

# 1994 DEVELOPMENTS IN INDIANA TAXATION

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## INTRODUCTION

It was business as usual in the Indiana tax arena during 1994. The Indiana Tax Court continued its role as the ultimate arbiter of Indiana tax cases, rendering forty-one published opinions during 1994 on a wide variety of issues. The Indiana Supreme Court, by contrast, issued only two opinions on Indiana tax. Subjects addressed by the Indiana Tax Court ranged from the constitutionality of Indiana's "drug tax" to routine property, income, and sales tax cases. This Article highlights the more significant 1994 Indiana tax decisions.

### I. CONTROLLED SUBSTANCES EXCISE TAX

As part of the war on drugs, and as a means of revenue enhancement as well, Indiana enacted a tax on the delivery, possession, and manufacture of controlled substances outlawed by Indiana's criminal code.<sup>1</sup> The Drug Tax applies when a person receives delivery of, takes possession of, or manufactures a controlled substance in violation of state or federal drug laws.<sup>2</sup> The amount of the tax imposed is based upon the weight and class of the drug,<sup>3</sup> and a penalty of 100% is imposed for failure to pay the tax.<sup>4</sup>

During the Survey period, several individuals who were assessed the Drug Tax challenged the statute in the Indiana Tax Court. Those with criminal convictions for their involvement with the particular drug met with success, while those without such convictions did not.

The leading case, *Cliff v. Indiana Department of State Revenue*,<sup>5</sup> contains the tax court's fullest discussion of the issue. In *Cliff*, a husband and wife were arrested for possession of 927 grams of marijuana. Law enforcement authorities shared this information with the Department of Revenue, which assessed a Drug Tax of \$37,080, a nonpayment penalty of \$37,080, and a 10% collection fee of \$3708 upon the Cliffs.<sup>6</sup>

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1. IND. CODE § 6-7-3-5 (Supp. 1994). The Controlled Substance Excise Tax took effect July 1, 1992. For simplicity, this Article will refer to the tax as the "Drug Tax." Proceeds from the Drug Tax go to drug abuse prevention and criminal investigation. IND. CODE § 6-7-3-16 (1993).

2. IND. CODE § 6-7-3-8 (Supp. 1994).

3. *Id.* § 6-7-3-6.

4. *Id.* § 6-7-3-11(a).

5. 641 N.E.2d 682 (Ind. T.C. 1994).

6. The collection fee is authorized by IND. CODE § 6-8.1-8-2(b) (Supp. 1994).

On the criminal side, Mrs. Clift pleaded guilty to possession of drugs as a class A misdemeanor and received a six month driver's license suspension and a one-year sentence of incarceration with all but two days suspended. The charges against Mr. Clift, however, were dropped (much to his later misfortune).

On the tax side, the Clifts challenged the Drug Tax under the Fifth Amendment (self-incrimination and double jeopardy), and the Fourteenth Amendment (equal protection and due process) of the United States Constitution. The Clifts raised similar claims for the parallel Indiana constitutional provisions, but failed to develop them, and as a result, the Indiana provisions were not at issue in the court's opinion.<sup>7</sup>

Judge Fisher began by noting the taxpayer's "difficult burden" of challenging the constitutionality of the tax.<sup>8</sup> He explained that the taxpayers must "rebut the strong presumption that statutes are constitutional."<sup>9</sup> He then addressed the Clift's arguments seriatim.

First, Judge Fisher rejected the self-incrimination argument. "It is well settled," he wrote, "that, standing alone, the illegality of an activity, such as the unauthorized possession of marijuana or other controlled substances, does not preclude taxation of the activity."<sup>10</sup> To be unconstitutional in this context, the imposition and collection methods must "create 'real and appreciable,' and not merely 'imaginary and unsubstantial,' hazards of self-incrimination."<sup>11</sup>

The Indiana Drug Tax, however, has an express provision prohibiting the Department from requiring taxpayers to reveal their identity. The statute provides that "[a] person may not be required to reveal the person's identity at the time the tax is paid."<sup>12</sup> Interpreting this language, Judge Fisher reasoned that the taxpayer could send an agent to pay the tax, and the statute would not otherwise require disclosure of the name, address, phone number, social security number, or any other identifying information for such individual. According to the court, the Drug Tax thus does not require any person to give self-incriminating evidence.<sup>13</sup>

Moreover, the Drug Tax statute prohibits the use of confidential information acquired by the Department "to initiate or facilitate prosecution for an offense."<sup>14</sup> The court reasoned that even if the Drug Tax did compel self-incrimination, it essentially granted use immunity and derivative use immunity, thus removing any Fifth Amendment self-incrimination problems.<sup>15</sup>

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7. *Clift*, 641 N.E.2d at 684 n.2.

