

Significant Developments in Indiana Taxation

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I. INTRODUCTION

The rapidly emerging role of the new Indiana Tax Court and Indiana's stance as to the taxability of the foreign source income of United States domestic companies again shared the limelight as significant developments in Indiana taxation during the survey period. However, closely following the prominence of these two significant state tax concerns has been the administrative establishment of the Great Lakes Interstate Sales Compact by the Indiana Revenue Department. A five-state reciprocal tax audit program, the Great Lakes Interstate Sales Compact will enable the Indiana Revenue Department to obtain from the states of Illinois, Michigan, Minnesota and Ohio tax audit information regarding possible, as well as confirmed, Indiana taxpayers. It appears that the proposed audit program will in turn require Indiana auditors to seek during their audits of Indiana taxpayers certain kinds of tax data that, while not relevant for Indiana tax purposes, could demonstrate that the taxpayer under audit also has a tax liability in any one of the other four Compact states. While commendable in its objective to shut down state tax evasion by taxpayers, particularly nonresident taxpayers that are either not reporting or are underreporting state tax liabilities to any of the members of the five-state reciprocal audit program, there is a real question whether Indiana's participation, if carried to the fullest extent apparently contemplated, would exceed the Department's statutory audit powers.

A major setback for the Revenue Department occurred during the survey period when the court of appeals in *Indiana Department of State Revenue v. Best Ever Companies, Inc.*,¹ struck down a gross income tax regulation that the Revenue Department had promulgated to curtail the availability to wholesale grocers of the "gross earnings" basis for reporting gross income tax liability. *Best Ever* will also be significant in the future as it represents once again a judicial admonition to the

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¹495 N.E.2d 785 (Ind. Ct. App. 1986).

state's tax agencies that their "powers are strictly limited to [their] authorizing statute."²

II. THE EMERGING ROLE OF THE INDIANA TAX COURT

Since its opening day in July 1986, the Indiana Tax Court has already proved itself to be an extremely capable and energetic court, resolved to examining tax issues thoroughly and rendering decisions with dispatch. In its inaugural term, the tax court issued over 20 opinions which give tax practitioners substantial direction on a broad range of Indiana tax issues.

From its early decisions, it is clear that the court perceives that it possesses broad jurisdiction over state tax matters and, very significantly, it also appears that the court may be positing its judicial role as a co-equal or near co-equal of the court of appeals. Admittedly, this latter observation may be premature and unwarranted. It is true that the tax court was statutorily established as "[a]n appellate court,"³ but it is also true that the court of appeals is a constitutionally established court.⁴ Therefore, the tax court, while denominated an "appellate court," may on its own—as it continues to develop its view of its proper jurisprudential role—assume a deferential position to the court of appeals and to the decisions of that court. Nevertheless, until this uncertainty as to the relative roles of the tax court and court of appeals is cleared up, the precedential value of existing court of appeals decisions may be clouded.⁵

A. *Perfecting an Appeal From the State Tax Board—The Tax Court Rejects the Margrat Decision*

In *LeSea Broadcasting Corp. v. State Board of Tax Commissioners*,⁶ the tax court, declining to follow a 1982 court of appeals decision, upheld the applicability of Trial Rule 5(E) to the filing of the notice of appeal with the State Tax Board that is required by Indiana Code section 6-1.1-15-5. In doing so, the tax court affirmed its support for the view that the Trial Rules should be applied in resolving ambiguities

²*Id.* at 787.

³IND. CODE § 33-3-5-1 (Supp. 1987).

⁴IND. CONST. art. VII, § 6.

⁵Note that appeals from tax court decisions are to be lodged directly with the supreme court and thus the court of appeals has no appellate jurisdiction as to tax court rulings. *State Bd. of Tax Comm'rs v. Fraternal Order of Eagles Lodge No. 255*, No. 80505-8703-TA-349 (Ind. Apr. 21, 1987) (order instructing on proper procedure in appealing tax court decisions). See also IND. CODE § 33-3-5-15 (Supp. 1987) (authorizing appeal of tax court decisions to the supreme court).

⁶512 N.E.2d 506 (Ind. T.C. 1987).

in the administrative procedures set forth in the tax laws. On August 18, 1987, the Supreme Court of Indiana sustained the tax court's decision, stating that it was in "total agreement with Judge Fisher's observation in his order" and that "Judge Fisher's order is therefore approved and adopted in its entirety for the guidance of the bench and the Bar and administrative offices of this state."⁷

In *LeSea*, the operator of religious television stations was denied a property tax exemption claim by the State Board of Tax Commissioners. Notice of that denial was given by the Board on November 7, 1986. As required by the statutory procedure governing court appeals from decisions of the State Tax Board,⁸ *LeSea*, within 45 days of being notified of the Board's decision, filed a complaint in the tax court and served the Attorney General with a copy of that complaint. However, Code section 6-1.1-15-5(c)(1) *also* requires that the taxpayer "file a written notice with the state board of tax commissioners informing the board of his intention to appeal" within 45 days after the Board gives the taxpayer notice of its final determination.⁹ *LeSea* did not deliver its notice of appeal to the Board on December 22 (the 45th day following the date of the Board's notice denying its exemption claim) but, instead it deposited its notice of appeal in the mail to the State Tax Board on December 22 (again, the 45th day). The State Tax Board did not actually receive the notice from *LeSea* until December 24.

The State Tax Board sought to dismiss *LeSea's* complaint for lack of jurisdiction because *LeSea* had failed to physically deliver the required notice to the State Tax Board before the expiration of the 45th day. The Board relied upon a number of cases discussing the requirements of section 6-1.1-15-5 and, in particular, the court of appeals' 1982 decision in *Margrat, Inc., v. Indiana State Board of Tax Commissioners*.¹⁰ *Margrat* held that, under section 6-1.1-15-5, which at that time required a notice of appeal to be filed with the State Tax Board within 30 days of a State Tax Board's determination, the mailing of such notice by the taxpayer on the 30th day was not satisfactory and that in the absence of a physical delivery of the required notice to the Board before the expiration of the appeal period, the court was without jurisdiction.¹¹ The court of appeals rejected the taxpayer's argument that, under the Indiana Rules of Trial Procedure,¹² his notice of appeal to the Tax

⁷State Bd. of Tax Comm'rs. v. *LeSea Broadcasting Corp.*, 511 N.E.2d 1009 (Ind. 1987).

⁸IND. CODE § 6-1.1-15-5 (Supp. 1987).

⁹IND. CODE § 6-1.1-15-5(c)(1),(d)(1) (Supp. 1987).

¹⁰448 N.E.2d 684 (Ind. Ct. App. 1982).

¹¹*Id.* at 685-86.

¹²Trial Rule 5(E) of the Indiana Rules of Trial Procedure allows filing by mail. IND. R. TR. P. 5(E).

Board, which had in fact been mailed to the Board on the 30th day, had been timely filed.

The tax court did not dispute that *Margrat* was on point with the issues raised in the *LeSea* case. Instead, the tax court found the *Margrat* decision unacceptable. The court stated early in its opinion that "the legislature has made significant changes in the tax laws since *Margrat*, chief among those being the creation of the Indiana Tax Court. In view of these changes, a reexamination of the aforementioned authorities is called for."¹³ The court then thoroughly discussed those court of appeals and supreme court decisions addressing the applicability of rules of trial procedure to administrative proceedings beginning with the Indiana Court of Appeals decision in *Weatherhead Co. v. State Board of Tax Commissioners*.¹⁴ A 1972 decision, *Weatherhead* held that under section 6-1.1-15-5's predecessor which provided in part that an appeal could be made by filing a written notice with the tax board, the term "filing" meant the delivery of the paper or document in question to the proper office and its paper or document in question to the proper officer and its receipt by him.¹⁵ In *Weatherhead*, the court of appeals also rejected the taxpayer's argument that the trial rules were applicable and thereunder filing by mail was permissible.

Two years later, the supreme court addressed a similar issue in *Ball Stores, Inc. v. State Board of Tax Commissioners*.¹⁶ The issue in the case was how the 30-day period in section 6-1.1-15-5's predecessor was to be computed. In that case, the 30th day had fallen on a Saturday. The taxpayer had mailed the notice to the Board but it was not actually received until the Monday following the Saturday which was the 30th day. The supreme court held that Trial Rule 6(A), which provides that in computing time, if the last day is a Saturday, Sunday or holiday, the period runs on the next day that is not a Saturday, Sunday or holiday, was applicable to appeals from the State Tax Board and that because the taxpayer's notice was received on the Monday, it was timely filed.¹⁷ The supreme court in *Ball Stores* distinguished *Weatherhead* on the basis that, in *Weatherhead*, the last day of the 30-day period was a Thursday and "the taxpayer was not prohibited from giving notice of appeal on . . . the final day of the statutory time period."¹⁸

In view of the supreme court's 1974 decision in *Ball Stores*, wherein the court had held that the trial rules were applicable in determining

¹³*LeSea*, 512 N.E.2d at 506.

