PUBLICATION

Mississippi State and Local Tax Developments In 2008

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There have been several important Mississippi legislative, administrative and legal developments that individuals and businesses should note. In addition, a tax study commission appointed by Governor Barbour at the beginning of the year released its final report in September. The report proposed sweeping changes to the Mississippi state and local tax structure.

- **Legislative Developments**

Income Tax Legislation

1. Employer Skills Training Credit: Under current law, an employer is eligible for a 50% income tax credit applicable to qualified training expenses when the employer participates in an employee skills training course through certain community and junior colleges. The credit is capped at $2,500 per employee, and/or 50% of the employer's income for the taxable year. Unused credit, however, may be carried forward for up to five years. The original repeal date for this credit was July 1, 2008, but legislation this year extended the repeal date to July 1, 2012. (*S.B. 2534, amending Miss. Code Ann. § 57-73-25*)
2. Disregarded Entities and Reportable Transactions: New legislation provides that entities taxed as a trust or partnership which are required to include in taxable income the activity of a disregarded entity under federal income tax laws must also include such activity under Mississippi state income tax law. In addition, the legislation gives the Chairman of the State Tax Commission the authority to require taxpayers and their material advisors to report participation in "reportable transactions" to the State Tax Commission where reportable to the Internal Revenue Service. (*S.B. 2562, amending Miss. Code Ann. §§ 27-7-27, 33, 37, 39*)
3. Credit for Investment in Community Development Entity: Mississippi law provides a state income tax credit and an insurance premium tax credit for taxpayers who make qualified equity investments in qualified community development entities. Taxpayers will generally qualify for the credit if the taxpayer qualifies for a New Markets Tax Credit under federal law. Under previous law, qualifying taxpayers were eligible for a credit equal to 4% of the investment made, and an insurance premium tax credit of 1 1/3%, both of which could be claimed in each of six successive years. The new legislation increases both credits to 8% but compresses the time period in which the credits can be claimed to three years. There is an annual credit cap of $15 million, $5 million of which can be allocated to the insurance premium credit. Unused portions of the credit may be carried forward up to seven years. (*H.B. 1662, amending Miss. Code Ann. § 57-105-1*)

Sales Tax Legislation

Mississippi sales tax law was amended by an important bill that made three significant definitional changes. In addition, the Legislature provided guidance on computer software sales.

4. Definitional changes: First, the legislation clarifies that an out-of-state taxpayer who engages in business in Mississippi without first obtaining a sales tax permit from the State Tax Commission must pay the 7% retail sales tax on all purchases of personal property within the state, even if the purchase can be classified as a wholesale purchase for retail sale. Upon obtaining a sales tax permit, the taxpayer is allowed a credit on its initial return equal to any sales taxes paid on wholesale purchases.

Second, the legislation provides that a seller may be taxed on consideration paid to the seller by a third party where the seller agrees to provide a discount to the seller's customers by reason of such consideration paid by the third party (a manufacturer's rebate being the clearest example), assuming the consideration is fixed and determinable at the time of sale. If one of three additional identifying criteria provided in the statute are present, that consideration paid by the third party will be defined as "gross proceeds of sales" and will therefore be taxable to the seller.

Third, the legislation defines a "material purchase certificate" as a certificate which can be applied for and obtained from the State Tax Commission which allows a taxpayer to purchase, free of sales tax, materials which will become a component part of property constructed by the taxpayer. If, after obtaining a material purchase certificate, a taxpayer purchases any components which are covered by the material purchase certificate, but nevertheless is charged sales tax on such purchases, the taxpayer may claim a credit on its sales tax return for such sales taxes paid. (*H.B. 1663, amending Miss. Code Ann. § 27-65-3*)

5. Treatment of software sales: New legislation provides that software which is purchased and transmitted over the internet to a destination outside of Mississippi is exempt from sales tax. This exemption applies only if the first use of the software is outside of the state. (*S.B. 3173, amending Miss. Code Ann. § 27-65-101*)

Property Tax Legislation

6. Exemption for Suppliers of Vendor Tooling: In certain circumstances, Mississippi law authorizes local governmental entities to exempt real and personal property from ad valorem taxation. Legislation effective in April of 2008 authorizes an ad valorem exemption equal to as much as 30% of the true value of "vendor tooling" which is owned by a "Tier One" supplier. Vendor tooling includes dies, molds, jigs, and items which are treated as "special tooling" under the federal income tax laws, where such tools are used to produce motor vehicles. (*S.B. 3092, amending Miss. Code Ann. § 27-31-48*)
7. Extension of Homestead Exemption for Unoccupied Homes Damaged by Hurricane Katrina: Generally, an owner must occupy his or her home in order for the home to qualify for the homestead exemption from ad valorem taxation. Legislation passed after Hurricane Katrina created a two-year window during which owners could continue to claim the exemption for a home which was unoccupied due to hurricane damage. The two-year window was extended to three years by legislation which became effective the first of this year. (*H.B. 19, amending Miss. Code Ann.§ 27-33-29*)
8. Expansion of Definition of "Project" under Mississippi Major Economic Impact Act: In general, the Mississippi Major Economic Impact Act enables counties and municipalities to enter into agreements to subsequently approve requests for ad valorem tax exemption made by enterprises which will create a "project" in the applicable county and/or municipality. The definition of "project" has been expanded to include enterprises which own or operate plants that manufacture major powertrain components for vehicles. (*S.B. 2532, amending Miss. Code Ann. § 57-75-35*)

