

Survey of Recent Developments in Indiana Taxation Law

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I. INTRODUCTION

During the survey period there were several significant developments in Indiana taxation. The general reassessment of all real property, which commenced on July 1, 1987, continued into 1989 and will be the basis for real property tax assessments effective March 1, 1989.¹ The new valuations of real property are to remain in effect until the next scheduled general reassessment to be completed by March 1, 1997.² As taxpayers litigate matters related to the general reassessment and other state and local tax issues, such cases will find their way to the Indiana Tax Court. Because of the ever growing importance of the Indiana Tax Court to Indiana practitioners, this Article will concentrate on the significant recent decisions of that court in an attempt to capture and convey its judicial philosophy.

Since it first opened its doors in July of 1986, the Indiana Tax Court has become a key figure in the development and interpretation of Indiana tax law. Judge Thomas Fisher, who presides over the Indiana Tax Court, rendered important opinions on a wide array of state tax issues during the survey period, ranging from the availability of injunctive relief to whether the rental of video tapes is subject to sales tax.

Part Two of this Article will address the Indiana Tax Court's power to enjoin the collection of tax pending the outcome of the original tax appeal.³ As will be seen, Judge Fisher has considered each such petition with great care and has not been hesitant to enjoin the collection of

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1. IND. CODE § 6-1.1-4-4 (1988). Real property taxes from the March 1, 1989 assessments will be due in May and November of 1990.

2. *Id.* Last year's Survey contained an excellent discussion of the general reassessment. See Stroble & d'Avis, *Current Issues Affecting Indiana Tax Policy*, 22 IND. L. REV. 449, 449-67 (1989). Given last year's thorough treatment of the issue, this Article will not repeat any discussion of the reassessment.

3. See *infra* text accompanying notes 6-45.

taxes pending the outcome of the original tax appeal in appropriate cases.

Part Three will discuss some of the Indiana Tax Court's decisions involving tangible property, sales and use, income, and death taxes.⁴ A few important decisions of the Indiana Supreme Court will also be highlighted. Finally, Part Four will briefly address the apparent demise of the intangibles tax in Indiana.⁵

II. THE INDIANA TAX COURT'S INJUNCTIVE RELIEF POWERS

Under its enabling statute, the Indiana Tax Court has the power to enjoin the collection of taxes pending the original tax appeal. Specifically, Indiana Code section 33-3-5-11 provides that a taxpayer may seek to enjoin the collection of a tax pending the original tax appeal by filing a petition with the Indiana Tax Court.⁶ The petition must set forth a summary of (1) the issues the taxpayer will raise in the original tax appeal, and (2) the equitable considerations upon which the collection should be enjoined.⁷ After holding a hearing on the petition, the Indiana Tax Court may enjoin the collection of the tax pending the original tax appeal if the court finds that:

- (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.⁸

During its three years in existence, the Indiana Tax Court has interpreted this statute some eleven times in deciding whether to grant or deny the petitions for injunctive relief. A rough scorecard for the injunction cases shows that the Indiana Tax Court has granted injunctive relief seven times,⁹ while it has denied such relief on four occasions.¹⁰

4. See *infra* text accompanying notes 46-87.

5. See *infra* text accompanying notes 88-91.

6. IND. CODE § 33-3-5-11(b) (1988). The 1987 and 1988 Surveys highlighted the Indiana Tax Court's injunctive relief powers. See Dlouhy & King, *Significant Developments in Indiana Taxation*, 21 IND. L. REV. 383, 395-98 (1988); King, *Some Very Significant Developments in Indiana Taxation*, 20 IND. L. REV. 361, 374-76 (1987). This Article will explore this important subject in more detail based on recent decisions.

7. IND. CODE § 33-3-5-11(b) (1988).

8. IND. CODE § 33-3-5-11(c) (1988).

9. See *Keller v. Indiana Dep't of Revenue*, 530 N.E.2d 787 (Ind. Tax Ct. 1988); *Perkins Paving & Trucking v. Indiana Dep't of Revenue*, 513 N.E.2d 1267 (Ind. Tax Ct. 1987); *National Private Trucking Ass'n v. Indiana Dep't of Revenue*, 512 N.E.2d 928

One of the most recent decisions, *Keller v. Indiana Department of Revenue*,¹¹ raises a number of key issues in this setting and shows the close scrutiny which the Indiana Tax Court gives to such petitions. The *Keller* case will be analyzed at some length in order to depict the Indiana Tax Court's philosophy in this important area.

A. The "Unclean Hands" Issue

In *Keller*, petitioner Teresa Keller challenged the Indiana Department of State Revenue's assessments of state income taxes. Along with her original tax appeal to the Indiana Tax Court, Ms. Keller filed a petition to enjoin collection of the taxes pending the outcome of the litigation on the merits. The Department of Revenue opposed the petition for injunctive relief on the grounds that Keller had "unclean hands." The Department specifically contended that the petitioner's income, which was earned from the operation of a business called "Barbie's Rubdown," was derived from an illegal business and, therefore, should not be the subject of equitable relief. Moreover, the Department argued, the petitioner had failed to timely file her returns.¹²

Notwithstanding these arguments, which seem appealing at least on the surface, the Indiana Tax Court found that the petitioner was entitled to injunctive relief. The court first addressed the fact that Keller's income was derived from what it called a "presumed illegal business."¹³ The court noted that in order to have unclean hands, the alleged wrong "must have an 'immediate and necessary relation' to the matter before the court."¹⁴ Hence, the Indiana Tax Court wrote, "Keller's unclean hands must derive from the transaction before the court."¹⁵

In the *Keller* case, however, the Indiana Tax Court found that the petitioner's business was only incidental to the issues at hand. The

(Ind. Tax Ct. 1987); *American Trucking Ass'n v. State*, 512 N.E.2d 920 (Ind. Tax Ct. 1987); *Dunkerson v. Indiana Dep't of Revenue*, 512 N.E.2d 504 (Ind. Tax Ct. 1987); *Video Tape Exch. Co-op v. Indiana Dep't of Revenue*, 512 N.E.2d 476 (Ind. Tax Ct. 1986); and *Energy Supply, Inc. v. Indiana Dep't of Revenue*, No. 49T05-8908-TA-00030, 1990 WL 4890 (Ind. Tax Ct. Jan. 19, 1990).