8. *Id.* at 685.

9. *Id.* (citing *State Line Elevators, Inc. v. State Bd. of Tax Comm'rs*, 528 N.E.2d 501, 503 (Ind. T.C. 1988)).

10. *Id.* (citing *Department of Revenue v. Kurth Ranch* 114 S. Ct. 1937 (1994)).

11. *Id.* (citing *Marchetti v. United States*, 390 U.S. 39, 44 (1968)).

12. IND. CODE § 6-7-3-8 (Supp. 1994).

13. *Clift*, 641 N.E.2d at 687.

14. IND. CODE § 6-7-3-9 (Supp. 1994).

15. *Clift*, 641 N.E.2d at 689.

The tax court then easily rejected the Cliffits' equal protection argument, noting that people who "possess controlled substances are not a suspect class," and as a result, Judge Fisher found no equal protection violation.<sup>16</sup>

The Cliffits next argued that the Drug Tax violates due process by allowing a jeopardy assessment to be immediately imposed without notice or a hearing. The tax court appropriately side-stepped this argument, noting that the Cliffits had received notice and a hearing, and that the Department had not taken any measures to collect on the jeopardy assessment. In any event, Judge Fisher noted that an injunction can be sought in the tax court to challenge a jeopardy assessment, and this remedy satisfies due process.<sup>17</sup>

Finally, the Cliffits challenged the Drug Tax on double jeopardy grounds, asserting that the Drug Tax, like the related criminal charges, constituted punishment. On this front the Indiana Tax Court agreed. Relying on *Department of Revenue of Montana v. Kurth Ranch*,<sup>18</sup> a similar case from the United States Supreme Court invalidating Montana's drug tax, Judge Fisher held that Indiana's Drug Tax violates the Fifth Amendment's prohibition against double jeopardy.

Judge Fisher observed that in *Kurth Ranch*, the Supreme Court found the Montana drug tax to be a second punishment because: (1) the tax had a criminal deterrent purpose; (2) the tax rate was very high; (3) the tax was conditioned upon the commission of a crime; (4) the tax was not assessed until arrest; and (5) the tax could be imposed even after the drug had been confiscated.<sup>19</sup> Judge Fisher noted that Indiana's Drug Tax is very similar to Montana's. The only difference is that arrest is not a predicate to imposition of the Indiana Drug Tax. Accordingly, Judge Fisher viewed *Kurth Ranch* as controlling, and held that the Indiana Drug Tax is a punishment that "must be imposed during the first prosecution or not at all."<sup>20</sup>

Because Mrs. Clifft had been prosecuted and convicted, she was thus immune from the Indiana Drug Tax.<sup>21</sup> Mr. Clifft, however, won the battle but lost the war. Because jeopardy had not attached in any criminal action against him, double jeopardy did not bar collection of the tax from him.<sup>22</sup>

In three related cases in which opinions were issued the same day, the tax court applied *Clifft* to other assessments of the Indiana Drug Tax. In *Bailey v. Indiana Department of State Revenue*,<sup>23</sup> a taxpayer was convicted of possession of a ten-pound brick of marijuana and was sentenced to two years' imprisonment. The Department of Revenue subsequently assessed a combined Drug Tax and penalty of \$356,400. The taxpayer was relieved of this obligation due to the *Clifft* holding.

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16. *Id.* at 689-90.

17. *Id.* at 690-91.

18. 114 S. Ct. 1937 (1994).

19. *Clifft*, 641 N.E.2d at 691-92 (discussing the *Kurth Ranch* analysis).

20. *Id.* at 693 (quoting *Kurth Ranch*, 114 S. Ct. at 1948).

21. *Id.* ("[T]he Department may not collect the tax from Mrs. Clifft, who has already pled guilty to Class A misdemeanor possession.").

22. *Id.* at 693-94.

23. 641 N.E.2d 695 (Ind. T.C. 1994).

Similarly, in *Hayse v. Indiana Department of State Revenue*,<sup>24</sup> a taxpayer was spared a \$391,393 Drug Tax assessment because of his related conviction for cultivation of marijuana. Finally, in *Hall v. Department of Revenue*,<sup>25</sup> married taxpayers were assessed a \$5.6 million Drug Tax for possessing 300 pounds of marijuana. Although the husband was relieved of the obligation due to a related conviction, Mrs. Hall was not prosecuted, and under *Cliff*, she thus remained liable for the entire tax.

