INDIANA'S MANDATORY UNITARY COMBINED REPORTING STUDY DUE SOON

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As we previously reported**,** this past spring the Indiana Legislature directed the Legislative Services Agency (LSA) to study the impact if Indiana were to change to a mandatory unitary combined reporting (MUCR) system for Indiana adjusted gross income tax purposes, and directed LSA to submit a report electronically before October 1 to the legislative council and to the interim study committee on fiscal policy. The report is required to include the following:

(A) A review of the practices in other states regarding combined reporting;
(B) A review of the administrative costs of implementing combined reporting;
(C) A review of studies and reports on combined reporting;
(D) An estimate of the fiscal impact of implementing combined reporting in Indiana; and
(E) A review of the issues related to transfer pricing under Indiana's income tax.

The interim study committee is directed to hold "at least" one public hearing at which LSA presents the results of its study. This subject is on the agenda for interim study committee's October 5, 2016 hearing.

LSA's assignment is not an easy one. LSA has a relatively condensed time period in which to conduct what is a complicated analysis and to make specific determinations in several areas. In order to conduct an economic analysis, LSA first needed to know the MUCR model it was to analyze. Unless instructed in advance by the Legislature on the specific terms of the MUCR model it was to analyze, LSA needed to identify all of the relevant alternatives for developing a MUCR model, and then seek direction from the Legislature as to the choices it was to make. That is because LSA does not make policy. The Legislature makes policy. LSA conducts economic analyses of specific proposed changes in the law, and drafts legislation to implement those proposed changes.

One of the many challenges in this case is the entanglement of policy as part of any economic analysis. There is not a uniform approach to MUCR among those states that have adopted MUCR. Assumptions as to the terms of any proposed MUCR legislation significantly impact any economic forecast. Those assumptions could also impact the Indiana economy and Indiana's economic development efforts. The threshold questions include, among others:

- Is LSA estimating the fiscal impact on a water's edge combined reporting basis or on a worldwide combined reporting basis, and if worldwide, how will it address the so-called "tax havens?"
- Are the utilization of losses limited in its analysis (as with the original version of Senate Bill 323), or does the analysis reflect a true unitary "one business enterprise" approach for both profits and losses?
- Will the analysis replace or supplement the existing consolidated return reporting election under Indiana law?

- Will financial institutions and insurance companies be excluded even if part of a unitary group?
- Will Indiana's model reflect the adoption of the *Joyce* or *Finnegan* approach to nexus for unitary reporting and will it "add back" the recently repealed throwback rule?
- What standards will be included in determining a unitary group, and changes to the group?
- How much discretion will be granted to the Indiana Department of Revenue given the myriad of subjective determinations which will be required?
- How will LSA's economic analysis take into account dynamic factors such as the impact on business decision making/economic development and business operational and structural changes, particularly given the State's need to push out an effective date so that the State can prepare to implement a completely new tax reporting methodology to replace the one it has used for over one half of a century?

The State of Indiana does not have the data on Indiana businesses to determine the fiscal impact of implementing combined reporting in Indiana specific to those companies. While some other states have sought to first obtain that information in order to make a more informed decision as to whether to adopt MUCR, Indiana has not taken that approach. Instead, LSA will presumably perform an "econometrics" approach which is based on extrapolating data from other states, states with different laws, different state economies, and for different time periods which reflect the impact of economic factors during those time periods which may not apply today. This requires LSA to attempt to reconcile many variables and presumably make only a very high level estimate of the fiscal impact of Indiana changing to MUCR. It is expected that LSA will use all the time is has been allowed.

LSA's report could influence whether MUCR is on the agenda for the 2017 Indiana budget year legislation session. The November elections, which among other things, will produce a new Governor, as well as other legislative initiatives, could also impact the Legislature's likelihood of making such a fundamental change in Indiana taxation.