December 2009

BUTLER | SNOW
ATTORNEYS AT LAW
a higher standard

- Our Firm
- Our Attorneys
- Our Tax Group
- Latest News
- Contact Us

New Mississippi Corporate Franchise Tax Regulation May Tax Certain Loans From Affiliates

The Tax Commission recently adopted a new franchise tax regulation announcing that it will change the method it uses in franchise tax audits to determine whether a corporation that is indebted to affiliates is adequately capitalized for franchise tax purposes. If not, all or a portion of the amounts owed by the corporation to affiliates must be reclassified as taxable capital.

Mississippi imposes a franchise tax on corporations for the privilege of doing business in Mississippi. The tax is calculated at the rate of $2.50 for each $1,000 of capital employed in Mississippi by the corporation.

For franchise tax purposes, taxable capital is measured by all issued and outstanding capital stock, paid-in capital and retained earnings. In addition, taxable capital also includes deferred taxes, deferred gains, deferred income, contingent liabilities and all true reserves. As a general rule, taxable capital does not include a corporation's debts, notes, mortgages, depreciation reserves or bad debt reserves.

Corporations doing business both within and outside of Mississippi must apportion taxable capital to Mississippi using a formula consisting of property and gross receipts factors. A corporation owning a direct or indirect interest in a "flow-through" entity must include its portion of the "flow-through" entity's gross receipts and property in its factors.

A corporation's indebtedness may be reclassified as taxable capital if it is a substitute for stock or paid-in capital. In franchise tax audits, the Mississippi Tax Commission has traditionally applied a three-to-one debt to equity ratio in determining whether a corporation having indebtedness to affiliates is adequately capitalized. If the debt to equity ratio exceeds this unwritten guideline, the Tax Commission would increase the taxable capital of the corporation for franchise tax purposes to the extent necessary to achieve the three to one debt to equity ratio.

Butler Snow has been a leading presence in the legal community for more than 50 years. With more than 160 attorneys, the firm provides a broad range of services to clients on a regional and national basis from its offices in Jackson and Gulfport, Mississippi, Memphis, Tennessee, and Bethlehem, Pennsylvania.

© 2009 MISSISSIPPI TAX BULLETIN is published by Butler, Snow, O'Mara, Stevens & Cannada, PLLC. MISSISSIPPI TAX BULLETIN is intended for general informational purposes only and is not intended to be comprehensive with respect to the subject matter. MISSISSIPPI TAX BULLETIN is not intended to create an attorney-client relationship with any user. MISSISSIPPI TAX BULLETIN is not designed or intended to provide legal or other professional advice, as any such advice requires the consideration of the facts of the specific situation.

If you no longer wish to receive this publication, please respond to this e-mail and type "Remove from Mailing List" in the subject line.

FREE BACKGROUND INFORMATION IS AVAILABLE UPON REQUEST.

The Tax Commission's new franchise tax regulation abandons the use of the historic but generic three to one debt to equity ratio. Under the new regulation, the Tax Commission must determine based on the facts of each corporate taxpayer whether or not its indebtedness to an affiliated company or stockholder is a substitute for taxable capital. The factors that it must consider in that determination are as follows:

1. Whether the debt-to-equity ratio of the corporate taxpayer compares favorably to the debt to equity ratio of its consolidated group if the related companies are in the same or a similar industry;
2. Whether the debt-to-equity ratio of the corporate taxpayer compares favorably to the industry standard for its industry;
3. If the affiliated company or shareholder borrowed the funds that were loaned to the corporate taxpayer from an unrelated third party, whether the corporate taxpayer could have obtained the loan from an unrelated third party without the relationship of the affiliated company or shareholder. If so, the corporate taxpayer's ability to have obtained the loan from the unrelated third party must be adequately documented; and
4. The Commissioner is authorized to consider any other factors it deems to be relevant.

If this analysis leads the Tax Commission to determine that loans from an affiliated company or stockholder or a substitute for stock or paid-in capital, it is authorized to add to taxable capital all or a portion of the loan necessary to achieve a debt-to-equity ratio that reflects an adequately capitalized corporation.

This new regulation became effective on July 1, 2009.

Contact Us

• **Paul Varner** is the Practice Group Leader for Butler Snow's Tax Group. His practice includes a wide array of taxation issues, including state and local taxation, tax planning and tax dispute resolution. Paul can be contacted via e-mail at paul.varner@butlersnow.com. He is licensed to practice in Mississippi.

Butler, Snow, O'Mara, Stevens & Cannada, PLLC