10. See *Video Tape Exch. Co-op v. Indiana Dep't of Revenue*, 533 N.E.2d 1302 (Ind. Tax Ct. 1988); *Keller Oil Co. v. Indiana Dep't of Revenue*, 512 N.E.2d 501 (Ind. Tax Ct. 1987); *Faris Mailing, Inc. v. Indiana Dep't of Revenue*, 512 N.E.2d 480 (Ind. Tax Ct. 1987); and *R.H. Marlin, Inc. v. Indiana Dep't of Revenue*, 512 N.E.2d 475 (Ind. Tax Ct. 1986).

11. 530 N.E.2d 787 (Ind. Tax Ct. 1988).

12. *Id.* at 788.

13. *Id.*

14. *Id.* (quoting *Keystone Driller Co. v. General Excavator Co.*, 290 U.S. 240, 245 (1933)).

15. *Id.*

question before the court was whether Ms. Keller owed a certain amount of income taxes, "not the manner in which she earned her income."¹⁶ The court explained its reasoning at some length, writing:

What is material is not that the plaintiff's hands are dirty, but [whether] [s]he dirtied them in acquiring the right [s]he now asserts, or that the manner of dirtying renders inequitable the assertion of such rights against the defendant. . . . [W]e should not by this [clean hands] doctrine create a rule comparable to that by which a careless motorist would be 'able to defend the subsequent personal injury suit by proving that the pedestrian had beaten his wife before leaving his home.'¹⁷

Moreover, the *Keller* court wrote, "[a]lthough courts of equity should not condone illegal behavior, neither should they be the moral judges of matters not before them."¹⁸ The court concluded that equity does not require one seeking equitable relief to lead a blameless life. Rather, it merely requires that "she shall have acted fairly and without fraud or deceit as to the controversy in issue."¹⁹ Because no such "unclean" activity had been alleged or proven with respect to the assessment of the taxes, the Indiana Tax Court rejected this portion of the Department's unclean hands defense.²⁰

The significance of this aspect of the *Keller* decision cannot be overlooked, for as is true in the federal system, many state taxpayers who have disputes with the state taxing authorities may be tainted with histories of illegal activities or other "badges" of what some might consider improper conduct. As in *Keller*, however, it is not always the case that such alleged misconduct relates to the specific issues before the court. Yet it would be easy to simply let the petitioner's general reputation cloud the narrow issues and serve as a basis for denying that individual a full and fair opportunity to obtain injunctive relief.

In the Indiana Tax Court, however, Judge Fisher has made it clear that each petition for injunctive relief will be decided on its own merits without consideration of irrelevant factors such as reputation or allegations of misconduct, whether proven or not. Only matters that bear directly on the taxation issues at hand will be considered by the Indiana Tax Court while sitting in equity. For this, Judge Fisher should be

16. *Id.*

17. *Id.* at 789 (quoting *Republic Molding Corp. v. B.W. Photo Utils.*, 319 F.2d 347, 349 (9th Cir. 1962) (citation omitted)).

18. *Id.*

19. *Id.*

20. *Id.*

commended. His decision on this issue will no doubt be instructive for all Indiana courts.

In the second part of the unclean hands analysis in *Keller*, the Indiana Tax Court decided the narrow issue of whether a taxpayer's failure to file timely tax returns precludes a grant of equitable relief. In answering this question negatively and enjoining the collection of taxes, Judge Fisher relied heavily on the fact that although Ms. Keller had not originally timely filed her returns for the years at issue, she did eventually file the returns and otherwise cooperated fully with the taxing authorities.²¹

The Indiana Tax Court explained that while absolute failure to file tax returns would give a taxpayer unclean hands in this setting, the eventual filing of late returns in essence purged her wrongdoing and restored her right to seek equitable relief. Because no harm resulted to the Department of Revenue as a result of the late filing,²² the Indiana Tax Court found that the late filing of the returns did not preclude injunctive relief.

B. The Statutory Requirements of Indiana Code section 33-3-5-11(c).

1. *Substantiality of Issues and Opportunity to Prevail.*—Next, the *Keller* court specifically traced the requirements of Indiana Code section 33-3-5-11(c) to determine whether: (1) the issues raised were substantial, (2) the petitioner had a reasonable opportunity to prevail on the merits, and (3) equitable considerations favoring enjoining the tax outweighed the state's interest in prompt collection. In ruling for the petitioner, the Indiana Tax Court first held that the issues were substantial. The court noted that it has given the term "substantial issue" a wide variety of meanings, and indicated that a tax case need not have statewide impact under the statute.²³ The *Keller* court then determined that a substantial issue was raised because the Department of Revenue had based its assessment on statements of Keller's former employee and had disregarded the amount represented by Keller's tax returns. The Indiana Tax Court found that the "best information available" test used by the Department "raises questions concerning what is the best information available and to what extent the test should be given validity in a *de novo* proceeding."²⁴

21. *Id.* at 789-90.