¹⁴151 Ind. App. 680, 281 N.E.2d 547 (1972).

¹⁵*Id.* at 687, 281 N.E.2d at 551.

¹⁶262 Ind. 386, 316 N.E.2d 674 (1974).

¹⁷*Id.* at 393, 316 N.E.2d at 677-78.

¹⁸*Id.* at 392, 316 N.E.2d at 677.

how the time period in Indiana Code section 6-1.1-15-5 should be computed, it certainly appeared that the taxpayer in *Margrat* had a strong argument in 1982 when the court of appeals considered in that case whether the trial rules were also applicable in determining what is a "filing" for the purpose of section 6-1.1-15-5, the statutory notice of appeal requirement. Despite the guidance provided by *Ball Stores*, the court of appeals in *Margrat* was not persuaded. The court refused to "expand upon" the *Ball Stores* decision and supported that conclusion by reference to its statement in *Wilks v. First National Bank of Mishawaka*,¹⁹ where it had said:

Ball Stores, Inc. is not to be interpreted beyond its express language that TR. 6(A) will only come into play if a statute of limitations governing administrative proceedings is silent as to the method of computation of time; no other Trial Rule, including TR. 5(E) allowing filings by mail, has yet been held by the Indiana Supreme Court to be applicable to administrative proceedings.²⁰

In short, in *Margrat*, the court of appeals concluded that *Ball Stores* addressed a different issue from that presented to it and that *Weatherhead* was dispositive of the issue presented to it.

LeSea, however, was successful in convincing the new tax court to expand upon *Ball Stores'* teachings. In fact, the tax court expressly observed that "the [narrow] interpretation given to the *Ball Stores* case by the Court of Appeals" in *Margrat* "has not been universally accepted."²¹ Citing Professor Harvey's criticism of the *Margrat* decision (which Professor Harvey declared to be "devoid of justice"),²² the tax court declined to follow it and concluded that, since section 6-1.1 is silent on the method of filing, Trial Rule 5(E) would apply.²³ The court observed that most attorneys would consider the mailing of a notice to be the equivalent of filing. It further noted that the law creating the Tax Court provides for a small claims docket and that to require physical delivery of a notice of appeal to the State Tax Board by the 45th day following the Board's denial would place a highly technical requirement on small claimants, contrary to the intent of the legislature in establishing a small claims docket in the first place.²⁴ By the supreme court's prompt

¹⁹164 Ind. App. 156, 326 N.E.2d 827 (1975).

²⁰*Id.* at 162, 326 N.E.2d at 831 (citations and footnote omitted).

²¹*LeSea Broadcasting Corp. v. State Bd. of Tax Comm'rs*, 512 N.E.2d 506, 508 (Ind. T.C. 1987).

²²W. HARVEY, INDIANA PRACTICE § 6.2, at 336 (2d ed. 1987).

²³512 N.E.2d at 509.

²⁴*Id.*

affirmation of the *LeSea* decision, taxpayers have been given definitive guidance on the meaning of "filing" under section 6-1.1-15-5. However, the *LeSea* decision certainly does not resolve the many other procedural questions facing tax counsel practicing before or appealing from the State Tax Board. For example, does the three extra day rule in Trial Rule 6(E)²⁵ apply because the State Tax Board gives the taxpayer notice of its final determination by mail or does the mailing of a notice to the taxpayer start the 45-day appeal period running?

The *Wilks-Margrat* view, which resulted in the Trial Rules being applicable on a piecemeal basis (i.e., Rule 6(A) applies; Rule 5(E) does not) gave little comfort to a taxpayer trying to perfect a tax case appeal. Conversely, it is questionable whether the *Ball Stores-LeSea* position will do any better. Neither *Ball Stores* nor *LeSea* makes the Trial Rules applicable to all proceedings before administrative agencies. Instead they recognize that there are "a variety of instances (where) the Trial Rules do apply to parts of law practice before the Indiana Administrative agencies."²⁶ But if it is still the job of the courts to "make the distinctions" and "develop the applications of the Trial Rules,"²⁷ taxpayers will remain in a somewhat precarious position, being forced to wait for the tax court or supreme court to provide case-by-case direction on when the Trial Rules are applicable and when they are not. It required three cases on the meaning of "filing" under section 6-1.1-15-5 to arrive at an answer.

In sum, the taxpayer and his counsel now know that with respect to the required notice of the taxpayer's appeal, the mailing of that notice to the State Tax Board on or before the 45th day will satisfy section 6-1.1-15-5 and that if the 45th day falls on a Saturday, Sunday or holiday, the next succeeding business day will be the last day to file that notice. But, with respect to *all other procedures*, the taxpayer and his counsel are advised to be extremely conservative, giving the Indiana state tax agencies no opportunity to object. Finally, as preliminarily discussed, the tax court's rejection in *LeSea* of the court of appeal's holding in *Margrat* may be a strong hint that the tax court will not feel circumscribed by existing court of appeals' opinions with which it disagrees. Whether this hint becomes a reality is at this moment conjectural, however, since the court referenced changed circumstances in rejecting *Margrat*.²⁸

²⁵See IND. R. TR. P. 6(E).

²⁶1 W. HARVEY, INDIANA PRACTICE § 5.3, at 320 (2d ed. 1987).

²⁷*Id.*

²⁸512 N.E.2d at 506.

B. Appealing a Denial of a Property Tax Refund Claim—The Tax Court Claims Exclusive Jurisdiction

The tax court also dealt with an issue raised in last year's Survey, namely, does the tax court have jurisdiction over appeals from the denial of a property tax refund claim by a county board of tax commissioners? The tax court concluded in *Herff Jones, Inc. v. State Board of Tax Commissioners*²⁹ that it does have exclusive jurisdiction over such appeals.

To understand the *Herff Jones* case, one must go back to the 1985 Act creating the tax court³⁰ and to the general property tax laws.³¹ Indiana Code section 33-3-5-2, as added by the Tax Court Act, provides "[T]he tax court has exclusive jurisdiction over any case that arises under the tax laws of this state and that is an initial appeal of a final determination made by" the Indiana Department of Revenue or the Indiana State Board of Tax Commissioners.³² While the Act describes the court as a "court of limited jurisdiction" and yet also as a court that has "exclusive jurisdiction over any case that arises under the tax laws of this state," the court's so-called "exclusive jurisdiction" is expressly limited to appeals of a "final determination" of the State Tax Board.³³ Consequently, the pivotal jurisdictional question is whether the matter at issue represents a "final determination" by the State Tax Board. To answer that question, one must understand the nature of the remedies afforded property taxpayers under the general property tax laws.

Under the general property tax laws, a property taxpayer actually has several statutory remedies for challenging property tax liability. For example, a taxpayer may employ an assessment appeal procedure which permits a taxpayer to challenge the assessed valuation of his property.³⁴ Also, a correction of errors procedure permits a taxpayer to petition either local assessing officials or the State Tax Board to correct certain kinds of errors that affect the validity of the taxpayer's assessed tax liability.³⁵ Finally, a tax refund procedure exists that permits a taxpayer who has paid an erroneous property tax to file a refund claim to obtain a refund of the wrongful tax.³⁶

The jurisdictional question in *Herff Jones* was complicated by the fact that the taxpayer, at the insistence of a county auditor, had filed

²⁹512 N.E.2d 485 (Ind. T.C. 1987).

³⁰Tax Court Act of 1985, Pub. L. No. 291-1985, 1985 Ind. Acts 2278.

³¹IND. CODE § 6-1.1 (Supp. 1987).

³²IND. CODE § 33-3-5-2 (Supp. 1987).

³³IND. CODE § 33-3-5-2 (Supp. 1987).

³⁴IND. CODE § 6-1.1-15-1 (Supp. 1987).

³⁵IND. CODE § 6-1.1-15-12 (Supp. 1987).

