

This Week in State Tax (TWIST)

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Massachusetts: Appeals Court Upholds Tax on Gains Received by Nonresident

A Massachusetts appellate court recently upheld taxation of a nonresident on gains from the sale of stock in a company he founded while residing in Massachusetts. In 2005, the taxpayer co-founded a Massachusetts corporation and received 50 percent of the corporation's common stock. The taxpayer served as CEO and Treasurer of the corporation until 2015; although he reportedly worked approximately 80 hours per week until 2009, he reported only minimal income in those years. The taxpayer left his role with the company in 2015, and sold his shares shortly thereafter. Although the taxpayer had been a resident of Massachusetts during his time with the company, he moved to another state shortly after leaving the company (and before the sale of his shares). For 2015, the taxpayer filed a Massachusetts nonresident/part-year resident return and did not report gain from the sale as Massachusetts source-income. On audit, the Massachusetts Department of Revenue (Department) took the position that gain from the sale should be allocated to Massachusetts; following a protest, the Board of Tax Appeals agreed with the Department.

Massachusetts law permits the Commissioner of Revenue (Commissioner) to tax income "derived from or effectively connected with any [Massachusetts] trade or business." A 2003 amendment defined this phrase to include income derived from the sale of an interest in a business and added language stating that the Commissioner may tax Massachusetts-source income regardless of the year it which it was earned. Although Department regulations provide that income from a trade or business may include income resulting from the sale of a business interest, the rule "generally does not apply" to the sale of shares of stock in a corporation if that income is characterized as capital gains for federal income tax purposes. The rule, however, will apply if such income is treated as compensation for federal income tax purposes. The taxpayer argued that because income from the sale was characterized as capital gains for federal purposes, it could not be treated as Massachusetts-source income.

The court rejected the contention that federal characterization was binding, noting that the rule merely stated that federal capital gains would "generally" not be subject to tax if received by a nonresident. Instead, the court ruled that a nonresident's gains from the sale of stock could be treated as Massachusetts-source income if "the stock is related to the taxpayer's compensation for services." Because the taxpayer acquired the stock with the expectation that it would be worth more in the future and was "looking forward to the payout from his hard work" for the company, there was ample evidence that the gain from the sale of shares was derived from his employment. For questions about [Welch v. Commissioner of Revenue](#), please contact [Nikhil Sequeira](#).

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