The tax issue in *Cliff*—widely watched among the criminal defense bar as well as the tax bar—is a substantial blow to the State's efforts to collect revenue from and deter drug activities. The Department of Revenue has filed a petition for review in the Indiana Supreme Court, so the issue is not yet completely determined.

In any event, the State remains free to simply enhance its sentencing and penalty levels for drug crimes through legislative amendments. Why it did not pursue that avenue in the first place is unclear.

For those representing individuals accused of illegal drug possession, delivery, or manufacture, *Cliff* requires a careful analysis of the potential benefits and burdens of pursuing the criminal prosecution to jeopardy. As *Cliff* and its related cases demonstrate, the potential penalty under the Drug Tax will typically be substantially more than any penalty in the criminal system. If the anticipated period of incarceration and the underlying criminal conviction are manageable for the client, the criminal route may be the preferred route.

## II. SALES TAX

Several decisions were issued in the sales tax area and are summarized below.

### A. Statute of Limitations

In *K&I Asphalt, Inc. v. Indiana Department of State Revenue*,<sup>26</sup> the issue was whether the taxpayer's claim for refund was timely filed within the three year limitation period of section 6-8.1-9-1(a) of the Indiana Code. The tax court held that regardless of whether the sales tax is paid directly to the vendor or the Department, a claim for refund of such tax can be filed within three years of the end of the calendar year for which the return was filed.

### B. Responsible Officer

In *Safayan v. Indiana Department of State Revenue*,<sup>27</sup> the Department attempted to collect a corporation's sales and withholding taxes from a 51% shareholder and president of a closely held corporation. In general, a corporate president is presumed to be liable for payment of taxes.<sup>28</sup> Because the president did not actively manage the corporation—indeed she lacked authority to sign checks, disburse funds, hire employees,

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24. 641 N.E.2d 698 (Ind. T.C. 1994).

25. 641 N.E.2d 694 (Ind. T.C. 1994).

26. 638 N.E.2d 901 (Ind. T.C. 1994).

27. 631 N.E.2d 25 (Ind. T.C. 1994).

28. *Id.* at 28 (citing *State v. Hogo, Inc.*, 550 N.E.2d 1320, 1324 (Ind. Ct. App. 1990)).

or pay taxes—the tax court held that she was not responsible for the corporate tax obligations.

### C. Governmental Entity Exemption

In *National Serv-All v. Indiana Department of State Revenue*,<sup>29</sup> a for-profit waste hauler claimed an exemption from sales taxation as a governmental agency or entity.<sup>30</sup> The tax court denied the exemption, reasoning that the for-profit hauler had no statutory creation and no other governmental connection other than hauling under contract for a municipality for profit.<sup>31</sup>

### D. Meaning of "Retail Transaction"

In *3551 Lafayette Road Corp. v. Indiana Department of State Revenue*,<sup>32</sup> the issue was whether sales tax could be assessed on a strip club's tokens sold to patrons where the tokens were then exchanged for "table dances." The case turned on whether the patrons were involved in a "retail transaction," since the gross retail tax (more commonly known as the sales tax) only applies to "retail transactions."<sup>33</sup> A retail transaction, in turn, arises when "tangible personal property [is] acquired for the purpose of resale and [is] transferred to another person for consideration."<sup>34</sup> The provision of services, by contrast, generally does not qualify as a retail transaction subject to sales tax.<sup>35</sup>

The tax court ruled for the night club, reasoning that the table dances were a service. The court also rejected the Department of Revenue's argument that the VIP rooms, where table dances occurred, were "rented" within the meaning of a separate statutory provision that imposes sales tax on room rental for adult dancing.<sup>36</sup>

## III. INCOME TAX

Of the income tax decisions during 1994, the following are noteworthy.

### A. Amended Return As Claim For Refund

In *UACC Midwest, Inc. v. Indiana Department of State Revenue*,<sup>37</sup> the taxpayer timely filed Indiana gross income tax returns for the years 1986 through 1990. The taxpayer subsequently filed amended returns with explanatory statements seeking a reduction in tax, but did not file the Department's Form 615 for refund claims. The

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29. 644 N.E.2d 954 (Ind. T.C. 1994).

30. See IND. CODE § 6-2.5-5-16(1) (Supp. 1994).

31. *National Serv-All*, 644 N.E.2d at 959-60.

32. 644 N.E.2d 199 (Ind. T.C. 1994).

33. See IND. CODE § 6-2.5-2-1(a) (Supp. 1994).

34. *3551 Lafayette Road Corp.*, 644 N.E.2d at 200 (quoting *Maurer v. Indiana Dep't of State Revenue*, 607 N.E.2d 985, 987 (Ind. T.C. 1993)).

