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## Reminder: Massachusetts Withholding by Pass-Through Entities

A pass-through entity that maintains an office or engages in business in Massachusetts must, for tax years beginning on or after January 1, 2009, deduct and withhold Massachusetts taxes from a member's share of the entity's Massachusetts-source income, *unless either the entity or the member qualifies for an exemption*. For purposes of the withholding regulations, pass-through entities include general and limited partnerships, limited liability partnerships, limited liability companies taxed as partnerships, S corporations and estates and trusts (including grantor-type trusts) not taxed at the entity level. For a calendar year pass-through entity that is not itself exempt, a member of the entity seeking exemption from withholding must provide certification of exemption by April 30, 2009.

### Exempt Pass-Through Entities

Certain pass-through entities are exempt and not required to participate in pass-through entity withholding:

- Investment partnerships;
- Certain trusts and estates required to withhold on non-residents under another Massachusetts provision; and
- Upper-tier entities that can demonstrate that a lower-tier entity has previously withheld the Massachusetts tax on Massachusetts-source income.

An investment partnership is a partnership that (1) is not engaged in a trade or business in Massachusetts; (2) derives substantially all of its income from interest, dividends and capital gains; and (3) has assets, substantially all of which consist of investment securities, deposits at banks or other financial institutions, or office equipment and office space reasonably necessary to carry on the activities of an investment partnership. A limited partnership that is engaged exclusively in buying, selling, dealing in or holding securities on its own behalf and not as a broker will not be exempt from these rules if the limited partnership is engaged in a trade or business in Massachusetts. Many hedge funds with offices in Massachusetts would not be considered to be engaged in a trade or business in Massachusetts and would be exempt from these withholding requirements.

Venture capital or private equity funds may qualify as investment partnerships and be exempt from these withholding rules if they can support the position that they are not engaged in a trade or business in Massachusetts. If a fund invests in a pass-through entity that itself engages in a trade or business in Massachusetts, however, the fund would not be exempt unless the pass-through portfolio entity does the withholding. Funds investing in Massachusetts real estate will not be exempt and will be required to comply with these rules.

An exempt pass-through entity does not need to obtain from its members the Form PTE-EX certifications described below.

### Exempt Members

The following types of members are exempt and withholding is generally not required for such a member, provided that a non-exempt pass-through entity obtains the appropriate certification from the member by the applicable deadline:

- A member that is exempt from federal income tax under Internal Revenue Code § 501 if the member's share of income from the entity is exempt from Massachusetts tax;
- An individual Massachusetts resident;
- A corporation with income (other than pass-through entity income) subject to Massachusetts tax for which it is filing a return;
- A pass-through entity, trust, estate or custodial account that certifies that it will be filing any required Massachusetts tax returns, reporting its share of income from the entity, and making required estimated tax or withholding payments, as appropriate;
- A non-resident member who:
  - Participates in a composite return prepared by the entity; or
  - Files a certification with the entity stating that it agrees to file any required Massachusetts tax returns, make any required quarterly Massachusetts estimated tax payments, and accept personal jurisdiction in Massachusetts state courts for the determination and collection of taxes;
- An upper-tier pass-through entity that certifies that all of its members are exempt from withholding under the exemptions described above; and
- An insurance company.

### Form PTE-EX Certifications

For a member to be treated as exempt, a non-exempt entity must obtain from the member, on or before the later of the last day of the fourth month of the

entity's taxable year or within 30 days of the member joining the entity, a completed Form PTE-EX certifying that the member is exempt from withholding. For calendar year non-exempt pass-through entities, the certification must be obtained from all members, including Massachusetts residents, by April 30, 2009.

A member's signed Form PTE-EX will remain in effect until it is revoked by the member, unless the member completed the Form PTE-EX prior to its amendment in December 2008, in which case the member must renew the form in 2010. A member whose reason for a withholding exemption changes or who loses exempt status during the tax year must notify the entity within 30 days. The non-exempt entity must retain the completed forms in its records and produce them upon request by the Massachusetts Department of Revenue.

### Withholding by Pass-Through Entity

If a pass-through entity is required to withhold, the entity must register for withholding and make a required annual payment, in four equal installments, on behalf of each non-exempt member. Each quarterly installment is due on or before the last day of the month following the close of the quarter of the entity's taxable year. An entity required to withhold is jointly and severally liable with each non-exempt member for Massachusetts taxes, together with related interest and penalties, imposed on the member with respect to the income of the entity. An entity that fails to meet its withholding obligation is subject to all applicable penalties for failure to adequately withhold.

### Schedule PTE

A non-exempt pass-through entity with non-resident members must electronically submit an annual schedule (Schedule PTE) on or before the last day of the third month of the year following the taxable year, unless an extension is obtained, and the schedule is considered part of the entity's annual tax return. The annual schedule generally must include non-resident and non-exempt members. Schedule PTE is used by the Massachusetts Department of Revenue to reconcile amounts withheld and credits claimed by members. The schedule must include the amount withheld on behalf of each non-exempt

member and the method of tax compliance for each non-resident member.

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