22. *Id.* at 790. The Indiana Tax Court based this finding on the auditor's testimony that the assessment results would have been the same whether or not they had the returns before them. *Id.*

23. *Id.*

24. *Id.*

As to the petitioner's reasonable opportunity to prevail, the Indiana Tax Court similarly found that Ms. Keller met this requirement under the "best information available" test.²⁵

2. *Equitable Considerations - Irreparable Harm and Posting of Bond.*—Finally, the court found that the petitioner had also met the equitable considerations prong of the statute. Ms. Keller had testified as to a lack of assets to pay the assessed taxes, and the court implicitly rejected the Department's argument that "mere economic injury does not warrant the granting of a preliminary injunction."²⁶

In some cases, the court has also considered whether irreparable harm would ensue if the tax had to be paid.²⁷ As in *Keller*, however, the irreparable harm component seems to now be part of the statutory "equitable considerations" analysis of Indiana Code section 33-3-5-11(c)(3), rather than a completely separate requirement as had appeared early on.²⁸ This is demonstrated in cases such as *Perkins Paving & Trucking, Inc. v. Indiana Department of Revenue*²⁹ and *National Private Trucking Association v. Indiana Department of Revenue*,³⁰ wherein the Indiana Tax Court specifically considered the irreparable harm component as part of the equitable requirements of subdivision (c) of section 33-3-5-11. After *Keller*, irreparable harm is properly viewed as one aspect of the equitable considerations analysis.

The *Keller* court then granted the taxpayer's motion for injunctive relief and ordered her to post bond or other security in the amount of

25. *Id.*

26. *Id.* at 791. In so holding, the Indiana Tax Court in essence followed its dicta in *Faris Mailing Inc. v. Indiana Dep't of Revenue*, 512 N.E.2d 480 (Ind. Tax Ct. 1987), wherein Judge Fisher wrote that while the statement that "mere economic injury does not warrant an injunction" is correct, this is a matter of degree because "there is a point at which economic injury could become so severe that it could constitute irreparable harm." *Id.* at 482.

27. See *Energy Supply, Inc. v. Indiana Dep't of Revenue*, No. 49T05-8908-TA-00030 (Ind. Tax Ct. Jan. 19, 1990) (irreparable harm found where taxpayer could not raise funds to pay the tax); *Faris Mailing Inc.*, 512 N.E.2d at 482 (Ind. Tax Ct. 1987) (the court discusses irreparable harm as a separate component); *R.H. Marlin, Inc. v. Indiana Dep't of Revenue*, 512 N.E.2d 475 (Ind. Tax Ct. 1986) (irreparable harm is addressed as a separate factor).

28. The 1988 Survey authors, for instance, wrote that the early *Marlin* and *Faris* decisions indicated the court might be imposing the irreparable harm aspect as a separate fourth component; the authors even concluded, and rightfully so at that time, that counsel seeking an injunction should be prepared to argue both that their client will suffer irreparable harm and that all three criteria of section 33-3-5-11 are met. See Dlouhy & King, *Significant Developments in Indiana Taxation*, 21 IND. L. REV. 383, 397-98 (1988).

29. 513 N.E.2d 1267, 1269 (Ind. Tax Ct. 1987).

30. 512 N.E.2d 928, 931-33 (Ind. Tax Ct. 1987). See also *Energy Supply, Inc.*, No. 49T05-8908-TA-00030.

the tax, interest, and penalties alleged to be due.³¹ Unfortunately, however, Ms. Keller did not obtain bond or other security, and the Indiana Tax Court later dissolved her injunction.³² This is an extremely important aspect of the *Keller* case, for it now appears that the Indiana Tax Court is requiring bond or other security to be posted in nearly all of its injunctive relief cases. Yet *Keller* is the first case in which such bond was not secured. In the seven decisions in which it has granted injunctive relief, the Indiana Tax Court has required bond or other security to be posted in six of the cases.³³ In the seventh case, Judge Fisher merely ordered the taxpayer to refrain from doing anything to impair its financial position and to permit the Department of Revenue to examine its books from time to time to ensure compliance.³⁴

The issue of posting security raises two important questions. First, on what authority is the Indiana Tax Court relying to require bond? Second, what are the practical ramifications of such a requirement? As will be seen, neither question has been squarely addressed to date.

In the first case in which the Indiana Tax Court required such a bond, *Video Tape Exchange Co-op. v. Indiana Department of Revenue*, the court did not specifically state the authority for imposing such a requirement.³⁵ The court there traced the statutory injunctive relief requirements of Indiana Code section 33-3-5-11(c), and simply added the bond requirement. It must be noted that nothing in the Indiana Tax Court's injunctive relief statute addresses the issue.

In the next case in which bond was ordered, the Indiana Tax Court did give authority for requiring such security. Specifically, in *American Trucking Associations v. State*, the court explained that the equitable considerations aspect of Indiana Code section 33-3-5-11(c) "incorporates the general body of traditional equity concepts."³⁶ Thus, citing a 1982 Indiana Court of Appeals opinion, the *American Trucking* court wrote:

The basic elements to be considered when a petitioner seeks injunction relief are:

31. 530 N.E.2d at 791.

32. *Keller v. Indiana Dep't of Revenue*, No. 49T0508804-TA-00028.

33. See *Keller*, 530 N.E.2d at 791; *Perkins Paving & Trucking v. Indiana Dep't of Revenue*, 513 N.E.2d 1267, 1269 (Ind. Tax Ct. 1987); *Nat'l Private Trucking Ass'n v. Indiana Dep't of Revenue*, 512 N.E.2d 928, 935 (Ind. Tax Ct. 1987); *American Trucking Ass'n v. State*, 512 N.E.2d 920, 927 (Ind. Tax Ct. 1987); *Video Tape Exch. Co-op v. Indiana Dep't of Revenue*, 512 N.E.2d 478 (Ind. Tax Ct. 1987); *Energy Supply, Inc. v. Indiana Dep't of Revenue*, No. 49T05-8909-TA-00030 (Ind. Tax Ct. Jan. 19, 1990).

34. See *Dunkerson v. Indiana Dep't of Revenue*, 512 N.E.2d 504, 505 (Ind. Tax Ct. 1987).

35. 512 N.E.2d at 478.

36. 512 N.E.2d at 923.

