

Indiana Tax Competitiveness and Simplification Conference

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Panel: Tax Simplification

Mark J. Richards, Partner
ICE MILLER LLP
1 American Square, Suite 2900
Indianapolis, IN 46282-0200
Phone: (317) 236-2471
Fax: (317) 592-4739
E-mail: Mark.Richards@icemiller.com

Introduction

Any discussion of tax simplification must be conducted in the proper context and with the ultimate goals of the State in mind. The State's ultimate goal should be to make itself the most attractive place to live, and to locate a business, as possible. The State's tax structure, including its tax policies and tax administration, is certainly one of several significant elements in measuring a State's overall attractiveness.

Theoretically, a State's tax system can be simple or it can be complex. "Tax simplification" is often used as a euphemism for tax reform of many types. As a broad proposition, "simplifying" tax laws is good *if* it reduces compliance costs for taxpayers, but it may actually increase costs in the long run if the simplification creates greater uncertainty. Stated another way, eliminating *unnecessary* complexities saves both the State and taxpayers money, and makes the State more attractive. On the other hand, eliminating other tax provisions, including valuable deductions, credits or even explanations, may be detrimental. Ultimately, you must look past generalities and to specific applications and determine what achieves the objectives of the State in making Indiana more attractive.

Inevitably, there will be a menu of options and ideas for making Indiana more competitive. Some will have a greater potential impact than others, and some will have a greater price tag than others. Indiana certainly needs to capture the "low hanging fruit" as well as the ideas with a low price tag, or no price at all. From there, the State needs to make particularly thoughtful business decisions.

Tax Simplification and State Competitiveness

- 1. Reduce the number of income tax add-backs:** The Indiana adjusted gross income tax starts with federal taxable income (or adjusted gross income) as determined under the Internal Revenue Code, and then makes adjustments determined by the Indiana

Legislature. In order to save money, Indiana has added a huge number of adjustments over the years. This “decoupling” from the Internal Revenue Code creates complexity and compliance costs for multi-state taxpayers, and makes Indiana less attractive. There is, of course, a cost with eliminating the add-backs, with the cost varying with each add-back, so that must be taken into account.

2. ***Eliminate the Throwback Rule:*** Indiana remains one of a select number of states which still has the throwback rule for income tax apportionment purposes. This rule makes Indiana less competitive generally, and in particular hurts Indiana’s efforts to be a logistics state. Again, there is a cost with eliminating the throwback rule. This rule is an impediment to Indiana’s business development efforts.
3. ***Streamline Tax Court Settlement Processes:*** Indiana Code § 6-8.1-3-17 currently requires approvals by the Governor and the Attorney General of most settlements in the Indiana Tax Court, even though the exact same disputes could have been settled by the Department of Revenue without those approvals prior to the disputes proceeding to Tax Court. The settlement process is unnecessarily slow and bureaucratic, and can be simplified at no cost to the State. In fact, it would save the State and taxpayers money.
4. ***Match the Burden of Proof with the Party Deviating from the Statute:*** The Legislature has provided a formula for allocating and apportioning income in Indiana Code § 6-3-2-2. The Department has, on audit, on those occasions which it deemed appropriate, determined that a taxpayer should be required to deviate from the statutory formula, and the Department has then claimed that it is the taxpayer’s burden of proof to justify its return position. Indiana is not unique on this issue, and the MTC recently did an analysis and made a recommendation that the party who proposes to deviate from the statute should have the burden of proof. Indiana should be out in front on this issue and ahead of its competition. This will show that Indiana is a business friendly state, transparent, and forward thinking. This is merely a procedural issue and should be at no cost to the State.
5. ***Reaffirm Indiana as a Non-Unitary State:*** Back in the 1980s, Indiana was courting Japanese companies to do business in Indiana. Those companies were worried about states that imposed unitary filing obligations. Governor Orr published a letter reassuring Japanese investors that Indiana was not a unitary state. While Indiana has continued to maintain the public position that it is a non-unitary state, over the last several years, many companies have been forced to file combined returns upon audit. The number of letters of findings (“LOFs”) over the last several years illustrates that. There is a concern that Indiana’s public position is not consistent with how its laws are being administered. In order for the State of Indiana to attract and retain business, it is vital that trust be established. Consistency and transparency in administering Indiana’s tax laws are essential, and reaffirming Indiana’s position as a non-unitary would help re-establish that trust. Since this would reaffirm the State’s existing position, this would be at no cost to the State.
6. ***Amend the Assessment and Refund Procedures to Create Uniformity and Eliminate Traps for the Unwary:*** There are differences between the procedures for proposed

assessments and refund claims, some of which are explicit and others of which are subtle. You can request a rehearing on one but not the other. You have 60 days to file in Tax Court on one, but 90 days on the other. The Department of Revenue has three different official forms for a final refund denial determination, when one should suffice. The Department of Revenue often combines its audits of proposed assessments and refund claims, as well as protest hearings. While the combination can appear efficient, the differences in the procedural rules can create confusion and timing problems as to these final actions, and can cause taxpayers to misunderstand the procedural status of matters and miss deadlines. Indiana should not be a State which, even inadvertently, misleads or confuses taxpayers into losing their rights. Indiana should be a State that wants to get it right, wants to be fair to taxpayers and allow taxpayers to preserve their procedural rights. In addition, the Department's notices should be more explicit as to what the document is intended to constitute, and the taxpayer's deadline. This would promote simplification, promote transparency and trust, and would be at no cost to the State.

