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February 28, 2017

Speaker Philip Gunn
Mississippi House of Representatives
Jackson, MS 39215

Via E-mail

Re: Concerns Regarding Senate Bill 2428

Dear Speaker Gunn:

On behalf of the Council On State Taxation (COST), I am writing to express concerns regarding legislation (S.B. 2428) that amends the income tax deduction for "income from dividends." This legislation appears to be intended to address the recent decision of the Mississippi Supreme Court finding the Department of Revenue's application of this deduction to violate the Commerce Clause of the U.S. Constitution (Mississippi Department of Revenue v. AT&T Corp., No. 2015-CA-00600-SCT, Oct. 27, 2016). However, the wording of the proposed amendment raises several troubling issues that could produce complexity, further litigation, and potentially a tax increase. COST suggests below an amendment to instead provide certainty and sound tax policy for Mississippi taxpayers.

Proposed Amendment. COST suggests the proposal be clarified so that the statute at issue (Miss. Code Ann. Sec. 27-7-15(4)(i)) reads as follows:

- (i) Income from dividends [add period and strike-through the following] that has already borne a tax as dividend income under the provisions of this article or under the laws of another state of the United States, when such dividends may be specifically identified in the possession of the recipient.

Infirmities with Current Proposal. The current proposal instead reads:

- (i) Income from dividends that has already borne a tax as dividend income under the provisions of this article or under the laws of another state of the United States, when such dividends may be specifically identified in the possession of the recipient.

- Deduction for "Income from Dividends." The proposed legislation currently contains the same confusing language parsed by the Mississippi Supreme Court in AT&T. The statute provides a deduction for "income from dividends that has already borne a tax as dividend income..." This language could be read to afford an

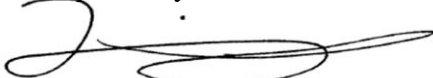
exemption only for a second-generation dividend and only if the first generation dividend had been taxed. That would be directly inconsistent with the Department's interpretation and application of the statute since at least 1993, including throughout the *AT&T* litigation, as they historically have applied the exemption based solely on whether the underlying earnings were taxed at the operating entity level. The Department expressly stated that this interpretation prevented the double taxation of the underlying earnings by again taxing them when distributed as dividends. Reenacting this statute while preserving this confusing language could disrupt the status quo and result in Mississippi's 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.

- **Requirement for Dividends to be Taxed.** The legislation also proposes to extend the deduction only to dividends that have borne a tax as dividend income in Mississippi or "under the laws of another state of the United States." This requirement premises the Mississippi deduction on the tax treatment of dividends (or income, if the statute is corrected) 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. Further, 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.
- **Failure to Account for Foreign Dividends.** Mississippi is clearly barred from taxing foreign dividends by U.S. Supreme Court precedent, and such income is currently treated as "nonbusiness income" not subject to tax in Mississippi. However, the proposed legislation fails to allow a deduction for foreign dividends. This failure, while allowing a deduction for domestic dividends, could be interpreted to overturn the current treatment and tax foreign dividends in violation of the U.S. Constitution.

COST's proposed amendment would provide certainty that "gross income" subject to tax does not include income from dividends. If the Department of Revenue believes there are dividends that should be subject to tax, it should clearly state so in its proposals so that the Legislature is properly apprised of the policy decisions it is making and whether any tax increases are being imposed on Mississippi businesses.

Please contact me with any questions or if COST can be of further assistance.

Respectfully,



Ferdinand Hogroian

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