Mississippi Tax Bulletin: Hold the Phone! AT&T's Constitutional Challenge to Mississippi's Dividend Exclusion Statute is Still Alive

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MISSISSIPPI TAX BULLETIN

Hold the Phone!

AT&T's Constitutional Challenge to Mississippi's Dividend Exclusion Statute is Still Alive

A Mississippi trial court has again found unconstitutional the state's dividend exclusion statute, which disadvantages certain multistate taxpayers as compared to solely Mississippi taxpayers. This result comes from AT&T's 16-year effort to attack two statutes that denied it benefits available to taxpayers doing all of their business in Mississippi. A number of cases in the administrative appellate pipeline present the same issue(s) as AT&T, stemming from audit positions firmly maintained by the Mississippi Department of Revenue ("MDOR"), and have been held in abeyance pending a decision from the state's highest court. The recent trial court decision discussed here appears to present the vehicle for resolution of these constitutional questions.

[To view a detailed version of this article, click here.]

Summary of the Litigation.

U.S. Supreme Court precedent makes clear that under the Commerce Clause of the U.S. Constitution, a state cannot place a greater income tax burden on a business simply for engaging in interstate commerce. In 2000, AT&T filed suit in state court to challenge Mississippi's income tax assessment for tax years 1993-1996 ("AT&T I"). AT&T I presented the question of whether it was constitutional for substantial tax benefits to be awarded to groups of affiliated corporations that did business exclusively within the state, while denying the same benefits to affiliated groups that conducted business across state lines.

AT&T alleged that the first law, Miss. Code § 27-7-37(2)(a)(i), the "Consolidated Return Statute," was unconstitutionally discriminatory because on the one hand it allowed consolidation in computing an affiliated group's Mississippi net business income, provided all members' business activities were carried on and taxable *solely* in Mississippi, while on the other hand, any affiliated group with one or more members whose business activities were carried on and taxable in another state (like AT&T) was not authorized to utilize the consolidated method. The latter group of multistate affiliated companies were permitted to file a single combined income tax return under Miss. Code § 27-7-37(2)

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(a)(ii) in lieu of separate company returns. AT&T demonstrated at trial that its inability to file on a consolidated basis (keeping it from eliminating intercompany dividends and making other appropriate adjustments for intercompany transactions), just because some of its affiliates carried on business in other states, resulted in a significantly higher Mississippi income tax burden.

Similarly, AT&T contended that the second law, Miss. Code § 27-7-15(4)(i), the "Dividend Exclusion Statute," unconstitutionally discriminated because MDOR applied this statute to prohibit an affiliated group from excluding intercompany dividends unless the distributing corporation did business in Mississippi or filed a Mississippi income tax return. The trial court ruled in favor of AT&T and MDOR appealed. However, on appeal, the Mississippi Supreme Court did not reach the constitutional merits of AT&T I because it held that the trial court lacked jurisdiction to hear the case since AT&T failed to post the "double the amount in controversy" appeal bond called for by the statute governing tax appeals (even through AT&T paid the full assessment under protest when it filed its appeal).[1] With its September 2012 ruling, the Mississippi Supreme Court dismissed AT&T's appeal with the result that (a) the MDOR audit assessment became final and AT&T's refund petition on the basis of the unconstitutionality of Consolidated Return Statute was denied, and (b) AT&T's challenge to the Dividend Exclusion Statute, which involved a refund claim due to its inability to exclude certain intercompany dividends solely because the payers did not do business in Mississippi, was dismissed. AT&T's motion for rehearing was denied.

But the story doesn't end there. A follow-up audit of AT&T's 1997-1999 tax years resulted in an assessment on the same basis alleged unconstitutional by AT&T. At stake was some $11.8 million in tax and statutory interest. However, in this litigation ("AT&T II"), AT&T posted the statutory appeal bond, thus ensuring jurisdiction. On March 19, 2015, the same trial judge again ruled in favor of AT&T, citing the same constitutional grounds on which he based his decision in AT&T I. (In AT&T II, the parties had reached an agreement as to the issue of the consolidated/combined return filing methods and therefore the constitutionality of the Consolidated Return Statute was not before the court.[2] The only issue was the constitutionality of the Dividend Exclusion Statute.)

What Next?

Given MDOR's long-held position that it has the obligation to assume and defend the constitutionality of the tax laws until the Mississippi Supreme Court says otherwise or the legislature changes the law, it will surely appeal this decision. And since jurisdiction appears to exist, the constitutionality of the Dividend Exclusion Statute may finally be settled within the next year or so.

Tax Tip.

Given this flux in the Mississippi income tax law, multistate taxpayers with open tax years, who have not been able to take advantage of the Dividend Exclusion Statute (because all of the dividends received did not come from subsidiaries doing business within Mississippi or because they did not file returns in Mississippi) should consider filing protective refund claims pending the final outcome of AT&T II.

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[1] In 2005, Miss. Code § 27-77-7(3) became law, allowing taxpayers to either pay the amount of assessment under protest and seek a refund of such taxes, plus interest or post a bond for double the amount in controversy. In 2010, the legislature further revised this section to allow taxpayers to either pay the amount under protest or post a bond for only half the amount in

controversy. Finally, the 2014 Mississippi Taxpayer Fairness Act, generally effective Jan. 1, 2015, again amended § 27-77-7(3), this time to eliminate the mandatory posting of a surety bond in the amount of one-half of the amount in controversy in order to perfect a judicial appeal (the so-called "pay to play" provision). Thus, after this change taxpayers are able to go to court without having to first post any kind of bond or security, except in limited circumstances.

[2] This agreement may have to do with the fact that by the time the AT&T II petition was filed in court (on Aug. 6, 2004), the legislature had amended Miss. Code § 27-7-37 to eliminate the consolidated method altogether, thereby placing both in-state and multistate taxpayers on the same footing and treating them equally on a prospective basis (the amendment affects tax years beginning on or after January 1, 2004). See H.B. 1333, 2004 Leg., Reg Sess (2004). Returns must now be filed on a separate company basis or using the combined method.

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Back to Top