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# Massachusetts Stock Sale Tax Case Threatens to Stymie Innovation

By Perry Cooper

Argument Preview

- State taxed stock sold after founder moved to New Hampshire
- High-tax states broaden reach as wealthy individuals leave

The Massachusetts Appeals Court is set to hear oral arguments Tuesday in an income tax case involving a nonresident that has the potential to discourage entrepreneurs from starting businesses in the state, taxpayer advocates warn.

New Hampshire resident Craig Welch is asking the court to reject 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, leading the state to argue that the gain was connected to his work there.

Taxing a nonresident on gain from a stock sale is a "departure from the way things generally work in the state tax area," said Hodgson Russ LLP state tax partner Timothy Noonan.

Typically nonresidents are only taxed on income earned in the state—such as wages or direct income from operating a business there, he said. That leaves intangible income like proceeds from selling shares of a company "off-limits" to all except the state where taxpayers live, he said.

Massachusetts could have a hard time attracting young entrepreneurs if the appeals court upholds the assessment, said Meaghan Mahon, an associate with Freeman Mathis & Gary LLP. "People who are coming out of school and creating startups are going to be more hesitant to do so if they're going to be impacted like this," she said.

**Broad Statute**

Welch and his wife did what many high-earners do—establish residency in a state without income tax before an event that they expect will make them a lot of money. Often it's Texas or Florida.

The couple chose New Hampshire—which doesn't impose income tax on wages—just months before Welch sold off his AcadiaSoft shares for $4.74 million after 12 years in Massachusetts with the company. They excluded the gain from their joint nonresident Massachusetts tax return, arguing the income can't be sourced to the state because they were out of the state by the time they received the proceeds.

The Massachusetts revenue commissioner disagreed, assessing $336,000 in income tax, interest, and penalties on the the gain because the commissioner considered the stock to be compensation for Welch's work at the company. Massachusetts law broadly defines a nonresident's income as taxable if it's connected with business the taxpayer carried on in the state in the tax year, regardless of when or where the taxpayer actually receives the income.

The state appellate tax board upheld the assessment, finding that the gain wasn't passive investment income, but rather the fruit of Welch's extensive contribution to the growth of the business that he founded.

The board latched onto Welch's own testimony that he complained over the years that he was underpaid and couldn't wait for his big payout as proof that the stock was compensation.

"I'm not sure how much he helped himself out on that aspect," Mahon said.

Welch argues on appeal that the stock wasn't payment for services he provided the company in Massachusetts, but instead long-term capital gain, outside the scope of the tax law at issue.

Freeman Mathis & Gary LLP partner Nancy Reimer said Welch seems to have done everything right for the income not to be taxable in Massachusetts after he moved out of the state.

He sold stock in a Delaware corporation, not a stake in physical property that's still in Massachusetts, she said.

**Millionaire's Tax**

The appeals court is considering the case at the same time the state is beginning to implement a 2022 constitutional amendment creating a 4% surtax on incomes over $1 million.

"Not surprisingly, now there's more interest—both from taxpayers' perspective of getting out of it and from the tax department's perspective—in looking at this because it's a bigger revenue item," Noonan said.

As taxpayers flee high-tax states, revenue departments might look for creative ways to broaden their tax on nonresidents, like the Massachusetts department did in this case, he said.

Reimer expressed concern that fewer Facebooks and Modernas will be founded in Massachusetts if the state continues to trail the founders after they move away.

“If this statute is as far-reaching as the tax board thinks it is, how’s it going to affect investment in the commonwealth?” she asked. “You need to give incentive to these entrepreneurs to create businesses here.”

Ohio and New York also have expanded their ability to tax nonresidents, albeit via new legislation. If Massachusetts is successful in reaching nonresidents though existing law, other states could follow suit, Mahon said.

“Massachusetts isn’t usually a trendsetter,” she said. “It will be interesting to see what other states pick up on this.”

The revenue department declined to comment on pending litigation.

Akerman LLP and O’Melveny & Myers LLP represent Welch.

The case is Welch v. Comm’r of Revenue, Mass. App. Ct., No. 2024-P-0109, oral argument scheduled 1/14/25.

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