- **Administrative Developments**

Sales Tax

9. Surety Bond Requirements: Rule 35.IV.01.03 of the Mississippi Sales and Use Tax Regulations has been amended to provide that a surety bond will be required from a person when that person fails to comply with the Mississippi sales tax laws but desires to continue business within the state. The surety bond is required whenever one of the following circumstances occurs: (1) a person fails to obtain a sales tax permit before beginning business, (2) a person continues to operate a business after its sales tax permit has been revoked, (3) a person fails to keep adequate records and invoices as required by the sales tax laws, (4) a person fails or refuses to permit inspection of records, or (5) a person fails to pay any sales tax due.
10. Credit for Sales Tax Paid on Bad Debts: Rule 35.IV.02.04 has been amended to provide that a taxpayer who reports and pays sales tax on a credit sale to a buyer is entitled to a sales tax credit attributable to debt on the sale which is actually charged off as uncollectible on the company books. The sales tax credit is only available if (1) the taxpayer remitted the correct sales tax due on the correct return and (2) the taxpayer, not a third party, extended the credit financing to the buyer. The rule also provides that sales tax is due not only on the actual sale portion of the purchase price, but on the financing portion of the price as well.

11. Motor Vehicle Sales Taxes: Rule 35.IV.11.02 has been amended to reflect the repeal of the federal luxury tax and the amended statutory treatment of dealer rebates (discussed above). The rule clarifies that "incentives" paid by a manufacturer to a dealer are not considered rebates if such incentives are not passed directly to the consumer in the purchase price.

12. Aircraft Repair Parts: Rule 35.IV.11.03 has been amended to reflect that there is no longer a Mississippi tax on aircraft repair and to reflect the repeal of the federal luxury tax. In addition, the Rule provides that sales of aircraft repair parts will be taxed at a rate of 7%.

Attorney General Opinions

Several Attorney General Opinions were issued to taxpayers on questions regarding ad valorem taxation. These opinions do not carry the weight of law, but are considered persuasive authority.

13. Opinion No. 2008-00069: A county questioned whether penalties for failure to file ad valorem tax rendition forms when due could be forgiven if the taxpayer swore out an affidavit stating that the renditions had been returned timely. The county could find no record of the renditions having been filed. The opinion concluded that neither the county nor the tax assessor had the authority to abate any penalties absent a finding that the tax assessor had erroneously assessed the penalties and that the renditions had indeed been timely filed by the taxpayer.
14. Opinion No. 2007-00428: A Mississippi county erroneously assessed only school district taxes against several companies for a period of years. As a result, the companies underpaid ad valorem taxes. Despite the fact that the underassessment was the fault of the county, the opinion concluded that the companies were liable for penalties on the underpaid taxes. The opinion held that the county had no authority to abate the penalties due.

III. Judicial Developments

The most notable case involving the state taxation of a Mississippi business was *Blount v. ECO Resources, Inc.*, decided by the Mississippi Court of Appeals in 2007 but published this year. ECO Resources, Inc. is a company which maintains water and sewer systems for municipalities. The State Tax Commission audited ECO in 1999, and determined that it owed contractor's taxes under Miss. Code Ann. § 27-65-21(1)(a)(i) on several of its contracts. The contractor's tax is due when repairs are made to real property. The State Tax Commission auditor, reviewing the job titles of ECO employees, determined that 70% of the work performed by ECO was attributable to repairs of real property. Thus, 70% of the fees collected on the contracts were assessed the 3.5% contractor's tax.

ECO objected to the assessment based on job titles, and provided the auditor with job descriptions of the various employees. The auditor responded by raising the assessment to 86% of the fees collected. ECO administratively appealed the auditor's findings with limited success, paid the assessment, and then filed a refund action in the Chancery Court of Harrison County, arguing that it was not subject to the contractor's tax because the repairs were made to personal property. The Chancery Court determined that ECO was entitled to a refund of the contractor's taxes paid.

On appeal to the Mississippi Court of Appeals, the Commission argued (a) that all repairs to water and sewer systems are statutorily subject to the contractor's tax, (b) that treating repairs to personal property differently from repairs to real property does not make sense, and finally (c) that the property in question was real property and not personal property. The Court rejected each of these arguments. The Appeals Court held that (i) there is clearly an exemption from the contractor's tax for repairs to personal property; and (ii) a distinction could be easily made by the Commission between repairs to real and personal property, as the Commission makes such a distinction in repairs to residential and non-residential portions of sewage systems.

