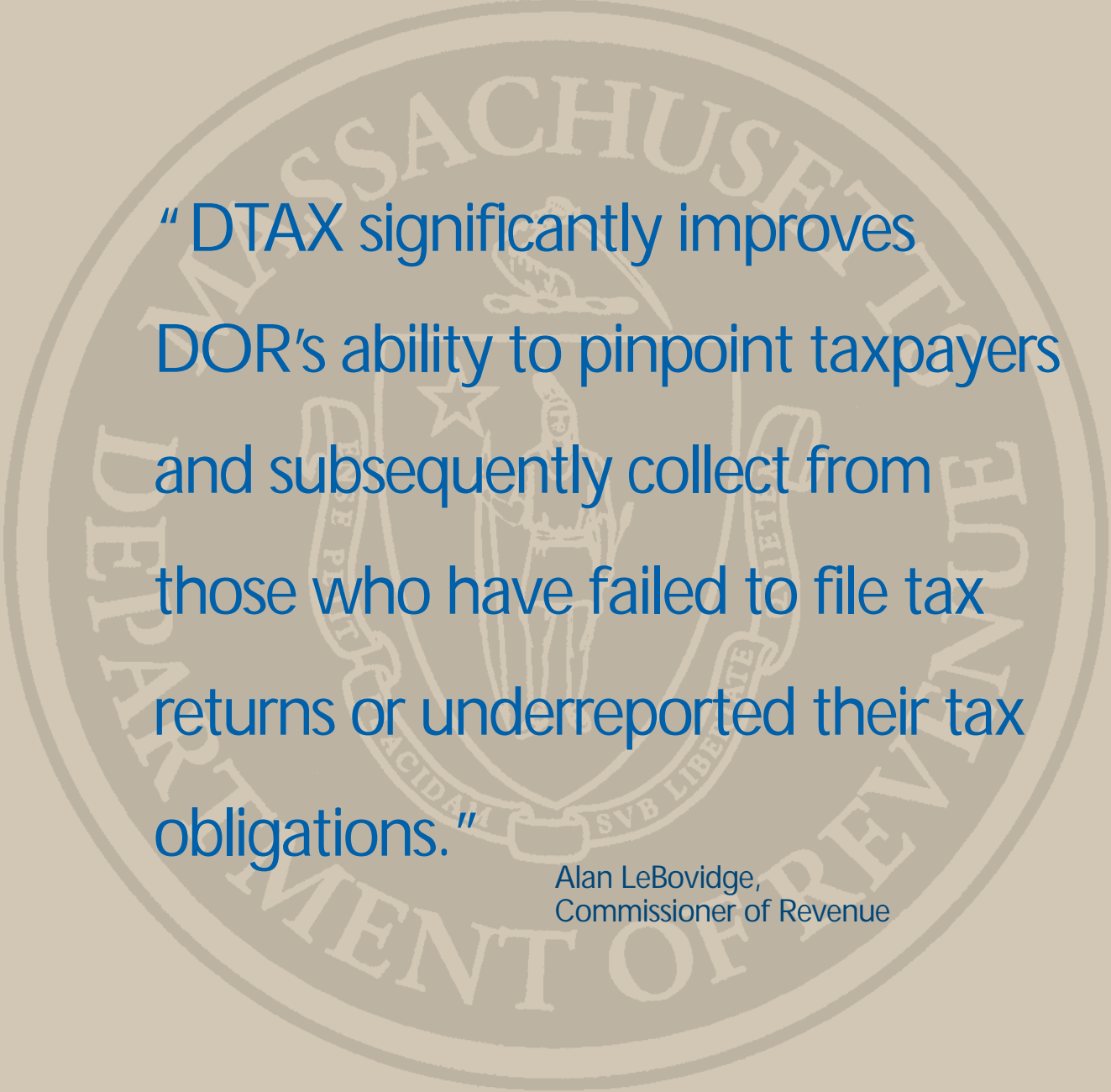
Chapter 209 of the Acts of 1988 permits the Commissioner of Revenue to use private collection agencies to collect unpaid state taxes. The Commissioner is required to notify all taxpayers whose accounts are to be assigned to a collection agency at least 30 days beforehand.

The law requires that the Commissioner list all agencies with whom collection agreements exist, the amount of taxes collected and the amount of compensation paid in the Department's annual report. They are as follows:

CONTRACTOR	TOTAL COLLECTED	FEES PAID	NET TO DOR
GCS	\$ 2,331,583	\$ 358,984	\$ 1,972,599
OSI	1,585,902	219,491	1,366,410
Walker Associates	1,836,259	236,753	1,599,506
TOTAL	\$ 5,753,744	\$ 815,228	\$ 4,938,515

Because of rounding, detail may not add to Totals.

The figures contained herewith are DOR figures pending the comptroller's Comprehensive Annual Financial Report.

The background of the slide features a large, faint, circular seal of the Massachusetts Department of Revenue. The seal contains the state coat of arms, which depicts a Native American figure holding a bow and arrow, with a five-pointed star above. The text "MASSACHUSETTS" is arched across the top, and "DEPARTMENT OF REVENUE" is arched across the bottom. A ribbon at the bottom of the seal contains the motto "ENSE PETIT PLACIDAM SVB LIBERTATE QUIETEM".

"DTAX significantly improves DOR's ability to pinpoint taxpayers and subsequently collect from those who have failed to file tax returns or underreported their tax obligations."

Alan LeBovidge,
Commissioner of Revenue