- (1) that the petitioner will suffer irreparable harm if relief is not granted;
- (2) that the harm to the petitioner if relief is denied outweighs the harm to the respondent if relief is granted;
- (3) that the public interest will not be harmed if relief is granted;
- (4) *that petitioner will post sufficient security to cover costs and damages which the respondent may suffer if it is wrongfully enjoined.*³⁷

Thus, the Indiana Tax Court has relied on the pre-Indiana Tax Court case of *Wells v. Auberry* for the security requirement in injunctive relief cases. A review of the *Wells* case, however, does not indicate the authority upon which the Indiana Court of Appeals was relying for such a bond requirement in that case.³⁸

A further independent review of the law on injunctive relief in Indiana, however, reveals that Rule 65 of the Indiana Rules of Trial Procedure clearly states that no "preliminary injunction shall issue except upon the giving of security by the applicant, in such sum as the court deems proper, for the payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined or restrained."³⁹ This requirement appears to be applicable to the Indiana Tax Court because Rule 1 of the Rules for the Indiana Tax Court provides that the general Indiana Rules of Trial Procedure "shall apply to actions in the Tax Court" except where the general trial rules are clearly inconsistent with the rules for the Indiana Tax Court. Because there is nothing in the Rules for the Indiana Tax Court speaking to posting of security in petitions for injunctive relief, the general provision of Trial Rule 65 should apply to the Indiana Tax Court.⁴⁰

Indeed, in an opinion issued just as this Article went to press, the Indiana Tax Court relied upon Trial Rule 65(c) in an injunctive relief case. Specifically, in *Energy Supply, Inc. v. Indiana Department of Revenue*,⁴¹ the court enjoined the Department from collecting some

37. *Id.* (emphasis added) (citing *Wells v. Auberry*, 429 N.E.2d 679, 682 (Ind. Ct. App. 1982)). The Indiana Tax Court cited the same authority in *National Trucking Ass'n v. Indiana Dep't of Revenue*, 512 N.E.2d 928, 930-31 (Ind. Tax Ct. 1987).

38. *See Wells*, 429 N.E.2d at 682.

39. IND. R. TR. P. 65.

40. A reasonable argument could be made that Trial Rule 65 does not apply because the Indiana Tax Court's injunctive relief statute does not speak to posting security. *See* IND. CODE § 33-3-5-11(c) (1988). Such an argument seems weak, however, given that the rules for the Indiana Tax Court require clear inconsistency for the Trial Rules not to apply. The mere failure to mention security in the Indiana Tax Court's injunctive relief statute seems to be much less than clear inconsistency.

41. No. 49T05-8908-TA-00030, slip op. (Ind. Tax Ct. Jan. 19, 1990).

\$230,000 in assessed taxes, but relied on Rule 65(c) to require that the taxpayer's refunds for other years in the amount of some \$200,000 be held by the Department "as security against any losses it could incur as a result of being wrongfully enjoined or restrained."

The Indiana Tax Court thus appears to have the authority to require the posting of security in preliminary injunction cases via Trial Rule 65. The question, then, is how the Indiana Tax Court is to determine the amount of security and how this affects the taxpayer.

Under Trial Rule 65, security shall be given "in such sum as the court deems proper, for the payment of such *costs and damages as may be incurred or suffered*" as the result of a wrongful injunction.⁴² Under well established Indiana precedent, the security required by Rule 65 is merely "intended to compensate the [respondent] for any damages incurred as a result of the preliminary injunction if [the respondent] prevails at a later hearing."⁴³ In the tax setting, such damages could arguably include the tax due, interest, and penalties thereon if the taxpayer squandered away assets during the pendency of the original tax appeal. Under this line of reasoning, it would seem that the Indiana Tax Court could require security to cover all such potential liabilities, just as it did in the *Keller* case.

In any event, it is not the purpose of this Article to fully address all possible issues relating to posting security. Rather, it is sufficient for now to merely locate the potential foundation for the requirement so that counsel can formulate their arguments accordingly. There is a substantial body of case law surrounding the security requirement of Trial Rule 65, including the general rule that the trial court has broad discretion in setting the amount of security.⁴⁴ Tax practitioners can work with such precedent to assist their clients in this aspect of obtaining injunctive relief.

A final issue concerning bond is the pragmatics of such a requirement. In *Keller*, for example, the taxpayer did not obtain bond and was thus unable to enjoin collection of the assessments. As a practical matter, it is quite likely that other individual taxpayers, unlike businesses, will be unable to post security in many instances. If this is the case, then the protections of the injunctive relief statute might be out of the reach of the taxpayers who most need its power.

This precise issue was originally raised in the *Keller* case during the taxpayer's appeal of the Indiana Tax Court's dissolution of her injunction

42. IND. R. TR. P. 65.

43. *Palace Pharmacy, Inc. v. Gardner & Guidone, Inc.*, 164 Ind. App. 513, 515, 329 N.E.2d 642, 644 (1975).

44. *See, e.g., Peters v. Davidson, Inc.*, 172 Ind. App. 39, 46-47, 359 N.E.2d 556, 561-62 (1977).

to the Indiana Supreme Court. The Indiana Supreme Court, however, dismissed that appeal without reaching the merits because the appellate brief failed to provide cogent argument for review.⁴⁵ Thus, it seems likely that many individual taxpayers will be hard pressed to post adequate security and thus obtain injunctive relief unless the legislature steps in to clarify this area or the Indiana Tax Court is lenient on this issue.

The *Keller* decision is thus an excellent example of how the Indiana Tax Court addresses petitions for injunctive relief. In considering the petitions, the court usually traces the requirements of Indiana Code section 33-3-5-11(c) to determine whether the statutory elements are present. In addressing the equitable considerations aspect of the statute, the court relies on general principles of injunctive relief including the requirement that security must be posted.