³⁶IND. CODE § 6-1.1-26-1 (Supp. 1987).

both a petition to correct errors and a refund claim. Unfortunately, these two statutory procedures are separate and independent procedures that culminate in a "final determination" by different tax officials and should not, therefore, have been combined. For example, under the correction of errors procedure, a taxpayer may petition a county auditor to correct the taxpayer's tax duplicate (the tax bill) if the auditor finds that:

- (1) The description of the real property was in error.
- (2) The assessment was against the wrong person.
- (3) Taxes on the same property were charged more than one (1) time in the same year.
- (4) There was a mathematical error in computing the taxes or penalties on the taxes.
- (5) There was an error in carrying delinquent taxes forward from one (1) tax duplicate to another.
- (6) The taxes, as a matter of law, were illegal.
- (7) There was a mathematical error in computing an assessment.
- (8) Through an error of omission by any state or county officer the taxpayer was not given credit for an exemption or deduction permitted by law.³⁷

A taxpayer who desires a county auditor to take such action files a Form 133, a Petition for Correction of Errors. If the alleged error is (6), (7) or (8) above, the auditor may not make a correction without first obtaining State Tax Board approval if the challenged tax is based on an assessment determined by the State Tax Board, or the requested correction is not approved by two of the following officials: the township assessor, the county auditor, the county treasurer or the county assessor.³⁸

As previously observed, *independent* of the correction of errors procedure under Indiana Code section 6-1.1-15, a taxpayer may file a claim under Indiana Code section 6-1.1-26-1 for a refund of all or a portion of property taxes paid. The claim is made on a Form 17-T. Indiana Code section 6-1.1-26-1 establishes the following three grounds upon which a refund claim may be based:

- (i) Taxes on the same property have been assessed and paid more than once for the same year;
- (ii) The taxes, as a matter of law, were illegal; or
- (iii) There was a mathematical error either in the computation

³⁷IND. CODE § 6-1.1-15-12(a) (Supp. 1987).

³⁸IND. CODE § 6-1.1-15-12(d) (Supp. 1987).

of the assessment upon which the taxes were based or in the computation of the taxes.³⁹

While Indiana Code section 6-1.1-26-4 does provide that the board of commissioners shall disallow a refund claim if the claim has been disapproved by the State Tax Board, it also further expressly provides a refund claim shall be submitted to “the *county board of commissioners for final review*,”⁴⁰ thus vesting the *county board of commissioners* (not the State Tax Board) with the authority to take the final administrative step in the allowance or disallowance of a property tax refund claim.

Against this statutory background, Herff Jones filed a Petition for Correction of Errors with the Marion County Auditor. In the first printed line of the Form 133, wherein the claimant “hereby petitions for correction of an error,” Herff Jones inserted the words “and a refund (per attached form 17-T).”⁴¹ The Petition was disapproved by the township assessor, county assessor, county auditor and county treasurer and thus was sent to the State Tax Board for a final determination. The State Tax Board denied the Petition for Correction of Errors, adding in the last sentence that it also disapproved the taxpayer’s claim for refund.⁴² Because the plaintiff appealed in both the county circuit court⁴³ and the Indiana Tax Court, the State filed a petition for the tax court to exert its exclusive jurisdiction in the case. The court’s disposition of that motion set the stage for the tax court’s determination that it has exclusive jurisdiction of the denial of property tax refund claims.

In deciding the State’s motion that the court exert its exclusive jurisdiction, the first question considered by the court was whether the State Tax Board had acted under section 6-1.1-15-12 to deny a Petition for Correction of Errors *or* under section 6-1.1-26-4 to deny a claim for refund. Based upon the record in this case, the court concluded that the action of the State Tax Board was a denial of a Petition for Correction of Errors under Indiana Code 6-1.1-15-12 and that it was unquestionable that the tax court had exclusive jurisdiction over this matter as an appeal from a final determination of the State Tax Board.⁴⁴

Two observations should be made regarding this part of the *Herff Jones* decision. First, there are instances where a Petition for Correction of Errors would not be reviewed or acted upon by the State Tax Board.

³⁹IND. CODE § 6-1.1-26-1 (Supp. 1987).

⁴⁰IND. CODE § 6-1.1-26-4 (1982) (emphasis added).

⁴¹*Herff Jones, Inc. v. State Bd. of Tax Comm’rs*, 512 N.E.2d 485, 488 (Ind. T.C. 1987).

⁴²*Id.*

⁴³A denial of a claim for refund may be appealed to the county circuit court as will be discussed below. IND. CODE § 6-1.1-26-4 (1982).

⁴⁴*Herff Jones*, 512 N.E.2d at 489.

Reasons (1)-(5) do not require State Tax Board approval or intervention.⁴⁵ Technically speaking, the tax court would not have jurisdiction over these claims brought under section 6-1.1-15-12.⁴⁶ Second, in reaching its decision on this point, the court stated that "indeed it would seem that a claim for refund would not even lie until the error was corrected" under section 6-1.1-26-4.⁴⁷ If, by this, the court is saying that a correction of errors is required before a refund can be made under section 6-1.1-26-4, it is submitted that this interpretation is faulty. The better interpretation of these two statutory provisions is that the correction of errors procedure under Indiana Code section 6-1.1-15 is totally independent from the refund procedure under section 6-1.1-26. Both of these procedures are creatures of the 1919 Property Tax Code. As first enacted in 1919, the correction of errors procedure actually contemplated that it would be the county auditor—not the taxpayer—who would initiate a correction of errors⁴⁸ and indeed the current statutory correction of errors procedure makes no provision for a taxpayer to initiate a correction of errors.⁴⁹ Conversely, the 1919 refund procedure expressly provided that the refund procedure was to be initiated by the taxpayer, by presenting to the Board of Commissioners proof that the taxpayer had paid wrongfully assessed tax.⁵⁰

In sum, dating back to their original enactment in 1919, these two procedures have performed different functions and have been and are today independent remedies for the wrongful assessment of tax. Indeed, the independent correction of errors procedure was separately recodified in the Property Assessment Act of 1961⁵¹ and the unrelated refund procedure was later recodified in the Property Tax Collection Act of 1963.⁵² It is accordingly submitted that the tax court's apparent suggestion that the correction of errors procedure and the refund procedure to review the State Tax Board's "final determination" to deny the taxpayer's

⁴⁵See *supra* text accompanying notes 37-38.

⁴⁶See IND. CODE § 33-3-5-2 (Supp. 1987).

⁴⁷*Herff Jones*, 512 N.E.2d at 489.

⁴⁸Property Tax Code of 1919, ch. 59, § 209, 1919 Ind. Acts (current version at IND. CODE § 6-1.1-15-12 (Supp. 1987)).

⁴⁹IND. CODE § 6-1.1-15-12 (Supp. 1987).

⁵⁰Property Tax Code of 1919, ch. 59, §§ 332-34, 1919 Ind. Acts (current version at IND. CODE § 6-1.1-26 (1982 & Supp. 1987)).

⁵¹Property Assessment Act of 1961, ch. 319, § 1208, 1961 Ind. Acts 893 (current version at IND. CODE § 6-1.1-15-12 (Supp. 1987)).

⁵²Property Tax Collection Act of 1963, ch. 280, §§ 801-03, 1963 Ind. Acts 280 (current version at IND. CODE § 6-1.1-26 (1982 & Supp. 1987)).

petition to correct errors, the court went further and assumed *that even if this had been a denial of a refund claim under section 6-1.1-26-4*, the tax court would have had exclusive jurisdiction.⁵³ This conclusion is clearly debatable.

First, it must be observed that section 6-1.1-26-4 provides that if the county board disallows a claim, the claimant may appeal that decision to the county circuit court.⁵⁴ The Act which created the tax court and expressly substituted the "tax court" as the court to which certain statutory appeals on tax matters were to be taken, did not amend section 6-1.1-26-4 to substitute the "tax court" for the "county circuit court."⁵⁵ Neither did the 1986 or 1987 legislature see fit to so amend section 6-1.1-26-4. Thus, because a decision on a claim for refund is not a final determination by the State Tax Board,⁵⁶ and because section 6-1.1-26-4 expressly states that denials of refund claims may be appealed to the county circuit court, it appears that the tax court does not have jurisdiction over property tax refund claim denials.

