

Daily Tax Report: State
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Massachusetts Ruling Upends Norms for Taxing Nonresident Income

Deep Dive

- Ruling could drive innovation out of the state, attorney warns
- Impact depends on how broadly state courts apply decision

A recent Massachusetts appeals court ruling endorsing the revenue department's broad reach to tax nonresidents' capital gains is unsettling expectations about how such stock sales are treated across the state.

New Hampshire resident Craig Welch failed to convince the Massachusetts Appeals Court to overturn a \$300,000 Massachusetts income tax assessment on 100% of the capital gain he made selling stock in his risk management services company, AcadiaSoft Inc.

Welch lived in Massachusetts from the time he co-founded the company until shortly before the sale, meaning the gain was derived from his business there, the court ruled Thursday.

The decision will "garner attention—and possibly consternation—from state tax lawyers and practitioners nationwide" because typically states don't tax nonresidents when they sell stock in a company unless the stock was awarded as compensation for services, said Richard Jones, a partner at Sullivan & Worcester LLP in Boston.

Key to the court's decision was its holding that the stock was related to Welch's compensation, Jones said. "Yet it is difficult to reconcile this conclusion with the fact that Mr. Welch acquired the stock on founding the company," he said.

Meaghan Mahon, an associate with Freeman Mathis & Gary LLP in Philadelphia, called the ruling "short-sighted" because it has the potential to freeze innovation and discourage entrepreneurs from coming to Massachusetts. The state's concentration of universities makes it a major hub for technology and pharmaceutical companies.

The court's determination that Welch's gain was really compensatory could also change the way companies frame compensation packages for their founders and officers, she said.

Entrepreneurs—especially at start-ups—often receive stock as compensation. But the ruling could make "owners and officers pause and reconsider whether it makes sense to forgo a salary or other benefits when they know they are going to be hit with a big tax bill when they go to sell their shares," Mahon said.

New Theory?

Eric Anderson, a managing director at Andersen Tax LLC, suggested that the case could represent a “unique circumstance applicable to a narrow set of entrepreneurs” or it could be “a new theory of nonresident taxation,” depending on how broadly other courts apply the ruling.

Applied narrowly, someone so inextricably linked to the formation and operation of a business that he or she is considered its alter ego may be taxed on the sale of stock wherever the company does business, he said.

Taken to an extreme, if a New Hampshire-based accountant working remotely for a Massachusetts company sold his or her stock in the corporation, Massachusetts could try to get its hands on the capital gains based on the business’s location, Anderson said.

Welch and his wife moved to New Hampshire—which only imposes income tax on interest and dividends—just months before Welch sold off his AcadiaSoft shares for \$4.74 million after 12 years with the company in Massachusetts.

The couple excluded the gain from their joint nonresident Massachusetts tax return, arguing the income can’t be sourced to the state because they didn’t live there when they received the proceeds.

The court upheld the state’s assessment of \$336,000 in income tax, interest, and penalties. The Massachusetts Department of Revenue’s controlling regulation, when read as a whole, “makes clear that the gain from the sale of stock in a C corporation may constitute Massachusetts source income if ‘the stock is related to the taxpayer’s compensation for services,’” the judges said.

Unique Regulation

The ruling reflects a trend of states extending their reach to nonresidents’ intangible income, said Timothy Noonan, a state tax partner with Hodgson Russ LLP in New York.

But because Massachusetts’s income tax regulation is unique, the decision isn’t likely to “lead to a barrage of other states taking a similar position,” he said.

Massachusetts allowed for a departure from the general rule of not taxing a nonresident’s intangible assets if the stock was “related to the taxpayer’s compensation for services,” Noonan said. “That kind of broad exception lends itself to the kind of analysis we saw from the court, where any employee who holding stock of their employer would have a tough time arguing that their stock holdings were not related to their services in some way or another.”

Noonan said the proper interpretation of the rule is that stock is only compensation if it’s given in exchange for services. The regulation’s broad language, however, “gives license to an aggressive taxing authority” to make a more expansive case, he said.

The couple's attorney, Michael Bowen of Akerman LLP, declined to comment except to say they plan to pursue an appeal at the Massachusetts Supreme Judicial Court. The state revenue department didn't respond to a request for comment.

Eric P. Rothenberg of Needham, Mass., also represented the Welches.

The case is *Welch v. Comm'r of Revenue*, Mass. App. Ct., No. 24-P-109, 4/3/25.

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