FEW HEADLINES, YET MUCH TAX POLICY SUCCESS

By Bill Waltz, vice president of taxation and public finance

While most of the discussion this session was not about tax issues, there were plenty of things for those focused on tax and public finance to be pleased about. There was a very positive tax policy change impacting service companies located in Indiana that do a lot of out-of-state business. There was a significant adjustment to the business personal property tax exemption for small businesses that own only a small amount of property.

An important bill was passed to govern how sales tax is collected on internet retail transactions. Seriously flawed legislation attempting to undo previous progress on the "big box" assessment issue was defeated. And after a series of productive discussions with the Indiana Department of Revenue (DOR), some troubling provisions were removed from its agency bill.

These items drew little attention but were nonetheless significant and helped comprise a successful session on the tax front. Of course, there were many other tax related and public finance matters associated with other, often more publicized legislation, and several of those are covered in other parts of this report.

Market Based Sourcing – SB 563

One element of the Governor's economic development bill, SB 563, made a significant change to tax policy regarding how Indiana apportions income derived from the sale of a service – what is taxable in Indiana. The provisions switch Indiana from what is known as the cost of performance (COP) method to the market-based sourcing (MBS) method.

The COP method taxes a company based on where the cost of performing that service is incurred. Under COP, a company that produced the service outside of Indiana and sold it to an Indiana customer is not taxed here. But a company that produced the service in Indiana and sold it to a customer outside of Indiana paid tax on that income. Meanwhile, under MBS, a company's income is apportioned based on where their customer is located, not where the cost of producing the service is incurred. So, a company will only pay tax on income generated by sales of the service to Indiana customers; those companies that are located outside of Indiana will have to pay tax on the income they generate from sales of a service to Indiana customers. The COP method actually penalized Indiana-based companies that do business outside Indiana by making them pay in Indiana, under the COP method, and again on that same income to states that apply MBS.

Before the session began, Bill Waltz (r) met with the Chamber's Tax Committee, which helps determine the organization's policies and positions on fiscal matters.

By switching to MBS, Indiana eliminates this potential double taxation of Indiana companies and now requires out-of-state companies to pay tax when their customers are in Indiana. Many states have made this switch in recent years. It is more sensible from an economic development standpoint and simply fairer. Besides helping Indiana companies directly and collecting revenue from companies outside Indiana, the switch also removes the disincentive for a service-based company to locate in Indiana. Previously, out-of-state companies were effectively discouraged from locating in Indiana because they would have been taxed on all their income once they moved here (instead of it being apportioned based on where their customers are located).

The Chamber worked closely with the administration in contemplating the scope and effect of this switch of apportionment methods. And again, it constitutes a very positive change in Indiana's tax policy. Special thanks go to Justin McAdam, policy director and general counsel, Office of Management and Budget, for taking the lead on this effort and shepherding it through.

Business Personal Property Tax Exemption – SB 233

In 2015, the Chamber advocated strongly and successfully for a "de minimus" exemption for small business taxpayers that had been required to pay the business personal property tax on a nominal volume of property. These businesses were burdened with significant costs in preparing returns even though they would only owe a very small amount in taxes. The threshold for triggering who qualifies for this "de minimus" exemption was set at $20,000, based on the purchase price of the property.

If you paid less than $20,000 for all the tangible property/equipment for your business, you were exempt and did not have to prepare a return or pay any tax. This was a great step in alleviating small businesses from the compliance cost of preparing a return when those costs exceeded the tax owed. The only problem was there turned out to be a lot of people on the cusp of that $20,000 threshold who were still paying as much to their accountant as they were in tax. There came a recognition that the threshold could and should be raised in order to better accomplish the original objective of the initial legislation.

Senate Bill 233, authored by Sen. Aaron Freeman (R-Indianapolis), provided the answer. The Chamber promoted the measure, which now doubles the exemption, raising the threshold to $40,000. This is a meaningful adjustment – one that eliminates some 27,000 returns and brings thousands more small businesses under the exemption, saving them each hundreds of dollars in compliance costs. And since the average tax liability of these newly qualifying businesses was only about $145, the legislation causes no substantial loss in local tax revenue.

Marketplace Facilitators – SB 322 and HB 1352 (Passed in HB 1001)

Last year the U.S. Supreme Court issued a long-anticipated decision reversing a 1996 decision that prevented states from requiring online retailers to collect the state's sales tax. The 2018 Wayfair decision cleared the way for states to pass laws that placed the obligation on remote sellers to collect sales tax when they sell their wares online. Indiana already had such a law in place, but like all the state's that were set up to place the obligation on the sellers to collect it, revenue officials realized that in order to achieve a reasonable level of compliance, they needed to place the collection obligation on the Amazons, Etsys and Wayfairs of the internet, aka the "marketplace facilitators" whose platforms actually bring the buyers and sellers together.

It is via these platforms that the transactions actually occur. It only makes practical sense to have the sales tax collected at the point of

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sale (just like you do at brick-and-mortar stores), when you click to pay. Otherwise, DOR would have faced the daunting and no doubt largely unsuccessful task of trying to collect from thousands of independent remote sellers.

Provisions placing the collection obligation on the market facilitators were originally passed in SB 322 and HB 1352, but were ultimately included in the budget bill, HB 1001. And that is a fitting place for them since it is expected that this more efficient means for newly authorized collections will produce around $100 million next year, a number that will certainly continue to grow as internet sales continue to take over the retail market.