- 7. *Statutorily Reinforce Isolated or Occasional Sales Provisions to Sales Tax Laws:*** Indiana, as a matter of administrative practice and interpretation of the levying statutes, has historically recognized isolated or occasional sales for sales tax purposes. In light of the Supreme Court's decision in *Indiana Dep't of Revenue v. Belterra Resort Indiana, LLC*, 942 N.E.2d 796 (Ind. 2011), it would promote certainty for business, help business development for the State, and save money for Indiana by avoiding disputes, by statutorily reinforcing the isolated or occasional sales provisions as other states have done. Since this would merely reflect current practice, this would be at no cost to the State.
- 8. *Statutorily Provide that a Taxpayer's May Rely on Examples in Regulations:*** Taxpayers and tax practitioners rely heavily on examples in regulations. The Treasury Regulations, which support the Internal Revenue Code, are loaded with examples, and these are viewed as part of the Treasury Regulations and reflective of the position of the Department of the Treasury. There are also examples in the Indiana Department of Revenue's regulations, and presumably the Department would not have included those examples if they did not reflect the Department's interpretations of the laws. In *Indiana Dep't of State Revenue v. Miller Brewing Co.*, 975 N.E.2d 800 (Ind. 2012), the Indiana Supreme Court held that, under Indiana law, examples are not part of the regulations and cannot be relied upon by taxpayers. This is a law that needs to be changed if you want to develop trust. This should be at no cost to the State.
- 9. *Allow the Department to "Clean-up" its Regulations:*** The Governor put a moratorium on new regulations for a good reason. However, the Department has regulations which are out-of-date and need to be cleaned up, as they have incorrect dates, tax rates, etc. Cleaning up these regulations can actually be helpful to business. This should likewise be at no cost to the State.
- 10. *Make sure Agencies' Actions Align:*** Once the State decides its course of action, it needs to make sure it has all its agencies on board. That not only will generate the best result, it will generate trust and confidence by those companies the State is trying to

attract. For example, if the State, through the IEDC, is marketing itself as an “R&D” friendly state, through income and sales tax credits for research and development, the State needs to make sure the Department of Revenue is operating on a consistent basis. If the IEDC is marketing those credits and the DOR is then denying the credits upon audit for reasons which are suspect, that will again greatly damage trust. Similarly, if the Governor is promoting a health care initiative, the Department’s approach to health care related tax provisions, and tax exempt entities in general, should be consistent with the Governor’s initiatives. This, again, is not only crucial for establishing trust, it offers great opportunities. Again, no cost to the State.

11. Department Policies should be driven by Sound Business Principles: Nothing is more frustrating to a taxpayer than a decision that the taxpayer believes makes no sense, without receiving any meaningful explanation for the decision. There are times when reasonable people can disagree. However, certain policies are harmful to business development and do not further any legitimate state interest. For example, a single member limited liability company (“SMLLC”) is a disregarded entity for federal income tax and Indiana adjusted gross income tax purposes. That SMLLC is treated as part of the same entity as its member. However, the Department treats that same SMLLC and member as different entities for sales tax purposes. This creates a trap for the unwary, particularly those new to the State of Indiana. In those cases in which the Department believes it needs legislation in order to be consistent, then it needs to seek legislative assistance. The more logical and consistent the Department’s decisions, the more trust there will be.

12. Every Action by the Department should be taken through the Prism of Trust: As mentioned several times, a key to developing business is developing trust. The State needs to understand the reasonable needs of its taxpayers, and its taxpayers need to understand the reasonable needs of the State. There needs to be an effort at trust and fair dealing both ways. If a company doesn’t trust the State, then that alone may cause the company to not come to Indiana. When someone (or some State) is a “stand up” person, word spreads. The converse is also true. Many states are in a bad financial position, unlike Indiana, and consequently, Indiana has put itself in a favorable competitive position to be honest with companies. Indiana needs to capitalize on that opportunity. Again, no cost to the State, but priceless.

I hope these ideas are of some assistance. Commissioner Alley brings strong business acumen to the Department, and he has many hard working people who exemplify the meaning of “public servant.” It is not easy working for any revenue department, and that certainly includes the Indiana Department of Revenue, as well as Indiana’s other taxing authorities. These individuals often are unfairly criticized, and regrettably that is probably an unavoidable occupational hazard. The fact remains that these individuals represent the State in interfacing with its taxpayers, and there is a necessary and great opportunity to do so in a way which illustrates that Indiana is a great State in which to live and work.