DEPARTMENT OF STATE REVENUE

01-20160256.LOF

Letter of Findings Number: 01-20160256
Individual Income Tax
For Tax Periods: 2011, 2012 and 2014

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Married couple were not entitled to claim a credit for taxes paid to another state against Indiana county income taxes.

ISSUE

I. Individual Income Tax - Credit for Taxes Paid to Georgia and Alabama.

Authority: IC § 6-3.5-1.1-6; IC § 6-3.5-6-23; IC § 6-3.5-7-8.1 (effective January 1, 2015); Comptroller of the Treasury of Maryland v. Wynne, 135 S. Ct. 1787 (2015); Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Indiana Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Bd. of Comm. of Howard County v. Kokomo City Plan Comm., 263 Ind. 282 (Ind. 1975); Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue, 867 N.E.2d 289; Md. State Comptroller of the Treasury v. Wynne, 64 A.3d 453 (Md. 2013); Frey v. Comptroller of Treasury, 29 A.3d 475 (Md. 2011); Frank H. Easterbrook, Presidential Review, 40 Case W. Res. L. Rev. 905 (1989); Letter of Findings 76-20060230 (January 10, 2007).

Taxpayers argue that they are entitled to claim credit for taxes paid to Georgia and Alabama against their Allen County income tax.

STATEMENT OF FACTS

Taxpayers are residents of Indiana who filed an Indiana income tax return for the years at issue. On their Indiana income tax returns, Taxpayers reported Allen County county income taxes (hereinafter "County taxes"). Taxpayers had taxes paid on their behalf by an S Corporation for taxes owed in Georgia and Alabama. The Indiana Department of Revenue ("Department") disallowed Taxpayers from taking a credit against Allen County taxes for taxes paid to the states of Georgia and Alabama.

For the years 2011 and 2012 Taxpayers initially filed a claim for refund with the Department; refunds were issued by the Department for those years. However, the Department subsequently billed Taxpayers for the years 2011 and 2012 after determining that the credit at issue should not have been allowed. For the year 2014 Taxpayers filed their Indiana income tax return and the Department denied the credit.

Taxpayers disagreed with the Department's decision and submitted a protest. An administrative hearing was conducted and this Letter of Findings results.

I. Individual Income Tax - Credit for Taxes Paid to Georgia and Alabama.

DISCUSSION

As a threshold issue, it is Taxpayers' responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Indiana Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing. . .[courts] defer to the agency's reasonable interpretation of [the]

statute even over an equally reasonable interpretation by another party.'" Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014). Thus, all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

In this protest, Taxpayers argue that the Department's refusal to grant a credit conflicts with the Supreme Court's decision in Comptroller of the Treasury of Maryland v. Wynne, 135 S. Ct. 1787 (2015). An examination of the Wynne decision, below, shows that Taxpayer is mistaken.

A. Maryland v. Wynne

In Wynne, the U.S. Supreme Court considered the constitutionality of Maryland's income tax structure. Maryland collected a state income tax, a "special nonresident tax," and a "county" income tax. Maryland required all its counties to impose the county tax, which the state collected, at a rate based on the county in which the individual taxpayer lived. Maryland State Comptroller of the Treasury v. Wynne, 64 A.3d 453, 457-58 (Md. 2013). According to a Maryland Court of Appeals, Maryland's county income tax was part of a single state-imposed income tax scheme because the state mandated the income tax, restricted the authority of the counties to set the rate, and distributed the funds collected pursuant to that tax. Frey v. Comptroller of Treasury, 29 A.3d 475, 483, 492 (Md. 2011); Wynne, 135 S.Ct. at 1792. ("Despite the names that Maryland has assigned to these [state and county income] taxes, both are State taxes, and both are collected by the State's Comptroller of the Treasury"). In other words, Maryland's county tax was a mandatory tax imposed by the state, not a local-option tax imposed by localities.

As a result of this system, Maryland created three categories of taxpayers: (1) Maryland residents, who earned all their income in Maryland, paid the state and county income taxes; (2) Maryland residents who earned some of their income outside Maryland, paid the state income tax and the county income tax on all income, and were entitled to a credit against state taxes only for income tax paid to other states; and (3) nonresidents who earned some income in Maryland, paid the state income tax and the special nonresident tax. Wynne, 135 S. Ct. at 1792.

In Wynne itself, the taxpayers, a married couple, earned income in Maryland and thirty-nine other states attributable to their ownership interest in a multi-state S Corporation. Maryland refused to give the taxpayers a credit against their Maryland county income tax for income taxes they had paid to other states.