Interestingly, the court did recognize that House Bill 1861 (the act which established the tax court) initially amended Indiana Code section 6-1.1-26-4 to substitute the tax court for the circuit court and that this amendment was deleted upon the recommendation of the Committee on Courts and the Criminal Code.⁵⁷ However, the court rejected the taxpayer's argument that this legislative history required the court to conclude that all appeals from refund claim denials should be taken to the county circuit court. Instead, the tax court made an effort to reconcile the wording of section 6-1.1-26-4 with the "assumption that decisions made by the State Board on the refund claims would be reviewable by the Tax Court."⁵⁸ The court reconciled these two contradictory positions by concluding that "the Legislature understood statute 26-4(c) to address only those appeals in which the county board has discretion to allow or disallow the claim" and that the circuit court retains jurisdiction of appeals when the disagreement is of a purely local nature, "being between the taxpayer and his local county board, without any decisive input from the State Board."⁵⁹ The court then provided the following two examples:

For example, where the State Board approves a refund claim under statute 26-2, but the county board ultimately disallows

⁵³Herff Jones, Inc. v. State Bd. of Tax Comm'rs., 512 N.E.2d 485, 491 (Ind. T.C. 1987).

⁵⁴IND. CODE § 6-1.1-26-4 (1982).

⁵⁵Tax Court Act of 1985, Pub. L. No. 291-1985, 1985 Ind. Acts 2278.

⁵⁶See *supra* note 40 and accompanying text.

⁵⁷512 N.E.2d at 490.

⁵⁸*Id.*

⁵⁹*Id.*

the claim under statute 26-4(c), the county board's decision is discretionary and therefore appealable to the circuit court under this interpretation of statute 26-4(c), even though the State Board has been involved in the decision process and was responsible for the disputed assessment in the first place. However, it is not the State Board with whom the taxpayer disagrees but the county board so it makes sense that the circuit court would hear the appeal. The same kind of situation would occur where the county board initially disapproves a claim under statute 26-3(a), the State Board reviews and approves the claim on appeal under statute 26-3(b), and then the county board opts to disallow the claim on final review under statute 26-4(c). Once again, despite the State Board's involvement, the real disagreement is between the local county board and the taxpayer.⁶⁰

The court also opted to apply the fundamental rule of statutory construction that "if a statute is susceptible to more than one interpretation, then the court may consider the consequences of a particular construction."⁶¹ What obviously bothered the court most was that, if the tax court did not have exclusive jurisdiction over appeals from refund claims, all appeals involving refund claims under section 6-1.1-26-4 are within the jurisdiction of the county circuit courts. "A panoply of significant tax questions would be subject to resolution by ninety-one separate circuit courts in the state."⁶² The court concluded that it was "difficult to believe that this result was intended when House Bill 1861 was amended to delete references to the tax court under statute 26-4(c), since consolidation of such cases was clearly the purpose of the act."⁶³

It is surmised that a strong influence on the court's thinking was that to find otherwise would permit a taxpayer to completely bypass the tax court by paying the tax and appealing under section 6-1.1-26-4 to the circuit court. The court was obviously concerned that such forum shopping would undermine the objective of having the tax court have exclusive authority to hear and resolve all tax matters. It is respectfully submitted that while the court's support of that objective is most laudable, it required the court to turn its back completely on the clear and unambiguous language of Indiana Code section 6-1.1-26-4 to reach the conclusion that the tax court, not the circuit court, would have exclusive jurisdiction over the denial of a refund claim. In these authors' opinion, the better legal argument in *Herff Jones* as to the jurisdiction of the

⁶⁰*Id.*

⁶¹*Id.* at 490-91.

⁶²*Id.* at 491.

⁶³*Id.*

tax court in refund cases was espoused by the taxpayer who simply relied upon the clear directive of section 6-1.1-26-4 that the appeal should be brought in the circuit court.

The authors understand that *Herff Jones* has been settled and that the tax court's decision will not be appealed. If the authors are correct in their belief that a decision to deny a refund claim is not a final determination of the State Tax Board so as to vest the tax court with jurisdiction, taxpayers are faced with a real dilemma as to how and where to file their court appeals of refund claim denials. It is suggested that the most appropriate remedy would be for the legislature to enact corrective legislation eliminating any doubt as to whether the tax court has jurisdiction over property tax refund denials. In the absence of such legislative clarification, taxpayers may be well advised to file duplicate actions in both the tax court and the local county court having venue jurisdiction.

C. *The Tax Court's Injunction Powers—Interpretation and Utilization*

The tax court is given the authority to enjoin the collection of tax pending the original tax appeal.⁶⁴ However, the tax court may enjoin the collection of tax only if it finds that *all* three of the following criteria are met:

- (1) The issues raised by the original tax appeal are substantial;
- (2) The petitioner has a reasonable opportunity to prevail in the original tax appeal; and
- (3) The equitable considerations favoring the enjoining of the collection of the tax outweigh the state's interests in collecting the tax pending the original tax appeal.⁶⁵

In this survey period, we were given several decisions that illustrate how the tax court is going to interpret and utilize its injunction powers.

In *R.H. Marlin v. Indiana Department of Revenue*,⁶⁶ the petitioner sought to enjoin the collection of Indiana special fuel (diesel) tax pending the appeal of an assessment of such tax. The Department introduced evidence that the petitioner had for Indiana Motor Carrier Fuel Tax purposes reported "0" miles traveled by vehicles subject to the Motor Carrier Fuel Tax, but that in fact diesel fuel had been used in vehicles traveling on the road (and thus was subject to the Motor Carrier Fuel Tax) during the period for which these reports were filed. The petitioner

⁶⁴IND. CODE § 33-3-5-11(c) (Supp. 1987).

⁶⁵*Id.*

⁶⁶512 N.E.2d 475 (Ind. T.C. 1986).

argued that it should be relieved from paying the special fuel tax until its appeal had been heard. The court, however, disagreed, stating:

For the Plaintiff to receive a preliminary injunction as prayed for, it has the burden of proving by a preponderance of the evidence that the injury to it would be certain and irreparable. That it has not done. The Plaintiff at best has shown that it will be a hardship for the tax to be paid or for the injunction not to be issued but this is not sufficient. Since the failure to pay the tax is not because the Plaintiff is unable to do so but "a matter of principle", the tax could be paid.⁶⁷

The court then went on to apply equity's "clean hands" doctrine and concluded that the petitioner in this instance did not come before the court with clean hands. The court said:

An action seeking a preliminary injunction is an action at equity in which the principles of equity apply. One of the principles which applies is "he who comes into equity must come with clean hands." This means that equity refuses to lend its aid in any matter to one seeking its active interposition, who has been guilty of unlawful or inequitable conduct in the matter with relation to which he seeks relief.⁶⁸

The court found that because the petitioner had reported zero miles of on-road travel for Motor Carrier Fuel Tax purposes when in fact it did have miles traveled on-road, the petitioner did not come before the court with clean hands and thus was not entitled to an injunction.⁶⁹

It should be observed that it is not clear from the decision whether the court was apprised that the special fuel tax⁷⁰ (the subject of the appeal) and the Motor Carrier Fuel Tax⁷¹ (the tax with respect to which the petitioner was shown to have misreported) are *entirely separate taxes* with separate reporting obligations, etc.. While the conclusion that the petitioner had "unclean hands" may have been justified in *Marlin* because both taxes (that being challenged and that with respect to which the petitioner had misreported) related to fuel consumption, it is certainly arguable that taxpayers should not be required to establish that with respect to other taxes (unrelated to the appeal) it has satisfied all reporting obligations. The court itself in *Marlin* said "equity refuses to lend its aid in any matter to one seeking its active interposition, who has been

⁶⁷*Id.*

⁶⁸*Id.*

⁶⁹*Id.* at 475-76.

⁷⁰IND. CODE § 6-6-2.1 (Supp. 1987).