Because of Judge Fisher's thoroughness, counsel considering injunctive relief from the Indiana Tax Court now have a significant body of case law from which to work. Although, as *Keller* demonstrates, there are still plenty of novel issues to be addressed in the injunctive relief setting, the Indiana Tax Court has laid the basic framework from which such questions will be decided. Importantly, the *Keller* opinion indicates that the extraordinary remedy of equitable relief will not be denied to a taxpayer merely on the grounds of bad reputation. The case also demonstrates what can be gained by cooperating fully with the taxing authorities. Finally, the case raises crucial legal and philosophical issues concerning whether security must be posted by a taxpayer seeking injunctive relief. It is, perhaps, this security question that will ultimately bring the most attention to the *Keller* case.

III. SUBSTANTIVE DECISIONS

A. Sales and Use Taxes

In two similar cases the Indiana Tax Court addressed a question of first impression in Indiana of whether a club is liable for the Indiana gross retail tax (the sales tax) on a gratuity service charge added to a club member's food and beverage charges. In *Summit Club, Inc. v. Indiana Department of Revenue*⁴⁶ and *Bloomington Country Club v. State*,⁴⁷ the Indiana Tax Court held that, under each club's specific arrangement, the club was not liable for sales tax on the 15% service charges added to the patron's bill.⁴⁸

45. *Keller v. State*, 549 N.E.2d 372 (Ind. 1990) (appeal dismissed for failure to comply with Appellate Rule 8.3(A)(7)).

46. 528 N.E.2d 129 (Ind. Tax Ct. 1988).

47. 543 N.E.2d 1 (Ind. Tax Ct. 1989).

48. *Summit Club*, 528 N.E.2d at 132; *Bloomington Country Club*, 543 N.E.2d at 3.

The disputes arose under the language of Indiana Code section 6-2.5-4-1(e), which provides for the imposition of a sales tax on the gross retail income received from selling at retail, but only to the extent that the income represents:

- (1) the price of the property transferred, without the rendition of any service; and
- (2) . . . any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer, and which are separately stated on the transferor's records.⁴⁹

In both cases the Indiana Department of State Revenue had assessed the Indiana gross retail income on the grounds that the 15% gratuity service was a "*bona fide*" charge made for the delivery of food.

In both cases, however, the Indiana Tax Court found for the taxpayers. In *Summit Club*, the court explained that within a public restaurant the "gratuity in question . . . would either be not left at all, left in cash on the table, or added by the customer on a credit card slip."⁵⁰ Thus, the Indiana Tax Court reasoned, in a public restaurant no sales tax would be imposed on the amount. The court found that "the 15% gratuity service charge in the case at bar is in lieu of the above methods of paying the gratuity."⁵¹

The decisions in *Summit Club* and *Bloomington Country Club* thus illustrate that the Indiana Tax Court will, in cases such as these, look to substance over form. Tax counsel should be careful, however, in structuring gratuity payments in this fashion. In each case the Indiana Tax Court focused on the particular facts presented. Given that the language of Indiana Code section 6-2.5-4-1(e) would, on its face, appear to apply to such service charges, it is possible that a structure different from that in these cases could result in the imposition of sales tax on the purported gratuity charge.

For instance, in each case the Indiana Tax Court appeared to find it important that the service charge went directly to the service personnel involved. This indicates that a different result might be reached if a pooling of the charges occurred. In *Bloomington Country Club*, for

49. IND. CODE § 6-2.5-4-1(e) (1988).

50. 528 N.E.2d at 132.

51. *Id.* It should be noted that in making its decision, the Indiana Tax Court found similar cases from Illinois and Wisconsin to be persuasive. *Id.* at 131 (citing *Sangamo Club v. Department of Revenue*, 115 Ill. App. 3d 617, 450 N.E.2d 1308 (1983) and *Big Foot Country Club v. Wisconsin Dep't of Revenue*, 70 Wis. 2d 871, 235 N.W.2d 696 (1975)).

example, the court specifically wrote that "service charges are taxable when employers collect the charges and pay them out as wages or bonuses."⁵²

Thus, counsel faced with this planning issue should carefully evaluate these two opinions. Although both cases found for the taxpayer, it remains to be seen whether slightly different service charge structures might not avoid the seemingly broad language of the sales tax statute. It is at least clear that service charges paid out as bonuses or wages will be treated as part of gross retail income and will thus be taxed accordingly.

In another sales tax case, *Video Tape Exchange Co-op. v. Indiana Department of Revenue*,⁵³ the Indiana Tax Court upheld the assessment of the sales tax on the rental of videos to consumers. There the taxpayer appealed from a final determination of the Indiana Department of State Revenue assessing sales tax. In finding for the Department, the court ruled that the rental of videos is taxable, notwithstanding the language of Indiana Code section 6-2.5-4-10(c) which excludes from sales taxation the renting or leasing of an audio or video tape if the person renting the video "broadcasts the film or tape for home viewing or listening."⁵⁴ The Indiana Tax Court focused on the word "broadcast," which it found to mean more than just viewing a video at home for personal pleasure. The court explained that the word broadcast carries with it connotations of widespread dissemination to the general public.⁵⁵

On the procedural side, the *Video Tape Exchange Co-op.* court also rejected the taxpayer's argument that the Department should be estopped from assessing the tax. The taxpayer argued that it should not have to pay the tax because an employee of the taxing authority had stated over the phone that video rentals were not subject to the gross retail tax. In dismissing this contention, the court noted the rule that estoppels against the state are disfavored and will be invoked only where there is clear evidence that state agents made representations upon which the taxpayer relied. In this case the taxpayer made "only bare assertions" of the conversations and was unable to identify the nature of the conversation and the name of the employee. Moreover, the taxpayer never sought written information on the taxability of its rentals. In sum, the Indiana Tax Court found that the taxpayer had not met its burden to prove an estoppel against the state.⁵⁶

52. *Bloomington Country Club*, 543 N.E.2d at 3.

53. 533 N.E.2d 1302 (Ind. Tax Ct. 1989).

54. IND. CODE § 6-2.5-4-10(c) (1988).

55. 533 N.E.2d at 1303-04.