35. *Id.* (citing IND. CODE § 6-2.5-4-1(e)(1) (1994); IND. ADMIN. CODE tit. 45, r. 2.2-4-2 (1992)).

36. *Id.* at 201; see IND. CODE § 6-2.5-4-4(a) (Supp. 1994).

37. 629 N.E.2d 1295 (Ind. T.C. 1994).

Department denied refunds on the grounds that no claim for refund had been filed, and the taxpayer appealed to the Indiana Tax Court.<sup>38</sup>

The court ruled in part for the taxpayer, explaining that the amended returns that were timely filed within three years of the latter of the due date of the return or the date of payment qualified as claims for refund.<sup>39</sup> The court reasoned that the explanatory statements attached by the taxpayer provided all of the information required by the Department for claims for refund.<sup>40</sup>

It is preferable, of course, for taxpayers to use the forms prescribed by the taxing authorities. The Department's regulations specify Form 615 for claims for refunds.<sup>41</sup>

### B. *Situs For Sale Of Federal Tax Benefits*

The issue in *Indiana Department of State Revenue v. Bethlehem Steel Corp.*<sup>42</sup> was whether an out-of-state taxpayer's sale of federal tax benefits relating to an Indiana facility were subject to Indiana gross income tax. Affirming the Indiana Tax Court, a divided Indiana Supreme Court held that Indiana gross income tax did not reach the sale. Focusing on the relationship between the intangible and the "business situs," the Indiana Supreme Court ruled that the sale of the tax benefits was not "integrally related" to the Indiana situs.<sup>43</sup>

Justices DeBruler and Sullivan dissented in separate opinions. Both Chief Justice Shepard's majority opinion and Justice Sullivan's dissenting opinion are thorough and detailed. If nothing else, *Bethlehem Steel* shows that the Indiana Supreme Court still has at least some interest in Indiana tax issues that come to the Indiana Supreme Court as a matter of discretion and not as a matter of right.<sup>44</sup>

## IV. REAL PROPERTY TAXES

As is typical of most Survey periods, the Indiana Tax Court heard several real property tax cases. The most noteworthy are highlighted below.

### A. *Jurisdiction: Failure To Timely File With All Necessary Entities*

To appeal from a final determination of the State Board of Tax Commissioners, within forty-five days, the taxpayer must: (1) file a written notice with the State Board of the taxpayer's intent to appeal; (2) file a complaint in the Indiana Tax Court; and (3) serve the Indiana Attorney General and the county assessor with a copy of the complaint.<sup>45</sup> In *Indiana Model Co. v. State Board of Tax Commissioners*,<sup>46</sup> the taxpayer

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38. *Id.* at 1297-98.

39. *Id.* at 1298-99; see IND. CODE § 6-8.1-9-1(a)(1), -(2) (Supp. 1994).

40. *UACC Midwest, Inc.*, 629 N.E.2d at 1299.

41. IND. ADMIN. CODE tit. 45, r. 15-9-2 (1994).

42. 639 N.E.2d 264 (Ind. 1994).

43. *Id.* at 271-72.

44. See IND. APP. R. 18.

45. IND. CODE § 6-1.1-15-5(c)(1)-(3) (Supp. 1994).

46. 639 N.E.2d 695 (Ind. T.C. 1994).

sent all copies to the the Indiana Tax Court Clerk to be sent to the above entities. The Clerk did so eight days later.

The tax court did not take issue with this manner of filing and service.<sup>47</sup> Unfortunately for the taxpayer, however, the clerk's mailing occurred after the mandatory time limits. As a result, the tax court lacked jurisdiction, and the appeal was dismissed. The decision serves as a painful reminder that the tax court's jurisdictional statutes must be scrupulously followed.<sup>48</sup>

### *B. Inability To Increase Assessment Without Proper Notice*

In *Mills v. State Board of Tax Commissioners*,<sup>49</sup> the County Board of Review issued a final determination, and later issued a subsequent determination increasing the assessment without notice. The tax court, applying Indiana Code section 6-1.1-13-1, held that the subsequent increase was invalid for lack of notice.<sup>50</sup>