⁷¹IND. CODE § 6-6-4.1 (Supp. 1987).

guilty of unlawful or inequitable conduct *in the matter with relation to which he seeks relief.*"⁷²

In *Faris Mailing, Inc. v. Indiana Department of State Revenue*,⁷³ the tax court declared that since the petitioner was not going to suffer irreparable harm if the injunction was not issued and since the petitioner did not have a reasonable opportunity to prevail on the merits, an injunction would not be issued. Faris Mailing sought an injunction against the collection of sales and use tax and gross income tax pending its appeal to the tax court. The court refused to accept the taxpayer's argument that it would suffer irreparable harm just because it had cash flow problems that made it difficult to pay the tax. The court observed that the taxpayer could borrow the funds necessary to pay the tax because its "ratio of current assets to current liabilities is favorable; the Petitioner is not carrying an overly large load of long-term debt; the assets appear to be more than sufficient to provide a basis for securing additional debt."⁷⁴ The court then concluded that the taxpayer's inability to pay the disputed taxes was due to its "own inaction" in not obtaining borrowed funds to meet its obligations.⁷⁵

Marlin and *Faris* are significant because "irreparable harm" is not one of the three criteria listed in Indiana Code section 33-3-5-11.⁷⁶ Although the parties to the *Faris* case said nothing about this point, the court itself raised it, noting that "[i]t has been suggested, at least, that a taxpayer has always had the ability to obtain an injunction where irreparable harm would ensue if the tax had to be paid in order to gain access to the courts and thus *additional* grounds for obtaining an injunction were given in IC 33-3-5-11."⁷⁷ The court went on to find that the taxpayer did not have a reasonable opportunity to prevail on the merits.⁷⁸ After *Faris*, one could conclude that if a taxpayer cannot prove irreparable harm, it may still be entitled to an injunction if it satisfies all three requirements under section 33-3-5-11. Conversely, the tax court also may be open to the argument that even if a taxpayer cannot meet the requirements of section 33-3-5-11, it may still be able to obtain an injunction where irreparable harm would "ensue if the tax had to be paid in order to gain access to the courts."⁷⁹ Tax counsel seeking an injunction should thus be prepared to argue both that their client will

⁷²*Marlin*, 512 N.E.2d at 475 (emphasis added).

⁷³512 N.E.2d 480 (Ind. T.C. 1987).

⁷⁴*Id.* at 482.

⁷⁵*Id.*

⁷⁶See *supra* text accompanying notes 64-65.

⁷⁷*Id.* (emphasis added).

⁷⁸*Faris*, 512 N.E.2d at 483-84.

⁷⁹*Id.* at 482.

suffer irreparable harm *and* that all three criteria of section 33-3-5-11 are met.

In *Video Tape Exchange Coop of America v. Indiana Department of State Revenue*,⁸⁰ the tax court issued an injunction after finding the taxpayer satisfied all three requirements of section 33-3-5-11. The issue in this case was whether Indiana sales tax was properly due on the rental of video tapes. The court found this to be a *substantial issue* with statewide impact, thus fulfilling the requirement of Indiana Code section 33-3-5-11(c)(1).⁸¹ The court also found that the equitable considerations favoring the enjoining of the collection of the tax outweighed the state's interest in collecting the tax. The court reached this conclusion in part because the petitioner had relied upon information received from the Department of Revenue in not collecting the tax, *and* the Department itself had refrained from taking steps to collect the tax from the petitioner.⁸² Thus, the requirement of section 33-3-5-11(c)(3) was fulfilled.⁸³

The court then devoted the rest of its opinion to the requirement of section 33-3-5-11(c)(2)⁸⁴ that the petitioner have a reasonable chance of success in its original tax appeal. The court defined the term "reasonable" as used in section 33-3-5-11(c)(2) as meaning "moderate," "tolerable," "rational," "honest" or "equitable."⁸⁵ The court then concluded that the issue in this case turned on the meaning of the word "broadcast" in Indiana Code section 6-2.5-4-10(c)(2) which exempts from sales tax the rental of video tapes by persons who broadcast the tape for home viewing or listening and that "the issue should be resolved in favor of the Petitioner."⁸⁶

III. GROSS EARNINGS TREATMENT—THE REVENUE DEPARTMENT'S DEFINITION OF A WHOLESALE GROCER IS HELD INVALID

In *Indiana Department of Revenue v. Best Ever Companies, Inc.*,⁸⁷ the Revenue Department's regulation defining a wholesale grocer as a taxpayer "engaged in the business of purchasing grocery stocks . . . from another for resale in substantively unchanged form to retail food establishments"⁸⁸ was struck down as being contrary to law and hence invalid. As a result, many taxpayers in Indiana may now want to reassess

⁸⁰512 N.E.2d 476 (Ind. T.C. 1986).

⁸¹*Id.* at 477.

⁸²*Id.*

⁸³See *supra* text accompanying note 65.

⁸⁴*Id.*

⁸⁵*Video Tape Exchange*, 512 N.E.2d at 477.

⁸⁶*Id.*

⁸⁷495 N.E.2d 785 (Ind. Ct. App. 1986).

⁸⁸IND. ADMIN. CODE tit. 45, r. 1-1-77 (1984).

whether they qualify for the more favorable wholesale grocer treatment under the Gross Income Tax Act.

The Indiana gross income tax is just that—a tax imposed upon the total gross receipts of the taxpayer without any deductions of any kind. Shortly after the enactment of the Gross Income Tax Act in 1933, it became apparent that it was particularly harsh on those businesses that operated on a very narrow margin, e.g., wholesale grocers, grain dealers, domestic casualty and fire insurance carriers, financial institutions, and brokers. As a result, the legislature enacted a series of special amendments to the Gross Income Tax Act that allowed some of these businesses to pay on what was called a gross earnings basis. In the case of a wholesale grocer, this meant that the tax base was its gross receipts *less* cost of goods sold and other related expenses. Specifically, the Gross Income Tax Act allows a wholesale grocer that is “engaged in the business of selling stocks of groceries” to calculate its taxes based on its gross earnings which “are derived from *wholesale sales* of stocks of groceries . . . to retail food establishments.”⁸⁹ “Wholesale sales” as defined in the statute include “sales of tangible personal property . . . for resale in the form in which it was purchased.”⁹⁰

In 1978, however, the Revenue Department adopted new gross income tax regulations which defined a “wholesale grocer” as a taxpayer who is “engaged in the business of purchasing grocery stocks . . . from another for resale in *substantively* unchanged form to retail food establishments.”⁹¹ Following a protest hearing, the Department of Revenue had issued a Letter of Findings concluding that Best Ever, a dairy operation, was not a wholesale grocer because it processed raw milk into homogenized milk, cottage cheese, ice cream, and half-and-half and, therefore, did not sell its product in “*substantially* unchanged form.”⁹² Best Ever filed an appeal. Although a good portion of the trial was devoted to whether the term “substantively unchanged form” as used in the regulation was the same as “substantially unchanged form,” as the Department had stated in its Letter of Findings, the court of appeals avoided that issue altogether by simply finding the regulation invalid.⁹³

The court found the Department’s regulation was inconsistent with the Gross Income Tax Act in two respects. First, it sought to require that the taxpayer claiming to be a wholesale grocer purchase grocery stocks (*i.e.*, finished grocery products). The court of appeals rejected this aspect of the regulation because the Gross Income Tax Act puts

⁸⁹IND. CODE § 6-2.1-1-4 (1982) (emphasis added).

⁹⁰IND. CODE § 6-2.1-2-1(c)(1)(A) (1982 & Supp. 1987).

⁹¹IND. ADMIN. CODE tit. 45, r. 1-1-77 (1984) (emphasis added).

⁹²495 N.E.2d at 786 (emphasis added).

⁹³*Id.* at 788.

no limitations on the wholesale grocer's purchases.⁹⁴ Second, the regulation sought to require the taxpayer, to be a wholesale grocer, to sell its goods in substantively unchanged form. Clearly, under the Act itself, *it is the wholesale grocer's customer, not the wholesale grocer*, that must resell the goods in the same form. The court said:

Under the pertinent provisions of the Act, a taxpayer that is engaged in the business of selling stocks of groceries may calculate its taxes based on its gross earnings derived from sales of stocks of groceries to a retail food establishment if the *retailer* purchased the grocery stocks for the purpose of reselling them in the form in which it purchased them. The Act thus looks to the identity and intentions of the *purchaser* at the moment of the sale to determine the character of the sale and, consequently, the method of calculating the taxpayer's gross income taxes. The Act says nothing about where or how the taxpayer acquired the grocery stocks or what it did with them prior to the sale to a retail food establishment.⁹⁵

In rejecting the Department's attempt to narrowly define the term "wholesale grocer" by regulation, the court of appeals reminded the Department again that it is an administrative agency and, as such, "[i]ts powers are strictly limited to its authorizing statute"⁹⁶ and "*it may not by its rules and regulations add to or detract from the law as enacted.*"⁹⁷

The *Best Ever* case represents another defeat for the Revenue Department in its efforts to administratively restrict the availability of the gross earnings treatment. Having lost *Indiana Department of State Revenue v. Stark-Wetzel*⁹⁸ and *Indiana Department of State Revenue v. Food Marketing Corp.*,⁹⁹ it is anticipated the Revenue Department will now abandon its efforts to interpret the gross earnings provision of the Gross Income Tax Act narrowly. The court in *Best Ever* has certainly again informed the Department that it will not tolerate efforts by the Department to constrain by rule or regulation the scope of the wholesale grocers provision.