Finally, the Appeals Court found that the property which was repaired by ECO was indeed personal property. Citing Rule IV.10.01.502, the Court found that the repaired property was movable and not permanently attached to the sewage systems.

Tax Study Commission Final Report

Earlier this year, Governor Barbour announced a Tax Study Commission (TSC) which would evaluate Mississippi's current state and local tax system and propose changes as necessary. The TSC released its final report in September. While the TSC found that Mississippi has an overall "diversified and balanced tax structure which ranks well in national studies," it nevertheless found "room for improvement in specific areas." Specifically, the TSC divided its recommendations into short-term and long-term.

Short-Term Recommendations

15. Shrink the tax gap: The State Tax Commission estimates that the Mississippi tax gap, the difference between taxes owed and taxes actually collected, may be as much as $120 million. The TSC concluded that the best way to shrink this gap is to upgrade the technology and hardware systems of the State Tax Commission.
16. Restructure the State Tax Commission: The TSC concluded that independence should be added to the tax appeals process by dividing the office of the Commissioner of Revenue into two distinct offices: The Chairman of the State Tax Commission and the Executive Director of the Department of Revenue. The name of the State Tax Commission would be changed to the Department of Revenue, and the current three member appeals board would retain the State Tax Commission name. Taxpayers or the Department of Revenue could appeal adverse

decisions of the State Tax Commission appeals board to the appropriate court. The TSC believed that a Mississippi business court should be created to handle these appeals.

17. Corporate Income and Franchise Taxes:

The TSC recommended the following: Reduce the franchise tax rate to $2.25 per $1,000 of capital.

Eliminate the following rarely-utilized income tax credits: The Research and Development Skills Credit, the Child Care Credit, the Financial Institutions Jobs Tax Credit, and the Airport Cargo Charges Credit.

Exempt the first $10,000 of income earned by corporations, then switch to a 5% flat rate. Currently, Mississippi has a graduated rate which climbs from 3% to 5% as income increases.

Conform Mississippi state depreciation with federal depreciation.

18. Personal Income Taxes: The TSC proposed:

Remove the option for married taxpayers to file jointly but report income separately.

Remove the option to claim a dependent when the dependent claims himself on a separate return.

Increase the standard deduction and personal exemption for Mississippi taxpayers.

Increase the exemption provided for dependents.

Expand the 3% and 4% tax brackets, so that the first $10,000 of income is taxed at 3%, the second $10,000 at 4%, and all remaining income is taxed at 5%.

19. Property Taxes: The TSC recommended expanding the existing Freeport Warehouse inventory exemption to give local entities the option to exempt all raw materials, work in progress, and finished goods inventory from ad valorem taxation. The TSC also recommended limiting the exemption only to manufacturing, warehousing and distribution facilities.
20. Sales Taxes: Sales tax recommendations by the TSC were as follows:

Provide that sales tax exemptions for bond financing will be made available only to a select group of industries.

Provide local governmental entities with the ability to levy local sales taxes for specific projects.

Divert one percent of state sales tax revenues to counties.

Remove the sales tax exemption for purchases made by non-profit hospitals.

21. Tobacco Taxes: The TSC recommended increasing the excise tax on cigarettes from the current 18 cents a pack to 50 cents a pack.
22. Incentive Programs: The rebate provided by the Advantage Jobs Program would be reduced under the TSC's recommendation, and would also be subject to the discretion of the Mississippi Development Authority. In addition, the TSC recommended a complete repeal of the Growth and Prosperity Program.
23. Capital Gains: The TSC recommended a capital gains rate of 3% for all long-term capital gains.
24. Entertainment District: An "entertainment district" category would be created under TSC's recommendation, and such district would provide accelerated depreciation for buildings

constructed in the district. Creation of an entertainment district would encourage the growth of theaters, convention centers, hotels and other entertainment entities.

Long-Term Recommendations

The TSC recommended that Mississippi participate in the Streamlined Sales Tax Project. The Streamlined Sales Tax Governing Board seeks participation by member states which agree to adopt simplified sales tax structures. If this Project is able to recruit enough participating states, its Board hopes to lobby Congress to pass legislation which will enable states to levy a sales tax on internet, catalog and telephone sales made to out-of-state customers.

The TSC proposed a broadening of the Mississippi sales tax base. According to the TSC, this will essentially involve (a) reducing the number of carve-out sales tax exemptions, and/or (b) increasing the breadth of services which are taxed. Concurrently, the TSC believes that the overall sales tax rate can be reduced.

The TSC opposed a state lottery, noting that this was a regressive form of taxation which inevitably taxed lower-income households at a higher rate than higher-income households.

Finally, the TSC proposed that Mississippi should adopt a "unitary" reporting method for taxation of corporations. The unitary method requires a family of corporations to report as one operating entity under certain circumstances, instead of reporting individually.