56. *Id.*

Finally, after rejecting what is usually a meritless argument that the Department of Revenue had selectively enforced the tax laws against the taxpayer, the *Video Tape Exchange Co-op.* court ruled that the penalties assessed against the taxpayer should be waived. The penalty was imposed pursuant to Indiana Code section 6-8.1-10-2(a), which provides:

If a person fails to file a return for any of the listed taxes or fails to pay the full amount of tax shown on his return on or before the due date for the return or payment, incurs, upon examination by the department, a deficiency which is due to negligence, or fails to timely remit any tax held in trust for the state, the person is subject to a penalty.⁵⁷

However, subsection (d) of the statute further provides that the penalty should be waived if the taxpayer shows that the failure to pay was due to reasonable cause.

In waiving the penalty, the Indiana Tax Court relied on the Department of Revenue's regulation governing reasonable cause in the penalty context. This regulation, which is found at Title 45 of the Indiana Administrative Code, section 15-11-2(c), begins by stating that the taxpayer must demonstrate "that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed. . . ."⁵⁸ The regulation lists a number of factors that may be considered, and states that reasonable cause "is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case."⁵⁹

In *Video Tape Exchange Co-op.*, the Indiana Tax Court found that while ignorance of the tax laws is normally not an excuse for failure to pay tax, in this case there was reasonable cause for not paying. Factors the court found persuasive included that the video industry was in its early stages, the statute was not as clear as it might be, no new regulation covered the industry, and the taxpayer had partially relied on a tax service report what indicated that rentals of video tapes were excluded from the sales tax. The court thus waived the penalty, but at the same time held that the interest on the deficiency could not be waived.⁶⁰

In the use tax area, the Indiana Tax Court ruled that the use tax was properly assessed on an airline's food purchased within Indiana and furnished to passengers and crew outside of Indiana during the course

57. IND. CODE § 6-8.1-10-2(a) (1988).

58. IND. ADMIN. CODE tit. 45, r. 15-11-2(c) (Supp. 1 1989).

59. *Video Tape Exch. Co-op.*, 533 N.E.2d at 1036.

60. *Id.*

of interstate flights. In *USAir, Inc. v. Indiana Department of Revenue*,⁶¹ the court rejected the airline's argument that the food was exempt as property purchased for resale. The court reasoned that it would strain the definition of "resale" to conclude that USAir was reselling the food to its crew and passengers when there was nothing in the price of the ticket to reflect the price of the meals. Moreover, the court ruled, the exemption from use tax for property used or consumed in providing public transportation did not apply because the service of food was not necessary and integral to the provision of transportation. Rather, the court found that such service was only incidental to the airline's transportation service.

Finally, the *USAir* court ruled that the exemption from the use tax for food sold for human consumption did not apply because of the statutory exception to that exemption whereby "take-out" or "to-go" food is taxed. In this case the court found that the food was packaged for immediate consumption and was thus not exempted from taxation.⁶²

B. Income Taxes

In affirming an earlier decision of the Indiana Tax Court, the Indiana Supreme Court held that the gross income tax applied to the sale of cheese where the buyer took delivery in state and transported the cheese in its own trucks outside the state subject to return upon out-of-state inspection. In *Associated Milk Producers v. Indiana Department of Revenue*,⁶³ the taxpayer had a facility in Warsaw, Indiana, where it produced cheese that it sold to Borden, Inc., in Ohio and Wisconsin. The cheese was loaded onto Borden trucks at Warsaw and driven to the out-of-state Borden facilities, where the cheese was inspected and tested.

The taxpayer was assessed gross income tax of some \$99,000 in relation to these sales. After paying the tax, the producer filed a claim for refund with the Department of Revenue, which was denied. The taxpayer unsuccessfully appealed to the Indiana Tax Court,⁶⁴ and then brought a direct appeal to the Indiana Supreme Court.

In affirming the Indiana Tax Court, a unanimous Indiana Supreme Court first began by noting the "onerous burden" that the taxpayer had on appeal from the Indiana Tax Court. The court wrote that it "will overturn the decision of the court below only if it was clearly erroneous," and noted that due regard shall be given to the opportunity

61. 542 N.E.2d 1033 (Ind. Tax Ct. 1989).

62. *Id.* at 1037-39.

63. 534 N.E.2d 715 (Ind. 1989).

64. 512 N.E.2d 917 (Ind. Tax Ct. 1987).

of the Tax Court to judge the credibility of the witnesses.⁶⁵ Then, in rejecting the taxpayer's Commerce Clause argument, the court found that the sale was completed in Indiana. Relying on the Department of Revenue's regulation on the issue, the court upheld the Tax Court's determination that the transactions at issue constituted a taxable out-shipment.⁶⁶ The court noted that the buyer took physical possession of the goods in Indiana and that title presumably passed to the buyer at that time pursuant to section 2-401 of the Uniform Commercial Code, absent an agreement otherwise. The Indiana Supreme Court upheld Judge Fisher's finding that the parties did not have an explicit agreement otherwise on the issue of when title passed.⁶⁷

Thus, the *Associated Milk Producers Case* shows that the mere fact that a transaction has some interstate connection does not preclude the imposition of a state tax. The case also illustrates the substantial burden a party will face in seeking to reverse the Indiana Tax Court's factual findings.

C. Tangible Property Taxes

1. *Real Property*.—In *St. Mary's Medical Center of Evansville v. State of Indiana Board of Tax Commissioners*,⁶⁸ the taxpayer appealed a final determination of the Board of Tax Commissioners denying a religious or charitable exemption from real property taxation. Indiana Code section 6-1.1-10-16 provides an exemption for all or part of a building and the land thereunder that is owned, occupied, and used for educational, literary, scientific, religious, or charitable purposes.⁶⁹ Based on this statutory provision, the Indiana Tax Court affirmed the final determination of the State Board that the taxpayer had failed to satisfy the "use and occupancy" requirements to obtain an exemption.

