

Missouri Revenue Officials Disallow REIT Dividend Deductions

Alert

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By Chuck Hatfield

Missouri law allows taxpayer corporations to reduce their Missouri-taxable income by the amount of “corporate dividends from sources within Missouri.” The statute is said to be a legislative policy choice to encourage investment in Missouri corporations by not taxing dividend income from those corporations. Many taxpayers have taken advantage of this tax policy throughout the years. Banks have particularly benefited from this policy when structuring mortgages in a way that provides dividend payments to the bank from real estate investment trusts (REITS) based in Missouri.

Historically, the Missouri Department of Revenue (Department) has allowed subtraction of dividends from Missouri’s taxable income so long as the corporation receiving the dividends paid federal taxes on them and the corporation paying the dividends was located in Missouri. Department forms and instructions made no distinctions about what types of corporations were paying—location in Missouri allowed the income to be subtracted. Now, the Department appears to have adopted a new policy that dividends received from federally-qualified REITS, regulated investment companies and others may not be subtracted from Missouri income. The Department’s auditors have begun to disallow subtraction of these dividends, making adjustments to the amount of taxes owed. Some of the audits go back several years.

In addition, the Department changed the instructions for the 2021 Missouri Corporate Income Tax Form, known as MO-1120. The instructions for line 10 (which the Department calls the Missouri Dividends Deduction) now includes a note telling taxpayers they should “not treat the following as dividends, even if income is 100 percent from Missouri sources.” The note then lists dividends from mutual savings banks, regulated investment companies and real estate investment trusts (among others). The Department’s reasoning is that federal law does not treat REIT (and other) dividends as dividends for purpose of the federal dividends paid deduction. The Department then relies on a Missouri revenue statute that instructs

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that words used in income tax statutes should be given the same meaning as when used in a “comparable context” in federal law.

At least one corporate taxpayer has received a final decision from the Department disallowing REIT dividend subtractions. That matter is on appeal to the Administrative Hearing Commission (AHC). Once the AHC rules, the losing party may appeal directly to the Missouri Supreme Court, because it involves an interpretation of state revenue laws. A taxpayer faced with a final decision disallowing REIT dividends has two lines of defense. First, the taxpayer will likely argue that the Department is simply wrong on the law and that the statute allows the taxpayer to subtract all Missouri-source dividends from taxable income. Next, the taxpayer may argue that the Department has changed its policy on dividends. If there was a policy change and the change was not reasonably foreseeable to the taxpayer, the new policy may only be applied prospectively after the most recently ended tax period.

Taxpayers who have been subtracting REIT dividends should consult with their accountants and attorneys on how to approach these recent developments and how to fill out their tax returns for 2021 on.

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