The Supreme Court held that Maryland's tax structure violated the dormant Commerce Clause. The Court explained that "States are allowed to tax a taxpayer's multistate income if the income is fairly apportioned among taxing jurisdictions," but a State may not impose taxes that "discriminate" against income earned interstate. Id. at 1796-98 (citations and quotations omitted). To determine whether a tax discriminates against interstate income, the Court adopted the "internal consistency" test:

> This test, which helps courts identify tax schemes that discriminate against interstate commerce, looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate.
>
> By hypothetically assuming that every State has the same tax structure, the internal consistency test allows courts to isolate the effect of a defendant State's tax scheme. This is a virtue of the test because it allows courts to distinguish between (1) tax schemes that inherently discriminate against interstate commerce without regard to the tax policies of other States, and (2) tax schemes that create disparate incentives to engage in interstate commerce (and sometimes result in double taxation) only as a result of the interaction of two different but nondiscriminatory and internally consistent schemes. . . The first category of taxes is typically unconstitutional; the second is not.

Id. at 1802 (citations and internal quotations omitted).

As the court explained, if every state had a scheme identical to Maryland's - which allowed no credit for county income tax paid out-of-state - then no taxpayer in any state could obtain a credit for county taxes paid in another state. Everyone earning interstate income in any state would be taxed at a higher rate than those earning only intrastate income. The disparate treatment of interstate income in Maryland was an intrinsic feature of Maryland's tax structure and not merely the result of the interaction of differing state tax structures. This violated the internal consistency principle.

Based on this analysis, the Court held that Maryland's tax scheme violated the dormant Commerce Clause because it "inherently" subjected interstate income to higher taxes than intrastate income. Id. at 1804.

B. Comparison of Maryland and Indiana

The tax regimes of Maryland and Indiana differ in several key respects. Like Maryland, Indiana imposes a state income tax, taxes residents on income earned elsewhere, and taxes non-residents on income earned in Indiana.

Unlike Maryland, however, Indiana allows credits for out-of-state taxes at both the state and local levels. Indiana allows a credit for out-of-state income taxes against Indiana's state income tax, and a credit for out-of-state local income taxes against local income taxes owed in Indiana. IC § 6-3.5-1.1-6; IC § 6-3.5-6-23; IC § 6-3.5-7-8.1 (effective January 1, 2015). Although Indiana does not permit out-of-state state income taxes to offset Indiana county income taxes, or allow out-of-state local income taxes to offset Indiana state income taxes, Indiana maintains symmetry in allowing credits at both the state-to-state level and the county-to-county level. According to the Supreme Court, had Maryland offered credits for out-of-state taxes, Maryland's tax system would have survived constitutional scrutiny: "To be sure, Maryland could remedy the infirmity in its tax scheme by offering, as most States do, a credit against income taxes paid to other States. If it did, Maryland's tax scheme would survive the internal consistency test and would not be inherently discriminatory." Id. at 1805.

Moreover in Indiana, unlike in Maryland, each county chooses whether to impose a county-level income tax, and each county's governing body must independently approve both the tax and the rate. Until 2013, at least one county in Indiana imposed no county-level income tax at all. Accordingly, Indiana's local-option income taxes are not part of a single state-imposed income tax scheme.

C. Analysis

Contrary to the Taxpayers' argument, Wynne suggests that Indiana's tax structure passes constitutional muster. Unlike Maryland, Indiana credits taxpayers for out-of-state income taxes at both the state-to-state level and the county-to-county level. According to Wynne, such credits allow a state's tax system to "survive the internal consistency test" because the tax system "would not be inherently discriminatory." Wynne, 135 S.Ct. at 1805.

Applying the internal consistency principle as the Court did in Wynne, if every state adopted a tax structure identical to Indiana's, then every state would impose state and county taxes, and taxpayers in every state would be entitled to claim credits for both state and county taxes paid on income earned out-of-state. Everyone earning interstate income would be taxed at the same rate as those earning only intrastate income. Any disparate treatment of interstate income in Indiana could only result from the interaction of differing state tax structures, not from anything inherent in Indiana's tax structure. A straightforward application of Wynne's internal consistency principle demonstrates that Indiana's tax structure fully comports with the dormant Commerce Clause.

D. Prudential Considerations

In general, the Department of Revenue is not the best forum in which to evaluate a constitutional question. Of course, every departmental employee, and every member of the executive branch, has an inherent responsibility to construe and interpret the constitution as it bears on the exercise of his responsibilities. See generally Frank H. Easterbrook, Presidential Review, 40 Case W. Res. L. Rev. 905 (1989). Nevertheless, "all statutes are presumptively rational and constitutional." Bd. of Comm. of Howard County v. Kokomo City Plan Comm., 263 Ind. 282, 286-87 (Ind. 1975). As a result, as a practical matter, the Department of Revenue usually denies challenges to a statute's constitutionality. In one typical decision, the Department concluded the following: "The Department takes note of Taxpayers' constitutional and statutory protests. However, Taxpayers raise issues which are beyond the purview of administrative review by the Department. Taxpayers' constitutional challenges will not be addressed here because the Department will not overturn a tax scheme enacted by the Indiana General Assembly based upon Taxpayers' facial constitutional and statutory challenges." Letter of Findings 76-20060230 (January 10, 2007), 20070328 Ind. Reg. 045070178NRA.

FINDING

Taxpayers' protest is respectfully denied.

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