Specifically, the court ruled that the State Board's findings that the medical buildings were not reasonably necessary for the maintenance of the taxpayer's religious purpose were supported by substantial evidence. The taxpayer failed to meet its burden to show that the property clearly fell within the exemption statute.⁷⁰

On the procedural front, the *St. Mary's* court also rejected the taxpayer's argument that the buildings were exempt under the doctrine of legislative acquiescence. The Tax Court noted that the Indiana Supreme

65. 534 N.E.2d at 716 (citation omitted).

66. *Id.* at 717 (citing IND. ADMIN. CODE tit. 45, r. 1-1-[119] (1988)).

67. 534 N.E.2d at 717.

68. 534 N.E.2d 277 (Ind. Tax Ct. 1989).

69. IND. CODE § 6-1.1-10-16 (1988).

70. 534 N.E.2d at 278-81.

Court had cast grave doubt on this doctrine in *Indiana State Board of Tax Commissioners v. Fraternal Order of Eagles Lodge No. 255*,⁷¹ and found that the taxpayer had not shown that the Indiana General Assembly had been apprised of and acquiesced in the prior interpretation of the statute by the Board allowing the exemption. After *Eagles Lodge*, mere incorrect administrative interpretations will not invoke the doctrine of legislative acquiescence.⁷²

2. *Personal Property*.—In *Keller Industries v. State Board of Tax Commissioners*,⁷³ taxpayer Keller Industries appealed a final determination of the Indiana State Board of Tax Commissioners, which determination had denied an interstate commerce exception from personal property taxation under Indiana Code section 6-1.1-10-30(b). This statutory provision allows an exemption for personal property that has been ordered for out-of-state shipment to a specific known destination, has been placed in an original package in a warehouse for the purpose of out-of state shipment, remains in the warehouse until shipment, and is actually shipped to that specific known out-of-state destination.⁷⁴

Keller Industries was a Florida corporation that manufactured outdoor furniture in Indiana. The company took orders from customers and matched actual production with existing purchase orders such that every bill of lading corresponded to a purchase order. The Indiana Tax Court found that this arrangement satisfied the requirements of the exemption statute and thus reversed the State Board of Tax Commissioners' decision as arbitrary and capricious.⁷⁵

In *Thomas Dodge v. State Board of Tax Commissioners*,⁷⁶ the taxpayer was an Indiana automobile dealership which, in February of 1987, sold 186 new cars to an Illinois new car dealer. On March 1, 1987, the taxpayer thus had reduced its inventory to only eleven vehicles; later in March the taxpayer rebuilt its inventory to 150 vehicles. Based on these facts the Indiana State Board of Tax Commissioners found that the only possible purpose of the February sale was to avoid payment of the Indiana personal property tax, which is assessed on March 1 of each year. The State Board of Tax Commissioners assessed personal property taxation against the dealership under the language of Indiana Code section 6-1.1-3-16, which states:

If, from the evidence before him, a township assessor determines that a person has temporarily converted any part of his personal

71. 521 N.E.2d 678 (Ind. 1988).

72. *St. Mary's Medical Center*, 534 N.E.2d at 281-82.

73. 529 N.E.2d 1221 (Ind. Tax Ct. 1988).

74. IND. CODE § 6-1.1-10-30(b) (1988).

75. *Keller Industries*, 529 N.E.2d at 1224.

76. 542 N.E.2d 245 (Ind. Tax Ct. 1989).

property into property which is not taxable under this article to avoid the payment of taxes on the converted property, the township assessor shall assess the converted property to the taxpayer.⁷⁷

The taxpayer thereafter appealed the Board's final determination to the Indiana Tax Court, which ruled in favor of the taxpayer.

In reversing the State Board of Tax Commissioners and finding for the taxpayer, the *Thomas Dodge* court held that no "temporary" conversion of personal property had occurred as found by the State Board. Rather, the evidence showed that the dealer entered into a *bona fide* sale of its 186 new vehicles to an out-of-state dealer. The Indiana Tax Court noted the maxim that "[m]ere tax avoidance is not tax evasion."⁷⁸ Rather, the court wrote, "[a] taxpayer has the right to minimize or avoid taxes by any means which the law permits."⁷⁹

The *Thomas Dodge* decision is thus an excellent example of the type of activity that a taxpayer can legally engage in to minimize taxation.

D. Estate Tax

The most important decision on Indiana estate and death taxes came from the Indiana Supreme Court in *State Department of Revenue v. Estate of Eberbach*.⁸⁰ In *Eberbach* the estate, on its federal estate tax return, claimed a federal credit for state death taxes of \$2,085. The estate then filed an Indiana inheritance tax return with the trial court, which court determined that the estate owed \$2,085, the same amount the estate had claimed as a state credit on its federal return. The trial court gave the estate a 5% reduction for early payment (equating to \$104), and the estate thus paid approximately \$1,981 in Indiana inheritance tax.⁸¹

A few months later the Indiana Department of Revenue determined that the estate owed some \$3,000 in Indiana estate tax. The estate paid

77. IND. CODE § 6-1.1-3-16 (1988).

78. *Thomas Dodge*, 542 N.E.2d at 246.

79. *Id.* (citing *Ogden v. Walker*, 59 Ind. 460 (1877)).

80. 535 N.E.2d 1194 (Ind. 1989). The Indiana Tax Court addressed two cases involving death taxes during the survey period; however, these decisions are not that significant in terms of Indiana taxation and are merely noted here. See *Estate of Sowers v. Indiana Dep't of Revenue*, 533 N.E.2d 1306 (Ind. Tax Ct. 1989) (court interprets trust language of "per stirpes among my living children and grandchildren" as requiring distribution in equal shares to the decedent's three living children and only to the grandchildren by representation); *Blood v. Poindexter*, 534 N.E.2d 768 (Ind. Tax Ct. 1989) (transfer of beneficial interest in charitable remainder unitrust, including as asset a beneficial interest in land trust holding Indiana real property, to be transfer of intangible property not subject to inheritance tax).

