



INTERIM UPDATE

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Tax and Public Finance Momentum for Significant Changes to Indiana Taxation

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Since 2002, there have been numerous changes to the Indiana tax laws to improve Indiana's competitiveness, while at the same time implementing cost controls and preserving Indiana's ability to balance its budget. Notable changes include the elimination of the gross income tax and the supplemental net income tax; the elimination of the inheritance tax; reductions in income tax rates for individuals, corporations and financial institutions; numerous deductions and credits designed to stimulate economic development; and the addition of property tax caps. As a result, various national studies have recognized Indiana's ability to improve its tax climate while maintaining fiscal discipline. The Tax Foundation in Washington, D.C. recently ranked Indiana's tax climate the eighth best in the country on its State Business Tax Climate Index.¹

Indiana, however, isn't resting on its laurels. On June 24, 2014, the Governor hosted the Indiana Tax Competitiveness and Simplification Conference, comprised of a mix of national and local economists and tax practitioners. As its name suggests, this one-day conference was intended to identify and discuss ways in which Indiana could make improvements to its tax laws to enhance Indiana's competitive positioning and to simplify its tax laws and tax procedures. In September, the state issued its 70-page Tax Competitiveness and Simplification Report.²

The Legislature had a similar initiative, but one with a different approach. The Legislature created a "blue ribbon" committee to study Indiana's business tax structure. Members of the committee were designated governmental leaders and representatives of select interest groups and key organizations (including the Chamber). The committee met three times to hear testimony from national and local groups and individuals, and then concluded with a meeting on November 12 to discuss and approve its findings and recommendations.³

The scope of the topics discussed has been extensive. The discussions have included some "big ideas," such as elimination of the personal property tax, the broadening of the sales tax base to include more services, the elimination of the corporate income tax or the reduction of the sales tax rate if the sales tax base is broadened and the idea of turning Indiana into a forced combination, or unitary, state. Big ideas to eliminate taxes in their entirety, or reduce tax rates, and even many of the

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less ambitious ideas, raise issues of finding replacement revenues to balance the budget and maintain Indiana's fiscal discipline. Other ideas, such as broadly taxing services or making Indiana a unitary state, may raise revenue to "fund" other changes, but they raise significant policy questions and potentially undermine Indiana's goal of being more competitive and simplifying its tax laws.

This should not, however, be written off as an academic exercise. There have been numerous ideas in which there appears to be a consensus of opinion for change. Some are areas in which there is very little or no discernable fiscal cost. Those areas include ways in which tax procedures can be improved and streamlined. There are other areas in which there is a conceptual consensus for change, but the improvements would have revenue implications of varying degrees. An example is simplifying Indiana income tax by reducing the number of "decoupling" adjustments from federal taxable income. For the most part, there is a revenue cost to each decoupling adjustment.

The state's report indicates that it envisions a "package" which will be revenue neutral. It includes a discussion of over 50 ideas, which does not include all of the ideas discussed at the conference or in the white papers prepared by conference speakers in advance of the conference. Some of the topics discussed in the report are very specific and include recommendations. Those seem the most likely to be presented to the Legislature during the 2015 session. Others topics were discussed in less specific terms and appear to reflect the state's view that additional analysis and discussion is needed. These topics appear more likely to be presented in future sessions if at all. The Legislative blue ribbon committee made 19 recommendations, with more focus on property tax changes.

The accompanying chart (www.indianachamber.com/media/TaxChartNov2014.pdf) identifies some of the topics which have been discussed, as well as possible prospects for change. With the high level of effort this year to identify areas for improvement, there is a genuine opportunity to enhance Indiana's tax climate and legitimate reason for optimism. On the other hand, a package which contains elements that raise revenue in order for the package to be revenue neutral or the temptation of the state to add or exclude elements in a package which give the state an unfair advantage in dispute resolution, could result in a package which includes provisions reflecting highly questionable tax policy and that hurt Indiana's competitiveness and create further complexity to Indiana's tax system, the exact opposite of the stated goals from the Governor's tax conference. Consequently, cautious optimism might be the best characterization.

While we do not yet know exactly what will be presented to the Legislature in 2015, many changes will likely be proposed and discussed. It could be an exceptionally interesting session.

¹ <http://taxfoundation.org/article/2015-state-business-tax-climate-index>.

² The State's report is available at <http://www.in.gov/dor/files/tax-conference-report-final.pdf>.

³ The committee's report is available at <http://iga.in.gov/documents/f455789a>.

<u>Potential Changes</u>	<u>Issues/Prospects in 2015</u>
<p><u>Income Tax:</u></p> <p>Reduce decoupling from Internal Revenue Code</p> <p>Eliminate the throwback rule</p> <p>Change Indiana from a non-unitary to a unitary state</p> <p>Change from COP to market based sourcing of services</p> <p>Change business income definition</p> <p>Eliminate the corporate income tax</p>	<p>Simplicity; replacement revenue/prospects depend greatly on cost and replacement revenue</p> <p>Enhance competitiveness; replacement revenue/prospects encouraging</p> <p>Competitiveness setback/prospects uncertain; State may push for it</p> <p>Competitiveness uncertainty; confusion; fiscal analysis/prospects uncertain; State may push for it</p> <p>Competitiveness and simplicity setback/prospects uncertain</p> <p>Enhance competitiveness; replacement revenue; politics/prospects appear unlikely at this time</p>
<p><u>Sales Tax:</u></p> <p>Move from double directness to single directness test</p> <p>Clarify temporary storage exception</p> <p>Broaden base by taxing some additional/all services</p> <p>Clarify software/cloud computing</p> <p>Streamline treatment of construction contracts</p> <p>Modify exemptions for medical equipment/drugs/supplies</p> <p>Enhance collection of sales/use tax on internet and other remote sales</p> <p>Simplify recycling exemption</p> <p>Clarify R&D exemption</p>	<p>Simplicity; fiscal impact/prospects encouraging</p> <p>Simplicity/prospects encouraging</p> <p>Potentially severe setback in competitiveness and simplicity/any change appears down the road</p> <p>Action unclear/change most likely down the road as analysis continues</p> <p>Simplicity/prospects moderate; may need more analysis</p> <p>Policy; action unclear/prospects uncertain</p> <p>State vs. Federal actions/likely to continue push for federal legislation</p> <p>Policy; actions unclear; simplicity/prospects moderate</p> <p>Competitiveness; simplicity/prospects encouraging</p>
<p><u>Property Tax/Local Government:</u></p> <p>Add mandatory property tax filing <i>de minimis</i> exception</p> <p>Phase out or other relief from 30% floor</p> <p>Simplify/consolidate local income taxes</p>	<p>Replacement revenue/prospects good, but may depend on finding replacement revenue</p> <p>Replacement revenue/prospects moderate; depends on features and replacement revenue</p> <p>Structural complexities/prospects moderate</p>
<p><u>Tax Administration (Department of Revenue):</u></p> <p>Align assessment/refund procedures</p> <p>Simplify tax court settlement procedures</p> <p>Allow interest on refunds from return/payment date</p> <p>Simplify/harmonize statutes of limitation</p> <p>Improve warrant expungement process</p> <p>Align burden of proof to MTC recommended changes</p> <p>Protect State from discovery: add privileges (State only)</p>	<p>Prospects encouraging</p> <p>Prospects encouraging</p> <p>Prospects moderate</p> <p>Prospects encouraging</p> <p>Prospects encouraging</p> <p>Prospects encouraging</p> <p>Competitiveness; fairness/Uncertain prospects; ignored in State and Committee report</p> <p>Competitiveness and fairness setback/State likely to push for it</p>