IV. THE NEW FOREIGN DIVIDEND DEDUCTION

The 1987 Session of the General Assembly resolved an inequity created by its adoption in 1985 of the so-called Sony Amendment¹⁰⁰

⁹⁴*Id.*

⁹⁵*Id.*

⁹⁶*Id.* at 787 (citing *Van Allen v. State*, 467 N.E.2d 1210 (Ind. Ct. App. 1984)).

⁹⁷*Id.* (quoting *Indiana Dept. of State Revenue v. Colpaert Realty Corp.*, 231 Ind. 463, 479-80, 109 N.E.2d 415, 422-23 (1952)) (emphasis added by court of appeals).

⁹⁸150 Ind. App. 344, 276 N.E.2d 904 (1971).

⁹⁹403 N.E.2d 1093 (Ind. Ct. App. 1980).

¹⁰⁰Sony Amendment, Pub. L. No. 75-1985, 1985 Ind. Acts 658.

which prohibited the Indiana Department of Revenue from applying the unitary business theory to combine an Indiana adjusted gross income taxpayer with a foreign corporation or foreign operating corporation. This amendment confirmed, as Governor Orr had assured the Sony Corporation and other foreign business investors in 1984, that Indiana was not a unitary state and that it would not seek to combine the income of a foreign parent with the income of a subsidiary for Indiana adjusted gross income tax purposes, even though the parent and subsidiary were engaged in a unitary business.

The Sony Amendment, while clearly beneficial to foreign multinational companies operating in Indiana through subsidiaries, had a discriminatory impact on domestic multinational companies because it did nothing to clarify Indiana's taxation of foreign source dividends received by domestic multinationals from their foreign operations. For example, a German multinational company operating through a subsidiary in Indiana would, under the Sony Amendment, clearly have no liability to pay Indiana tax on its income earned in Germany, no matter how integrated the two corporations were. A U.S. multinational, however, operating in Indiana with a subsidiary in Germany has been under a cloud as to whether it could be held liable for Indiana adjusted gross income tax on its dividend income from the German subsidiary.

Recognizing the need to eliminate any ambiguity as to this inequity, the 1987 legislature enacted Indiana Code section 6-3-2-12 which expressly provides a deduction from adjusted gross income of foreign source dividends.¹⁰¹ Note that this is a deduction provision rather than an exemption provision, requiring the taxpayer to include and then deduct foreign source dividends *from* adjusted gross income to arrive at *Indiana* adjusted gross income. Under section 6-3-2-12, "'foreign source dividend' means a dividend from a foreign corporation" and "includes any amount that a taxpayer is required to include in its gross income for a taxable year under section 951 of the Internal Revenue Code,"¹⁰² which is commonly known as Subpart F income. However, the section expressly provides that the term "foreign source dividend" does not include the foreign tax gross-up.¹⁰³ Under section 78 of the Internal Revenue Code, certain taxes which are deemed to be paid by a corporation are treated as dividend income received by the corporation. This income is commonly referred to as the foreign tax gross-up. The legislature has separately provided that the foreign tax gross-up should be subtracted from a taxpayer's section 63 taxable income *to arrive at* adjusted gross income,¹⁰⁴

¹⁰¹IND. CODE § 6-3-2-12(b) (Supp. 1987) (effective Jan. 1, 1988).

¹⁰²*Id.* § 6-3-2-12(a).

¹⁰³*Id.*

¹⁰⁴IND. CODE § 6-3-1-3.5(b)(4) (Supp. 1987) (effective Jan. 1, 1988).

the foreign tax gross-up is not considered foreign source dividend.

The amount of the foreign source dividend deduction to which the taxpayer is entitled depends upon the taxpayer's percent of ownership of the dividend payor. The deduction is equal to 100% of the foreign source dividend if the taxpayer owns at least 80% "of the total combined voting power of all classes of stock of the foreign corporation from which the dividend is derived."¹⁰⁵ The deduction is equal to 85% of the foreign source dividends if the taxpayer owns at least 50% but less than 80% of the total combined voting power of all classes of stock of a foreign dividend payor.¹⁰⁶ The deduction is reduced to 50% of the foreign source dividends if the taxpayer owns less than 50% of the total combined voting power of all classes of stock of the dividend payor.¹⁰⁷

With the 1987 enactment of Indiana Code section 6-3-2-12, it is hoped that the potential for discriminatory taxation of U.S. multinationals will be laid to rest. U.S. multinationals are certainly entitled to compete both domestically and in the worldwide marketplace on an equal footing with their foreign multinational competitors. The constitutional mandates of the federal due process and equal protection clauses,¹⁰⁸ as well as the unreasonable classification prohibition of the Indiana Constitution,¹⁰⁹ may indeed dictate equal tax treatment for the foreign source income of both foreign and domestic multinational companies. On this question, the form of the income (i.e., whether the foreign source income is taxed on a combination basis or is taxed in the form of divided income) should be included since the substance of the taxation is still to tax the U.S. multinational's foreign earnings. As noted, section 6-3-2-12 should serve to eliminate any further ambiguity as to the equal tax treatment of foreign and domestic multinational companies.

V. THE GREAT LAKES INTERSTATE SALES COMPACT

On July 21, 1986, Indiana, joining five other midwestern states, signed the Great Lakes Interstate Sales Compact. Indiana, Illinois, Michigan, Minnesota, Ohio and Wisconsin entered into this Compact for the expressed primary purpose to ferret out those out-of-state vendors who sold to customers in the six states but who had never collected or remitted sales tax to the customer's state.¹¹⁰ The targets were principally

¹⁰⁵IND. CODE § 6-3-2-12(c) (Supp. 1987) (effective Jan. 1, 1988).

¹⁰⁶*Id.* § 6-3-2-12(d).

¹⁰⁷*Id.* § 6-3-2-12(e).

¹⁰⁸U.S. CONST. amend. XIV, § 1.

¹⁰⁹IND. CONST. art. I, § 23.

¹¹⁰Great Lakes Interstate Sales Compact, July 21, 1986. Wisconsin withdrew from the Compact by an executive order signed by Governor Anthony S. Earl on August 31, 1987. South Dakota signed the Compact on December 11, 1987, and North Dakota, Iowa and Nebraska are considering signing the Compact.

to be the border retailers who sold appliances, furniture and other big ticket items to nearby customers in adjacent states, *without charging the customer's state's sales tax*. As Indiana Revenue Commissioner M. F. Renner stated in a letter to Indiana retailers, "these are the sales which represent unfair competition to you, our in-state merchants, who find out-of-state business undercutting your prices because they are not required to collect the sales tax, as you do."¹¹¹

Given this laudable objective, the Great Lakes Compact hardly seemed like an issue that most state taxpayers should be concerned about, especially those taxpayers who were not engaged in retailing. But the Compact does indeed have the potential for becoming a controversial multistate audit program that may impact taxpayers far beyond those selling goods across state lines. It appears now that the Compact may be invoked by the member states, not only to encourage out-of-state vendors to collect and remit sales tax, but as a vehicle for obtaining and sharing a broad range of information about all taxpayers—not just information relating to sales tax and not just about taxpayers engaged in retailing. It appears that *anyone*—retailer, wholesaler, manufacturer, or service provider—who does business in any of the Compact states may be affected by seemingly innocuous but actually far-ranging reciprocal audit arrangements.

A. *What the Compact Says*

Each of the states was authorized to enter into this Compact by enabling legislation passed by its respective legislature or by an executive order. In Indiana's case, Indiana Code section 6-8.1-3-7 permits the Indiana Department of Revenue to enter into reciprocal agreements with the taxing officials of other state governments "*to furnish and receive information relevant to the administration and enforcement of [Indiana's] taxes.*"¹¹² Thus, the threshold question as to the propriety of Indiana's

¹¹¹Letter from M. F. Renner to Indiana Retail Merchants (Jan. 19, 1987) [hereinafter Renner Letter].