81. *Eberbach*, 535 N.E.2d at 1195.

the assessment, sought a refund from the Department of Revenue, but the claim for refund was denied. The estate then timely appealed the Department of Revenue's final determination to the Indiana Tax Court, which held that the estate owed only \$104 in Indiana estate tax. The Indiana Tax Court ruled that the estate was liable for this amount because it was the difference between the federal credit taken for state death taxes and the actual amount of death taxes paid.⁸²

The Department of Revenue appealed the Indiana Tax Court's decision to the Indiana Supreme Court, which affirmed the Indiana Tax Court's holding. The Indiana Supreme Court explained that the Indiana estate tax is only imposed if the total state death taxes paid (which death taxes by definition include an inheritance or other transfer tax imposed because of death but do not include the Indiana estate tax)⁸³ are less than the maximum federal estate tax. By statute, the Indiana estate tax thus equals the remainder of (1) the federal death tax credit allowed against the federal estate tax, minus (2) the total state death taxes actually paid.⁸⁴

In this case, then, the Indiana estate tax equalled the credit allowed for death taxes, which was \$2,085, minus the total state death taxes actually paid, which was \$1,981. By applying the statute, then the total Indiana estate tax was just \$104, not the \$3,000 that the Department of Revenue assessed. The Department of Revenue had based its higher assessment of the Indiana estate tax on the maximum federal credit that the estate could have taken on its federal return for state death taxes, which maximum credit was some \$5,000. The Department had thus subtracted the approximately \$2,000 in state death taxes paid from the maximum federal credit for state death taxes to arrive at its \$3,000 figure.⁸⁵

The Indiana Supreme Court, however, followed the reasoning of the Indiana Tax court that the language "federal death tax credit allowed" of the Indiana estate tax statute means the amount of federal credit for state death taxes actually taken on the federal estate return, and not the amount of credit that could have been taken. In so holding, the court reasoned that the purpose of the Indiana estate tax is merely to pick up revenue that otherwise would go into the federal treasury. The court expressly stated that the "purpose of the Indiana estate tax is not furthered by allowing the Department to calculate the estate tax without regard to the actual credit taken."⁸⁶

82. See *Estate of Eberbach v. Indiana Dep't of Revenue*, 512 N.E.2d 902 (Ind. Tax Ct. 1987).

83. IND. CODE § 6-4.1-1-12 (1988).

84. *Id.*

85. *Eberbach*, 535 N.E.2d at 1196.

86. *Id.* at 1197.

The *Eberbach* estate tax decision, much like the *Thomas Dodge* personal property tax opinion, is thus another example of the maxim that taxpayers can legally attempt to reduce their tax liabilities. As the *Eberbach* court stated in quoting from one of Judge Learned Hand's most famous passages, "Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes."⁸⁷

IV. THE DEMISE OF THE INTANGIBLES TAX

Indiana Code section 6-5.1-1-1, *et seq.*, formerly provided for the imposition of a tax on the transfer of or receipt of income from an intangible such as a promissory note, bond, contract, or other similar instrument.⁸⁸ The tax, which had been scheduled by statute to gradually phase out by the year 1996,⁸⁹ had historically raised millions of dollars in revenue for the state. During the survey period, however, the intangibles tax fell to the Constitution, the courts, and the legislature.

The first attack came from the Marion County Superior Court, which declared the intangibles tax unconstitutional in *Felix v. Indiana Department of Revenue*.⁹⁰ In *Felix*, the plaintiffs brought a class action suit challenging the constitutionality of the intangibles tax under the Commerce Clause. In striking down the tax, the court ruled that the statute impermissibly discriminates against non-Indiana corporations and their stockholders by exempting intangibles issued by Indiana entities from the intangibles tax. Moreover, the court ruled, the tax violates article ten, section one of the Indiana Constitution because the tax is in essence a property tax as it is based on a year-end valuation regardless of whether the taxpayer engaged in any transactions during the year. Because ownership of stock in foreign corporations was taxed at the intangibles rate, while stock in Indiana corporations was not taxed at all, the intangibles tax set unequal rates of property assessment in violation of the Indiana Constitution.

After much debate by the Department of Revenue and Governor Evan Bayh's administration, it was finally concluded that the case would be appealed. The case is before the Indiana Supreme Court awaiting decision.⁹¹

Effective November 10, 1988, the General Assembly repealed the intangibles tax completely. However, it remains to be seen whether the

87. *Id.* (quoting *Helvering v. Gregory*, 69 F.2d 809, 810 (2d Cir. 1934)).

88. IND. CODE ANN. § 6-5.1-1-1 (Burns Supp. 1989).

89. IND. CODE § 6-5.1-2-2 (1988).

90. No. S186-0406, slip op. (Marion Sup. Ct. Nov. 10, 1988).

91. *Indiana Dep't of Revenue v. Felix*, No. 49500-8905-60-388 (consolidated appeal).

intangibles tax might be reintroduced if the Indiana Supreme Court finds the tax to be constitutional.

ADDENDUM

As this Article went to press, the Indiana General Assembly passed a bill that would clarify the jurisdictional questions concerning death taxes in Indiana. Specifically, Indiana Senate Bill Number 318 proposes that when an appeal from the Department of Revenue's denial of a claim for refund of Indiana inheritance or estate taxes is pursued, it must be lodged with the local probate courts having jurisdiction over the decedent's estate. Any further appeal of the tax matter would then go to the Indiana Tax Court.

This proposal, if signed into law by Governor Bayh, would clear up the statutory conflicts over jurisdiction of such cases that came about with the creation of the Indiana Tax Court.⁹² If enacted, tax practitioners should scrutinize the statute and ensure that death tax issues are presented to the appropriate tribunal.

92. See *Blood v. Poindexter*, 524 N.E.2d 824 (Ind. Tax Ct. 1988) (discussing statutory conflict and concluding that Tax Court had exclusive jurisdiction over death tax cases).