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Inside This Issue

This issue of *Mississippi Tax Bulletin* examines two recent Mississippi Tax cases:

- Pursue Energy v. Tax Comm'n[1]
- Barton v. Blount[2]

Pursue Energy v. Tax Comm'n[1] - Use Tax

On September 20, 2007, the Mississippi Supreme Court held that the corporate owner of natural gas wells and a gas processing plant in Mississippi was subject to use tax on gas that it used and consumed in its operations. The taxpayer owned and operated a number of sour gas wells in Mississippi. Sour gas requires processing to remove hydrogen sulfide before it can be sold. The taxpayer also owned the plant that removed the hydrogen sulfide from the gas. Most of the processed or clean gas was sold by the taxpayer in the wholesale market. A portion of the processed gas, however, was used by the taxpayer to run the gas processing plant and to run its equipment at well sites.

Upon audit, the Tax Commission imposed use tax at the rate of 1.5% (the rate applicable to manufacturers) on the value of the gas used to run the processing plant and use tax at the rate of 7% (the rate applicable to retail sales) on the value of the gas used to run its well site equipment. This assessment was affirmed at both administrative review hearings. The taxpayer subsequently paid the full assessment and filed suit for a refund of the use tax. In response to a summary judgment motion, the trial court affirmed the assessment, and the taxpayer appealed to the Mississippi Supreme Court.

The taxpayer first argued that the fuel used in its operations was neither sold, nor placed in the market for

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sale, and therefore there was no transaction upon which to impose the tax. The court found that the only necessary requirement for the imposition of the use tax is a use or consumption of personal property in Mississippi.

The taxpayer then argued that because it was a wholesaler, the gas used at the plant was exempt from use tax under the wholesaler exemption. The court found that the wholesaler exemption did not apply to the gas used at the plant because it was not sold to other parties for resale.

Finally, the taxpayer argued that the use tax only applies to tangible personal property that is purchased outside of Mississippi and later used or consumed in Mississippi. The court rejected the taxpayer's argument finding that it was irrelevant that the taxpayer's gas came from within Mississippi as opposed to being brought into the state.

Barton v. Blount[2] - Income Tax

On September 4, 2007, the Mississippi Court of Appeals reversed an income tax assessment resulting from an excessive calculation of depreciation recapture in connection with the sale of all assets by a corporation followed by a complete liquidation. The husband and wife taxpayers owned all of the stock of a corporation that operated a franchise restaurant business in Mississippi. In 2000, the corporation sold all of its assets and liquidated.

Mississippi law generally imposes an income tax on gain resulting from the sale of assets. During the year in question, however, an exemption from the gain recognition requirement applied if a corporation sold all or substantially all of its assets, the assets had been held for more than one year and the corporation was completely liquidated within one year from the date of sale. The exemption in question was repealed for transactions occurring after March 29, 2005.

The applicable gain exclusion statute did not apply to depreciation recapture "computed in the same manner as provided for in Section 1245 of the Internal Revenue Code." Upon audit of the taxpayers' 2000 return, the taxpayers and the Tax Commission could not agree on the proper method of computing the taxable amount of depreciation recapture from the sale.

The taxpayer first contended that the reference in the statute to computing depreciation recapture "in the same manner as provided for in Section 1245" meant that depreciation had to be recaptured only on Section 1245

property and not for other types of depreciable property. The court noted that the plain language of the statute unambiguously indicates that all depreciable assets of the corporation are subject to recapture, not just Section 1245 assets.

The taxpayers then objected to the method used by the Tax Commission to compute the depreciation recapture. The taxpayers and the buyer of the assets had agreed to an allocation of the total consideration among the assets in the transaction for purposes of calculating gain for the seller and basis for the buyer for each asset. The taxpayers asserted that they were required to recapture depreciation only to the extent of the lesser of the depreciation claimed on a given asset or the gain from the sale of that asset based on the agreed allocation.

The State Tax Commission took the position that the allocation of the sales price among the assets, which was agreed to by the taxpayers and the buyer, was irrelevant to the depreciation recapture computation. It asserted that the proper method for computing the depreciation recapture was to include all prior depreciation on all assets sold so long as that amount did not exceed the total amount of sales proceeds.

The court held that because the statute required the depreciation recapture to be computed "in the same manner as provided for in Section 1245," and because Section 1245 requires depreciation recapture to be determined on an asset-by-asset basis, the Tax Commission's computation of the depreciation recapture on an aggregate basis was erroneous. The Court of Appeals reversed and remanded the case and instructed the Tax Commission to recalculate the proper amount of depreciation recapture in a manner that was consistent with its opinion.

This decision creates an income tax refund opportunity (subject to the applicable statute of limitations) for those taxpayers who filed returns prior to the repeal of this exemption that reported excessive depreciation recapture from a liquidating sale of assets.

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[1] Docket No. 2006-CA-01390-SCT.
[2] Docket No. 2006-CA-00698-COA.