### *C. Economic Obsolescence*

In *Simmons v. State Board of Tax Commissioners*,<sup>51</sup> a pro se taxpayer appealed the State Board's assessment of an apartment building in Indianapolis, arguing that the State Board should have made an adjustment for economic obsolescence.<sup>52</sup> The tax court reversed and remanded, holding that the plight of the surrounding neighborhood should have been considered in determining economic obsolescence. Indeed, one of the Board's regulations listed the following items as causes of economic obsolescence: (1) "[l]ocation of structure [inappropriate] for its neighborhood," and (2) "[a] neighborhood that is in transition of use."<sup>53</sup> As a result, the court concluded that "[b]ecause a commercial improvement's neighborhood can cause economic loss (i.e. economic obsolescence), it is simply contrary to its own regulations for the State Board to assert that a neighborhood may not affect a commercial building's depreciation."<sup>54</sup>

## V. PERSONAL PROPERTY TAX

### *A. Penalties*

For taxpayers who undervalue their personal property on their tax returns by more than 5%, Indiana Code section 6-1.1-37-7(e) prescribes a 20% penalty of the additional taxes finally determined. In *Dav-Con, Inc. v. State Board of Tax Commissioners*,<sup>55</sup> the tax court affirmed the imposition of this 20% penalty if the undervaluation exceeded 5% as

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47. *Id.* at 698 n.4 ("The court is not so much concerned with *who* mails the documents, but rather that the documents are mailed *within the prescribed time period.*").

48. *See also* *Coachmen Vans v. State Bd. of Tax Comm'rs.*, 639 N.E.2d 1066 (Ind. T.C. 1994) (appeal dismissed for failure to serve county assessor as required by IND. CODE § 6-1.1-15-5 (Supp. 1994)).

49. 639 N.E.2d 698, 700 (Ind. T.C. 1994).

50. *Id.* at 703-04.

51. 642 N.E.2d 559 (Ind. T.C. 1994).

52. *Id.* at 560.

53. *Id.* at 561; *see* IND. ADMIN. CODE tit. 50, r. 2.1-5-1 (1992).

54. *Simmons*, 642 N.E.2d at 561.

55. 644 N.E.2d 192 (Ind. T.C. 1994).

determined on remand. Judge Fisher noted that the "penalty is mandatory and offers no opportunity for discretion when 'the facts meet the requirements of the statute.'"<sup>56</sup>

### B. Bailee's Possession

In *Mid-America Mailers v. State Board of Tax Commissioners*,<sup>57</sup> a company in the business of mailing advertisements, fund-raising requests, and solicitations was assessed business personal property tax for printed materials that it possessed but did not own. The tax court affirmed the assessment, reasoning that the printed materials were "held, used, or consumed in connection with the production of income" as set forth in Indiana Code section 6-1.1-1-11(6)(ii), which defines personal property.<sup>58</sup> Further, Indiana Code section 6-1.1-2-4(b) imposes liability on any person "holding, possessing, controlling, or occupying any tangible property on the assessment date."<sup>59</sup>

Under this statutory scheme, the Board may tax "either the owner or the possessor unless the possessor can prove the owner is being taxed, or the owner has accepted liability for the tax under contract."<sup>60</sup> Thus, the fact that Mid-America did not own the property and was a mere bailee presented no defense to the inventory tax.

## VI. MISCELLANEOUS

Finally, several miscellaneous decisions were decided that merit brief mention:

### A. Intangibles Tax

The tax court held that intangibles tax liability, incurred prior to the effective repeal date of the tax, November 10, 1988, could not be avoided.<sup>61</sup>

### B. Inter-Agency Comity

The tax court held that where Indiana law granted the Indiana Department of Environmental Management (IDEM) the authority to grant property tax deductions for resource recovery systems, the State Board of Tax Commissioners was powerless to disturb IDEM's decision.<sup>62</sup>

56. *Id.* at 198 (quoting *Gulf Stream Coach, Inc. v. State Bd. of Tax Comm'rs.*, 519 N.E.2d 238, 243 (Ind. T.C. 1988)).

57. 639 N.E.2d 380 (Ind. T.C. 1994).

58. *Id.* at 384.

59. *Id.*

60. *Id.* (quoting *State Bd. of Tax Comm'rs. v. Jewell Grain Co.*, 556 N.E.2d 920, 922 (Ind. T.C. 1990) (emphasis added)).

61. *Kenny Kent Chevrolet Co. v. Indiana Dep't of State Revenue*, 627 N.E.2d 890 (Ind. T.C. 1994). The court relied upon IND. CODE § 1-1-5-1 (Supp. 1994), which states that the "repeal of any statute shall not have the effect to release or extinguish any penalty, forfeiture or liability incurred under such statute, unless the repealing statute shall so expressly provide."

62. *Auburn Foundry v. State Bd. of Tax Comm'rs.*, 628 N.E.2d 1260 (Ind. T.C. 1994).