

## State Revenue-Raising Challenges



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Mark J. Richards is a partner with Ice Miller LLP, Indianapolis. With many states facing deficits, downward revenue trends, and infrastructure and other governmental service needs, state legislatures are facing increasing pressure to find politically viable ways to

fund state government and do so amid concerns that the federal government will push additional costs down to the states. Indiana, one of the more fiscally healthy states, provides an example of a state wrestling with how best to address its needs while still trying to maintain an overall attractive state tax climate to promote economic growth.

### Sales, Use Taxes

With revenue trending downward, some states are going after remote sales in the hope that *Quill Corp. v. North Dakota*<sup>24</sup> will be overturned.<sup>25</sup> Indiana passed such a law this past session,<sup>26</sup> following the lead of South Dakota. The number of disputes will undoubtedly increase,<sup>27</sup> but states are hoping that the U.S. Supreme Court will overturn *Quill* based on statements made by Justice Anthony M. Kennedy in his concurring opinion in *Direct Marketing Association v. Brohl*,<sup>28</sup> and that this preemptive effort will pay off. Indiana laid the groundwork for the future consideration of an ambitious broad-based sales tax on services in passing H.R. 3, seeking to study the issue. That would raise many tax and economic development policy issues.

<sup>24</sup> *Quill Corp. v. North Dakota*, 504 U.S. 311 (1992).

<sup>25</sup> South Dakota passed S.B. 106, and other states have promulgated regulations (Ala. Admin. Code r. 810-6-2-.90.03 and Tenn. Comp. R. & Regs. 1320-05-01-.129) designed to tax remote sales.

<sup>26</sup> Pub. L. 247-2017.

<sup>27</sup> See *South Dakota v. Wayfair Inc.*, No. 3:16-CV-03019-RAL (D.S.D. Jan. 17, 2017); *Newegg Inc. v. Alabama Department of Revenue*, No. S. 16-613 (Ala. Tax Trib. filed June 8, 2016).

<sup>28</sup> 135 S. Ct. 1124 (2015).

## Income Taxes

After an extended period of essentially a status quo on the number of states requiring mandatory unitary combined reporting (MUCR), there has been recent renewed interest in MUCR, with some additional states converting to MUCR.<sup>29</sup> This is politically positioned as a way to close loopholes but raises many tax and economic policy questions. After an Indiana study in 2016 did not generate enthusiasm to convert to MUCR, Indiana did not pursue it in its 2017 legislative session.

### Sin Taxes

One area of perceived lower political risk historically has been the so-called sin taxes (for example, alcohol, tobacco, and gaming taxes). The additional strain on gaming operators from increased competition has made it difficult to increase taxes on gaming, and Indiana in fact enacted relief (phased-in) to address the unfairness of the add-back of wagering taxes to the adjusted gross income tax.<sup>30</sup> Indiana considered an increase on cigarette taxes this year as a funding source for its infrastructure bill, but ultimately no such increase was passed, as Indiana is believed to be waiting to see what happens in Washington, including on healthcare reform.

### Gas Taxes

Gas tax increases may be near the top of the list of tax increases that voters dislike the most.<sup>31</sup> However, given state infrastructure needs, this seems to be a logical and equitable source of revenue as it approximates a user fee, and Indiana took this approach in 2017.<sup>32</sup>

### Retroactive Taxes

Probably the most disturbing trend has been the increased use of legislation to retroactively

<sup>29</sup> See, Combined Reporting Study, Office of Fiscal and Management Analysis, Indiana Legislative Services Agency, Oct. 1, 2016.

<sup>30</sup> Pub. L. 268-2017.

<sup>31</sup> Richard C. Auxier, "Voters Hate Gas Tax Hikes — That's a Problem for States," Tax Policy Center (Nov. 6, 2014).

<sup>32</sup> Pub. L. 218-2017.

change the law, particularly after that state (or another state) loses a tax case in court.<sup>33</sup> Last year, Indiana added itself to the list of states willing to take this action in retroactively reversing an Indiana Tax Court decision addressing sales and use tax on construction contracts.<sup>34</sup> Taxpayers are bound to follow the law, and they should be able to rely on the law as well. A state's willingness to retroactively change the rules after the fact severely undermines trust in state government, and makes the state a less attractive one in which to conduct business.

### Administrative Actions

Given the inherent difficulty in getting legislation passed, departments of revenue may simply take more aggressive positions under existing laws. The Indiana Department of Revenue began a pilot project to go after individuals who claimed to have changed residency from Indiana to another state, but who still have some ties to Indiana. While the department's position may be questionable in some cases, it can be too costly to fight these assessments.

States such as Indiana, with a budget surplus rather than a deficit, are better positioned to make good tax policy decisions in addressing their revenue needs, but even those states are challenged. These tough issues are not going to go away.

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<sup>33</sup> See *In re Estate of Hambleton*, 335 P.3d 398 (2014); *Dot Foods Inc. v. Department of Revenue*, 372 P.3d 747 (2016); *Gillette Commercial Operations North America & Subsidiaries v. Department of Treasury*, 878 N.W.2d 891 (2015).

<sup>34</sup> Pub. L. 181-2016; *Lowe's Home Centers LLC v. Indiana Department of State Revenue*, 23 N.E.3d 52 (Ind. T.C. 2014).