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September 20, 2019

Mr. Sam Portera
Deputy Office Director, Tax Policy
Mississippi Department of Revenue

Re: Proposed Amendments to Miss. Admin. Code Title 35.III.2.06

Dear Mr. Portera,

On behalf of the Council On State Taxation (COST), I am writing to express concerns regarding proposed amendments to Mississippi's regulations addressing the income tax deduction for dividends, Miss. Admin. Code Title 35.III.2.06. The proposed amendments appear to effectuate a Mississippi tax policy change in response to the Mississippi Supreme Court's 2016 holding in *Mississippi Department of Revenue v. AT&T Corp.* The Court in *AT&T* held that allowing a deduction for dividends from Mississippi subsidiaries while denying a deduction for non-Mississippi subsidiaries violates the Commerce Clause of the U.S. Constitution. Law changes to address the *AT&T* decision should be addressed by, and indeed have been considered by, the Legislature; the Department should not seek to expand the taxation of intercompany dividends through regulatory amendment. In addition, the wording of the proposed amendment raises several troubling issues that could produce complexity, further litigation, and potentially a tax increase. We respectfully request you refrain from seeking regulatory changes until the Legislature has acted.

About COST

COST is a nonprofit trade association consisting of approximately 550 multistate corporations engaged in interstate and international business. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

Comments re Proposed Regulatory Amendments

The proposed amendments to paragraphs 104-106 (103-105 in the amended regulations) would import new language into Mississippi law not contained in the current statute, Miss. Code Ann. Sec. 27-7-15(4)(i). Similar language was considered but not passed by the Legislature in 2017 in S.B. 2428, and the current proposed regulatory amendments have the same infirmities as the proposed legislative language. Absent the correction of the underlying statute, the proposed regulatory amendments would preserve the confusing statutory language parsed by the Mississippi Supreme Court in *AT&T* and would likely result in an effective tax increase for multistate taxpayers operating in Mississippi.

The language in the proposed regulation could be read to afford a deduction only for a second-generation dividend and only if the first-generation dividend had been taxed. Such a reading would be directly inconsistent with the Department's historic interpretation and application of the statute since at least 1993, including throughout the *AT&T* litigation, as it historically has applied the deduction based solely on whether the underlying earnings were taxed at the operating entity level. Indeed, in our members' experiences this is the Department's present application of the statute in virtually all corporate income tax audits. The Department in *AT&T* expressly stated that this interpretation prevented the double taxation of the underlying earnings by again taxing them when distributed as dividends. Adopting the proposed regulatory language while preserving the confusing language regarding second-generation dividends could disrupt the status quo and result in a fundamental change in Mississippi's current policy by enabling the taxation of virtually all dividends (including for Mississippi-based companies) unless the dividends are redistributions of dividends (rather than income) that were separately taxed. Because Mississippi would be one of the only states to tax dividends, this would place Mississippi as a clear outlier in taxing both operating income and distributions of those same earnings.

The regulation also proposes to extend the deduction only to dividends that have borne a tax in Mississippi or "another state." This requirement premises the Mississippi deduction on the tax treatment of dividends in another state. With such a policy, Mississippi would be seeking to indirectly tax income earned, and entities located, in another state, raising Constitutional concerns. Such a policy would create distortions, prompting, for example, impacted companies to accumulate intercompany debt rather than paying dividends. Taxing such dividend income in Mississippi would increase the cost of doing business in the State, particularly increasing the cost of financing in-state operations and expansion.

Recommended Changes to Proposed Amendments. If the Department feels compelled to act in the wake of the *AT&T* decision without Legislative guidance on how to proceed, the Department could bring its regulations up to date with the *AT&T* decision and the Department's present policies by clarifying that dividends are not included in a corporation's gross income. This could be achieved, for example, by deleting, rather than amending, paragraphs 104-106 (103-105 in the proposed amended regulations) Miss. Admin. Code Title 35.III.2.06 and would effectively conform the Department's regulations with the Mississippi Supreme Court's *AT&T* decision and the Department's present practices without adding further confusion to Mississippi's tax treatment of dividends while properly leaving the final tax policy determination to the Legislature.

Conclusion

We respectfully request that the Department of Revenue either withdraw its proposed changes or change the regulation to clarify that dividends are not included in gross income.

Respectfully,



Patrick J. Reynolds

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director