

Mississippi Court Holds Dividend Received Exclusion Unconstitutional

April 29, 2015

Overview

A recent decision by a Mississippi Chancery Court in *AT&T Corp. v. Mississippi Department of Revenue* held that the state's dividend exclusion statute violates the U.S. Constitution's Commerce Clause.¹ The Mississippi statute allows an exclusion from a taxpayer's gross income for intercompany dividends received from domestic affiliates doing business and filing income tax returns in Mississippi.² The Chancery Court held in favor of AT&T Corporation and its subsidiaries (collectively, the "taxpayer"), ruling that such an exclusion discriminates against interstate commerce because it "clearly favors domestic corporations over foreign competitors and discourages corporations from choosing to locate their operations outside Mississippi."³ The Mississippi Department of Revenue ("Department") has appealed the Chancery Court's decision to the Mississippi Supreme Court. Thus, the case is not yet final.

In this Tax Alert we summarize the Chancery Court's decision and offer some taxpayer considerations.

Background

In June 2003, the Department issued an assessment against the taxpayer for income taxes in the amount of \$11,755,044, resulting from the Department's audit and subsequent adjustment of the taxpayer's returns for tax years 1997, 1998 and 1999. Ultimately, both the Department and the taxpayer agreed on the adjustments made to the returns in question, except for Mississippi's taxation of the intercompany dividends.

Miss. Code Ann. § 27-7-15(4)(i) permits the recipient of intercompany dividends to exclude such dividend income from the calculation of its gross income if the distributing corporation is doing business in Mississippi in the year of the distribution and files a Mississippi Income Tax Return for that year.⁴ For the years at issue, the Department determined that the taxpayer had improperly excluded from its gross income those dividends received from affiliates that had no business activities or income tax filing obligations in Mississippi. As a result, the Department added the excluded dividend income back to the Mississippi corporate income tax base and assessed additional corporate income tax against the taxpayer.

In its protest before the Department's Board of Review, the taxpayer asserted that the dividend exclusion statute violated the U.S. Constitution's Commerce Clause and that the assessment was therefore unconstitutional. The Board of Review upheld the assessment in full. The taxpayer appealed the matter to the full Tax Commission, where the assessment was upheld, but with a slightly reduced deficiency amount. The taxpayer appealed the Tax Commission's ruling to the Chancery Court for the First Judicial District of Hinds County, Mississippi.

The Chancery Court's Decision

To determine whether the dividend exclusion statute would survive a Commerce Clause challenge, the Hinds County Chancery Court applied the four-prong test from the U.S. Supreme Court decision in *Complete Auto Transit, Inc. v. Brady*, as articulated in the Mississippi Supreme Court decision in *Marx v. Trucking Renting and Leasing Association, Inc.*: (1) the tax must be applied to an activity with a substantial nexus with the taxing state; (2) the tax must be fairly apportioned; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to the services provided by the state while analyzing the state's tax scheme.⁵

Ultimately, the Chancery Court concluded that Miss. Code. Ann. § 27-7-15(4)(i) disallowed a "valuable tax exemption based solely upon an interstate element, that is whether the distributing corporation maintains property

¹ *AT&T Corp. v. Miss. Dep't of Revenue*, 04-CV-001393-CH1 (Miss. Ch. Mar. 20, 2015).

² Miss. Code Ann. § 27-7-15(4)(i), Note: The statute remains unchanged since the years at issue.

³ *AT&T Corp. v. Miss. Dep't of Revenue*, 04-CV-001393-CH1 (¶19) (Miss. Ch. Mar. 20, 2015).

⁴ Although this case concerns tax years 1997, 1998 and 1999, the applicable provision has not been modified and accordingly the logic of the decision, pending the ultimate resolution of this case, may apply to other open tax years.

⁵ *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977); as cited in *Marx v. Trucking Renting & Leasing Ass'n, Inc.*, 520 So.2d 1333 (Miss. 1988).

and/or employees in Mississippi or files a Mississippi income tax return.”⁶ Citing this required “interstate element,” the court determined that the statute clearly favored domestic corporations over foreign competitors in violation of the third prong of the *Complete Auto* test for determining constitutionality.⁷ On this basis the court held that the statute violated the Commerce Clause.⁸

Having found the dividend exclusion statute to be unconstitutional, the Chancery Court next sought to determine an appropriate remedy. The Department suggested rescinding the offending portion of the statute and disallowing the dividend exclusion for all taxpayers. The court rejected this suggested remedy, concluding that such a retroactive change would encounter “significant constitutional and statutory limits.”⁹ As a result, the court found that the only appropriate remedy that would place the taxpayer in the same position as all other taxpayers who had enjoyed the tax benefits would be to “strike the offensive limitations and grant those applicable tax benefits to [the taxpayer] for the tax years at issue.”¹⁰

Considerations

On April 8, 2015, the Department appealed the case to the Mississippi Supreme Court. Accordingly, this case is not yet final. While the case remains pending, taxpayers that have open years for which a dividends received exclusion was not taken may wish to consider whether they may potentially benefit from filing protective refund claims, before the applicable statute of limitations expires, asserting application of the exclusion.

Contacts

If you have questions regarding this Chancery Court decision or other Mississippi tax matters, please contact either of the following Deloitte Tax professionals.

Todd Senkiewicz
Director
Deloitte Tax LLP, Atlanta
tsenkiewicz@deloitte.com
(404) 631-3371

Amber Rutherford
Manager
Deloitte Tax LLP, Nashville
amberrutherford@deloitte.com
(615) 259-1830

The authors of this alert would like to acknowledge the contributions of Hanish Patel and Harrison Sullivan to the drafting process. Hanish and Harrison are Tax Consultants both working in the Atlanta Multistate Tax Practice of Deloitte Tax.

This alert contains general information only and Deloitte is not, by means of this alert, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This alert is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this alert.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2015 Deloitte Development LLC. All rights reserved.
Member of Deloitte Touche Tohmatsu Limited

⁶ *AT&T Corp. v. Miss. Dep’t of Revenue*, 04-CV-001393-CH1 (¶9) (Miss. Ch. Mar. 20, 2015).

⁷ *Id.*

⁸ *Id.*

⁹ *Id.* at ¶14.

¹⁰ *Id.* at ¶15.