¹¹²IND. CODE § 6-8.1-3-7 (1982) (emphasis added). This statute restricts the Revenue Department's power with regard to reciprocal agreements to the administration and enforcement of listed taxes. According to IND. CODE § 6-8.1-1-1 (Supp. 1987):

"Listed taxes" or "taxes" includes only the gross income tax (IC 6-2.1); the state gross retail and use taxes (IC 6-2.5); the adjusted gross income tax (IC 6-3); the supplemental net income tax (IC 6-3-8); the county adjusted gross income tax (IC 6-3.5-1-1); the county option income tax (IC 6-3.5-6); the auto rental excise tax (IC 6-6-9); the bank tax (IC 6-5-11); the production credit association tax (IC 6-5-12); the intangibles tax (IC 6-5.1); the gasoline tax (IC 6-6-1.1); the special fuel tax (IC 6-6-2.1); the motor carrier fuel tax (IC 6-6-4.1); the hazardous waste land disposal tax (IC 6-6-6.6); the cigarette tax (IC

participation in the Compact is whether, under the agreement, the Revenue Department will be committed to furnish and indeed will furnish to the other member states information which, while possibly *relevant* to the enforcement and administration of the *other* state's taxes, would have no relevance to the enforcement and administration of Indiana taxes. Consequently, the scope of the Compact must be carefully examined in the light of the underlying statutory authority. As emphasized by the underscored quoted language, the Indiana reciprocity provision literally limits the Revenue Department to the furnishing and receiving of information *relevant* to the administration and enforcement of *Indiana* taxes.

The purpose of the Compact is set forth at its beginning. The Compact states:

This Compact is designed to increase compliance with each states' sales and use tax law, primarily as that law applies to sale transactions made across the state boundaries. The constitutional constraints placed on a state's power to tax transactions in interstate commerce have caused all states . . . that levy a retail sales tax to impose a complementary use tax, to assure that all transactions are equally subject to tax and to protect instate vendors from unfair competition from vendors located in other states. However, in practice, goods purchased from an outstate vendor and shipped to a consumer instate frequently escape use taxation unless the outstate vendor is registered to collect and remit the use tax to the consumer's state. This tax avoidance is particularly likely to occur when the consumer is an individual and probably will not be audited for sales or use tax purposes. By this Compact, the tax collection agencies of the Great Lakes States will increase compliance with the sales and use tax laws of their states¹¹³

The body of the Compact can be divided into three parts. The first part could be called the "registration phase." The signatory states agree that they will "vigorously encourage" vendors in their home states to register with other signatory states to collect and remit use tax on sales into those other states.¹¹⁴ In this regard, all Great Lakes Compact signatory states engaged in a letter writing and publicity campaign in

6-7-1); the beer excise tax (IC 7.1-4-2); the liquor excise tax (IC 7.1-4-3); the wine excise tax (IC 7.1-4-4); the malt excise tax (IC 7.1-4-5); the petroleum severance tax (IC 6-8-1); the various innkeeper's taxes (IC 6-9); the county food and beverage tax (IC 6-9-13); and the oil inspection fee (IC 16-6-11).

¹¹³Great Lakes Interstate Sales Compact, July 21, 1986.

¹¹⁴*Id.* at 2.

early 1987 encouraging their in-state vendors to register in the other Compact states. There was also a carrot offered to encourage such registration. The states provided that if a vendor voluntarily registered in another Compact state before March 31, 1987, the vendor's state of residence would not exchange any information with that state on the vendor's past transactions.¹¹⁵ The member states also advised their resident vendors that "the chances of being audited for failing in the past to collect use tax, and of being required to pay it, are also reduced if you voluntarily register by March 31, 1987."¹¹⁶

The second part of the Compact involves conducting audits. The signatory states agree to "vigorously pursue by audit *the discovery* of untaxed sales made by in-state vendors to individual or business consumers in the other Great Lakes States."¹¹⁷ The Compact contemplates two types of audits. First, there are audits conducted by the Compact state on its own.¹¹⁸ This would be where Indiana audits an Indiana-based taxpayer and discovers that this taxpayer is making interstate sales to Michigan customers. Secondly, there are audits conducted by a Compact state at the specific request of another state.¹¹⁹ This would be, for example, where Indiana audits an Indiana-based taxpayer at the request of Michigan because Michigan suspects that the taxpayer is making untaxed sales to Michigan consumers.

These audits will then lead directly into the third phase of the Compact, the exchange of information. The Compact provides that information gathered in these audits regarding interstate sales shall be transmitted to the other state or states.¹²⁰ How the information will be used is not specified in the Compact, although the implication is that it will be used to encourage voluntary registration of the out-of-state vendor and/or compel the payment of use tax by in-state residents who purchased from the vendor.¹²¹

The Compact itself has at least two other provisions that are worth noting. First, it specifically provides that the signatory states "will not attempt to subject any vendor to franchise, income, property, or other taxes of their states *solely* because that vendor has registered to collect use tax in response to requests made under this Compact" and that "registration to collect tax, in and of itself, will not require the vendor

¹¹⁵Renner Letter, *supra* note 111, at 1.

¹¹⁶*Id.*

¹¹⁷Great Lakes Interstate Sales Compact, July 21, 1986, at 2 (emphasis added).

¹¹⁸Great Lakes Interstate Sales Compact, July 21, 1986, at 2.

¹¹⁹*Id.*

¹²⁰*Id.*

¹²¹*Id.* at 1.

to register to do business in that state."¹²² Second, the Compact recognizes that:

Although this Compact addresses cooperation between the Parties in the administration of sales and use taxes, any of the Parties may enter into Addenda creating cooperative administrative efforts for other taxes, including corporate franchise or incomes tax [sic] and excise taxes, such as motor vehicle fuel and cigarette taxes.¹²³

Thus, on its face, it certainly appears that the Compact may require the Indiana Revenue Department to furnish to the other member states various kinds of tax information and data obtained from Indiana taxpayers that is *not relevant* to the administration and enforcement of *Indiana* taxes.

B. *How the Compact has been Administered*

On the voluntary registration phase, the states have been very active and apparently persuasive, having had surprising success. Indiana reports that, in the first 12 months following the signing of the Compact, it has had over 4,000 requests for registration materials from vendors in other Compact states, with over 2,400 of such requests coming from Illinois vendors. Indiana has had almost 2,000 vendors actually register with it, almost 1,200 of those being Illinois vendors.¹²⁴ Taxpayers considering registration in another Compact state, however, should be aware that their voluntary registration may result in being approached about audits for other taxes by that state. The simple fact is that once a retailer registers in another state, its name and business are then known to that state's revenue department and it is more likely that *that* state will audit the retailer. Consequently, while the Compact provides that the member states will not attempt to impose any other tax *solely* because a taxpayer has registered to collect sales tax for that state,¹²⁵ it does *not* say that if the state finds some other nexus between the registrant and the state it will not impose other taxes. Thus, a taxpayer who voluntarily registers in another state to collect sales tax will likely incur an increased exposure to an audit for *all* the state's taxes, and an increased potential for liability—past, present and future—for *all* of the state's taxes.

¹²²*Id.* at 4 (emphasis added).

¹²³Great Lakes Interstate Sales Compact, July 21, 1986, at 3.

¹²⁴Interview with James Mundt, Deputy Commissioner, Indiana Department of Revenue (June 11, 1987).

¹²⁵Great Lakes Interstate Sales Compact, July 21, 1986, at 4.

The Great Lakes audit program and the exchange of information are underway. It is understood that Indiana, for example, has instructed all of its auditors to routinely examine a taxpayer's books and records for interstate sales to other Compact states as part of the regular audit procedure. Lists of such sales are compiled and handed over to the other Compact states. As a practical matter, the taxpayer may or may not be advised that this is happening. Generally, the states will leave it up to the auditor whether to tell the taxpayer that he is gathering this information to hand over to another state. States are also requesting other Compact states to perform audits on their behalf. Indiana has received only a few such requests during the survey period.¹²⁶

On the enforcement side, the Compact states are proceeding to issue proposed assessments against vendors which are discovered to be making interstate sales and which have nexus under the traditional standards in the assessing state. This is an important point about the Compact. It does not change a signatory state's nexus standards for sales tax collection responsibility. If the member state has adopted one of the new nexus laws, then this standard will control. However, if the state is still using a limited definition of when a retailer is engaged in business in the state so as to trigger sales tax collection responsibility, the more limited standard will control.