The Chamber supported this very practical legislation but recognized that it needed to be carefully crafted to be fair to all the affected parties and avoid inadvertently encompassing online entities that aren't really engaged in a retail transactions. DOR was very accommodating in refining the language to accomplish these goals, with special acknowledgement to policy director Chris Russell.

Big Box Assessment – SB 623

An issue that has persisted for several years and remains unresolved is how is how to fairly assess the "big box" retail stores for property tax purposes. County officials complain that these properties are taking advantage of our system because it allows vacant stores to be used as comparable sales in appraisals to assess the value of a newly built, occupied big box store. The problem is how they want to remedy the disputes.

Their answers would ignore accepted appraisal principles and dictate an assessment method that would take the assessments to the opposite end of the spectrum. This would result in an assessment that unfairly reflects the value, establishing an exaggerated assessment that is tied to aspects of the business that are unique to the business that operates the property, as opposed to the value of the real estate itself. Property tax assessments must be based on the value of the building and land, not the value of the business operating in the building.

The Chamber acknowledges that there is a need to assure that assessments are not based on the sale price of properties that are not truly comparable from an appraisal standpoint. But we are equally concerned about maintaining a system that treats all types of properties equitably. Finding the right methodology to assure a proper middle ground on this issue has been elusive thus far. Legislation was passed in 2015, then deemed unworkable and repealed in 2016. The replacement legislation has not yet been properly tested in the context of appeals challenged on the basis that the comparable sales do not meet the "market segmentation" test.

This year, SB 623 was designed to negate market segmentation and essentially replace it with what was first passed in 2015 and then repealed (for good reason) in 2016. In other words, it would have taken us full circle, back to where we were four years ago. The Chamber opposed this legislation because (a) it was seriously flawed and (b) any fix to the fix is premature, until the legal/appeal system has had an opportunity to interpret the market segmentation legislation. Our viewpoints went largely ignored by the Senate, where the bill passed easily, but our concerns were recognized later by the fact that it did not receive a hearing in the House. A big thank you goes to Sen. Brian Buchanan (R-Lebanon) and Rep. Todd Huston (R-Fishers) for listening and understanding our apprehension. Though this bill died an appropriate death, the underlying issues remain and, at some point, have to be dealt with.

DOR Initiatives – SB 565 (and one provision in HB 1001)

As introduced, SB 565 contained the DOR's wish list of statutory changes sought to help it better conduct its administrative functions – a good and admirable goal. The only problem is that the bill included a couple of troubling pieces. One had to do with recordkeeping requirements – the effect of which unnecessarily restricted a taxpayer's rights in submitting evidence when attempting to make their case in the context of a tax protest.

Another provision would have unnecessarily limited the return of interest to a taxpayer who overpays and retains a refund. To the department's great credit, it spent a good deal of time and effort to work through these issues with representatives of the Chamber. Our representative and DOR officials had very divergent opinions on these issues. And it took a few lengthy meetings and lots of communication, but we found resolutions. The recordkeeping provision was changed to essentially incorporate federal standards and case law. The interest provision was deleted.

The Chamber appreciates DOR's willingness to work through those disagreements and believes that the thorough discussions led us all to a better understanding of our respective concerns. Once the contentious points were resolved, the bill ended up with what the Chamber sees as mostly innocuous provisions.

AN IMPORTANT NOTE: The above-referenced discussions with DOR also involved consideration of language concerning the research expense credit that was introduced by the department and later included in the budget bill (HB 1001). That language will require taxpayers who claim a state research credit, but not a federal research credit, to disclose and explain that fact on their state return. The department is seeking to learn more about these circumstances, but the language led to a broader discussion as to what degree of scrutiny need be applied to a state credit review when the taxpayer did, rather than did not, claim a federal credit.

If the Internal Revenue Service approves the federal credit, shouldn't the department accept that as controlling? A healthy understanding was reached between DOR and the business community that will be documented in an information bulletin to be issued by the department this interim. The Chamber is very optimistic that this bulletin will provide important and beneficial clarification to the standards to be applied by DOR in future research credit reviews.

Special thanks go to the entire DOR team (Ross Teare, legislative director, for being the critical liaison, and all department personnel who participated) for their cooperative nature; the Chamber Tax Committee work group: Donna Niesen of Katz Sapper, Mark Richards of Ice Miller and Randy Kaltenmark of Barnes & Thornburg for their time and expertise; and to Andrew Berger of the Indiana Manufacturers Association for his steadfast allegiance and assistance in forwarding our shared positions on these matters.

RV Sales – SB 131

For several years, recreational vehicle (RV) dealerships in Indiana have been on the decline, in part due to the complications that non-resident buyers face when they take their new RV home to license it in their home state. It has to do with sales tax. First, nobody wants to pay a 7% Indiana sales tax when their home state tax is only 6% or less. This situation is typically avoided if Indiana has reciprocal agreements with other states to only collect the amount of the resident's home state. But there are nine states that we have no reciprocal agreement with.

And there is another issue related to how a non-resident proves they paid the Indiana sales tax and gets a credit for that payment in their home state. The fiscal leaders have been trying to rectify this situation for several years through various means. This year, with SB 131, authored by Sen. Blake Doriot (R-Syracuse), they entertained a couple options. The bill passed the Senate and the House in different forms. Unfortunately, no final agreement was found acceptable to all involved and the bill died in conference committee, frustrating the proponents of a fix, including the Chamber, which has supported all efforts to find a reasonable manner for addressing the problem. We appreciate the dedication of Sen. Doriot and perhaps something can finally be figured out by next year.