If no nexus between the vendor and the state is found, the state will likely issue assessments of use tax against the vendor's customers. Some states have found the assessment of use tax on the customer an effective "club" to compel an out-of-state vendor to register and collect tax. New York, for example, has made no secret of its intent to assess the in-state customers of certain out-of-state retailers until those retailers register or their customers quit buying from them.¹²⁷

In addition to the foregoing, which relates only to sales and use tax, in June, 1987, the Compact states *also* began auditing all taxpayers who apportion their net income to determine whether they have activities in any of the other Compact states for income and franchise tax purposes and sharing that information with the other Compact states. The Compact states have adopted what is called the "Great Lake States' Questionnaire." This Questionnaire asks the taxpayer first to state whether, for the current year and the three preceding years, it filed a sales and use tax return *and* an income or franchise tax return in each of the Great Lakes states. Unless a taxpayer answers that it did file in all of the

¹²⁶Interview with James Mundt, Deputy Commissioner, Indiana Department of Revenue (June 11, 1987).

¹²⁷Pamphlet, *New York/New Jersey Cooperative Interstate Tax Enforcement*, Feb. 1986.

Compact states for all four years, the taxpayer is asked to fill out the "activities" section of the questionnaire which lists 22 activities and asks the taxpayer whether it performed any one of these in any of the Compact states.¹²⁸ The activities listed include:

1. Maintained a business location of any kind (*e.g.*, an office, repair or parts shop, warehouse, place of distribution, or sample, display or sales room). . .
6. Owned a stock of goods in hands of a distributor or other nonemployee representative. . .
8. Leasing of tangible property or licensing of intangible rights for use in the state. . .
10. Performed construction contracts or personal service contracts. . .
13. Collected delinquent accounts or deposits on new accounts. . .
14. Conducted credit investigations.¹²⁹

These questionnaires are then provided to any of the other states in the Compact with respect to which the taxpayer provides an affirmative answer.

C. *Questions About the Great Lakes Compact*

Can Indiana—indeed can the Compact member states as a regional body—legitimately, collectively carry out the dictates of the Compact? Proponents of the Compact point to the U.S. Supreme Court decision in 1978 in *U.S. Steel Corporation v. Multistate Tax Commission*.¹³⁰ In *U.S. Steel*, the Supreme Court declared the Multistate Tax Compact to be constitutional despite the argument that it violated the United States Constitution which prohibits a state from entering into any agreement with another state without the consent of Congress.¹³¹ The Court rejected a literal reading of this constitutional prohibition and reaffirmed the position that such interstate agreements are only prohibited when they tend to increase the political power of the states so that it encroaches upon or interferes with the just supremacy of the United States.¹³² While *U.S. Steel* argued that the enforcement powers conferred upon the Multistate Tax Commission permitted that body to exercise authority over interstate business to a greater extent than the sum of the states'

¹²⁸Great Lakes States' Questionnaire at 1.

¹²⁹Great Lakes States' Questionnaire at 2.

¹³⁰434 U.S. 452 (1978).

¹³¹U.S. CONST. art. I, § 10, cl. 3.

¹³²434 U.S. at 471.

authority acting individually, the Court found that this was “nothing more than reciprocal legislation for providing mutual assistance to the auditors of the member States” and that such reciprocal legislation should be upheld.¹³³

However, what the proponents of the Great Lakes Interstate Sales Compact miss is that the issue of whether, regardless of its facial constitutionality, a reciprocal agreement which seeks to expand a state’s investigatory power beyond *either constitutional or statutory authority* is still lawful was not presented in *U.S. Steel*. Suppose a taxpayer runs a retail business from its headquarters in Seattle, Washington. It has a retail outlet in Indiana. It has no activity whatsoever in Illinois, but it does make interstate sales to Illinois customers from its Seattle office. Indiana audits this taxpayer. In performing that audit, Indiana learns about the taxpayer’s sales from Washington into Illinois. Does it not violate due process and state jurisdictional tenets for Indiana to obtain this information and then hand it over to Illinois—when in fact Illinois would have had no nexus under traditional jurisdictional standards over the taxpayer? Implemented in this way, the Compact could become a network of jurisdictional transmission lines that would eviscerate traditional state jurisdictional standards. In any event, it is wrong to think that the *U.S. Steel* decision provides the answer to the issue—because this issue was never addressed in that case.

The Compact should also be viewed in light of each state’s law. It is well settled that each state’s department of revenue is a part of the executive branch of that state. As a general tenet, revenue departments can only exercise those powers granted to them by their state legislatures. It should therefore be axiomatic that the state revenue departments cannot use multistate compacts to expand their powers beyond those provided by their respective legislatures. But it appears that, at least in the case of the Indiana Revenue Department, the Great Lakes Compact in some instances goes well beyond the restraints of the Indiana statutory law on the audit and investigatory scope of the Indiana State Department of Revenue. For example, the statutory authority of the Indiana Audit Division to inspect any books, records or property of any taxpayer is limited to inspection of only such documents as are “*relevant to the determination of the taxpayer’s tax liabilities.*”¹³⁴ If, in the above example of the Seattle, Washington business, information regarding the taxpayer’s sales from Washington to Illinois customers is not relevant to the determination of the Indiana tax liabilities of that taxpayer, can Indiana, in compliance with its Compact obligations, seek to obtain such infor-

¹³³*Id.* at 475-76.

¹³⁴IND. CODE § 6-8.1-4-2(3) (1982) (emphasis added).

mation that seems beyond the scope of the inspection authority?

Buttressing the conclusion that the authority of the Indiana Revenue Department to audit an Indiana taxpayer and to inspect the books and records of an Indiana taxpayer is statutorily circumscribed is the fact that, under Indiana Code section 6-8.1-5-4, an Indiana taxpayer, for Indiana sales and use tax and income tax purposes, is *only* required to keep, retain and make available for inspection those books and records that are necessary to enable the Indiana Revenue Department to determine the taxpayer's liability for those *Indiana* taxes.¹³⁵

It is submitted that an examination of the statutory audit authority of the revenue departments of the other member states in the Compact might well raise the same serious doubt as to whether those revenue departments do indeed have the statutory authority to carry out the reciprocal audit amendments of the Compact.

Finally, a broad policy question must be asked. Did the Indiana General Assembly really intend that Indiana start auditing for Michigan, Wisconsin, Illinois, etc., sales tax and now apparently income tax purposes when it provided that Indiana could enter into reciprocal agreements to furnish and receive information for purposes of administering and enforcing *Indiana's* taxes? Remember, also, that the Indiana General Assembly specifically pulled Indiana out of the Multistate Tax Compact in 1977. Is this new Great Lakes Questionnaire in spirit contrary to the legislature's intent that Indiana not be part of the type of joint auditing program used by members of the Multistate Tax Compact?

Taxpayers have been surprisingly quiet about the Great Lakes Compact, as well as the many other compacts that have sprung up around the country. New York now has such agreements with several states, including Arizona, California, Florida and Connecticut.¹³⁶ Ohio, in addition to the Great Lakes Compact, has compacts with Pennsylvania, West Virginia and is currently negotiating with Kentucky.¹³⁷ Perhaps, up to now, most taxpayers have had very little reason to be concerned about these compacts because they were not affected by the compacts. But if the Great Lakes states are intent upon using this new Questionnaire with every taxpayer that apportions its net income, there are many taxpayers who will *now* be affected by the Great Lakes Compact.

In conclusion, in only a short time, the Compact seems to have grown from a device to encourage vendors to collect and remit sales tax to a vehicle for expanding the jurisdictional power of the states to obtain information for net income tax purposes. And, therefore, we

¹³⁵IND. CODE § 6-8.1-5-4(a)-(c) (Supp. 1987).

¹³⁶Telephone interview with the New York Department of Revenue (Sept. 1987).

¹³⁷Telephone interview with the Ohio Department of Revenue (Sept. 1987).

suspect that taxpayers will start questioning and even challenging this Compact in either the courts or the state legislatures.¹³⁸

¹³⁸As noted in footnote 110 above, Wisconsin withdrew from the Compact on August 31, 1987. Wisconsin is the home state for a large number of mail order houses involved in the *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), fight on the national level, and Wisconsin's participation in the Great Lakes Compact become the subject of an organized lobbying effort to withdraw Wisconsin from the Compact. Opponents of Wisconsin's participation in the Compact argued that the Compact was just a subterfuge to get around the constitutional prohibitions set forth in *National Bellas Hess* against compelling mail order sellers to collect sales tax. They also argued that under the Compact, Wisconsin and the other Compact states would be obtaining and sharing trade secrets regarding their businesses (presumably customer lists, etc.). Whether Wisconsin is an aberration because of the influence of the mail order houses in that state or portends that other states will re-evaluate their participation in the various compacts, remains unanswered.

