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# The Indiana Business Tax Roadblock

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# THE INDIANA BUSINESS TAX ROADBLOCK

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It seems certain that the 1971 session of the Indiana General Assembly will be forced to confront the most serious and difficult set of problems faced by any legislature since the traumatic regular and special sessions of 1963.[1] The problems faced by the 1963 session—tax revision and reapportionment—are once again demanding attention. In response to that demand this article will focus upon one aspect of the tax revision problem—the taxation of Indiana business and industry. Despite this narrow focus, the thesis of the article is that the solution to the current business tax quandary is the key to a successful revision of the total state revenue structure in 1971. Unless the business taxation methods now used by state and local government in Indiana are overhauled, it will be exceedingly difficult to solve the problems of property tax relief, aid to the aged and disadvantaged, and necessary support for the maintenance and development of the educational system, penal and health institutions, and other areas dependent upon state government for support.

## BACKGROUND—THE REVENUE PROBLEM

While the United States Congress was wrestling over the 1969 Tax Reform Act, tax action at the state level continued at an accelerated pace. State taxes were increased in 34 states during the year and some three billion dollars (an increase of roughly 7 per cent) was added to state government coffers.[2] According to the Tax Foundation, two-thirds of the nation's population will be affected by at least one or more than 75 major taxes imposed or raised in 1969.[3]

Tax measures levied by state legislatures include new major taxes

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1. In that year, neither party had a constitutional majority in the Senate, the Republicans controlled the House of Representatives, and there was a Democratic Governor with a Republican Lt. Governor. In spite of the obvious difficulties of such a political division, the General Assembly reapportioned the legislature and enacted sweeping revisions in the tax and revenue structure of the State. The scars of that encounter are still carried by many of those involved.

2. TAX REVIEW, Oct. 1969, at 41.

3. *Id.*

in five states.[4] Both personal and corporate taxes were introduced in Illinois, Maine and Washington. Vermont became the 45th state to impose a general sales tax, and North Carolina became the last state to add a cigarette tax. Illinois claimed the distinction of enacting the most comprehensive tax package of 1969. The taxes were designed to yield 826 million dollars in additional revenues[5] (an increase of 48 per cent over 1968 collections). Major provisions were for new taxes on individual and corporate income, and increases in existing rates on gasoline, cigarettes, and alcoholic beverages.

There are two major reasons for the continued pressure on state revenue structures beyond the simple fact that people are asking for more governmental services. First, most functions performed by state and local governments (*e.g.*, education) are highly labor intensive. Thus, productivity gains are small from year to year while the cost of labor in government has advanced at rates equal to those in industry—where output per annual man hour gains are much higher. Second, the nature of their tax structures forces the states into "returning to the tax well." State and local taxes increase at about the *same rate* as do the state economies.[6] Thus, low productivity in governmental functions causes a percentage increase in costs at a rate more rapid than the rate at which new income can be produced by the constant rate state and local tax structures. The result is soaring local property tax rates, the enactment of new taxes and increased state tax rates across the country. Unfortunately, since the federal government has, as a practical matter, prevented the states from using the graduated net income tax base, there is no easy solution to the dilemma of the states.

The one proposal that offers promise for getting at the problem —the sharing of federal revenue with the states—has yet to receive serious consideration by the Congress. Even if Congress passed the proposal recently made on behalf of the Nixon Administration, the immediate returns to the states would be small. The most frequently discussed revenue sharing plan would only yield Indiana about 12.5 million dollars in fiscal 1971.[7]

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4. In addition to the imposition of heavier taxes at the state level, state legislatures in five states (Missouri, Nebraska, North Carolina, South Carolina and Wisconsin) passed enabling legislation to permit the use of local sales taxes by counties or municipalities.

5. TAX REVIEW, Oct. 1969, at 42.

6. The federal tax yield increases, because of the more graduated income tax, *more rapidly* than does the national economy.

7. S. 2948, 91st Cong., 1st Sess. (1969).

Indiana's General Fund revenues and expenditures for the current biennium are shown in Table 1 below.

Table 1.
General Fund Estimated Revenues and Expenditures*
1969-71 Biennium ($ Millions)

| | | FY 1970 | FY 1971 |
|---|---|---|---|
| (1) | General Fund Surplus | $ 30.3 | $ 55.5 |
| (2) | Est. Reversions** | 42.0 | 16.0 |
| (3) | Est. Revenues | 670.8 | 713.7 |
| (4) | Total G.F. Avail. | $743.1 | $785.2 |
| (5) | Less G.F. Appropriations | $662.9 | $734.9 |
| (6) | Less Other Charges Against Income*** | 24.7 | 16.0 |
| (7) | Total Appropriations and Charges | $687.6 | $750.9 |
| (8) | Est. Unappropriated Surplus | $ 55.5 | $ 34.3 |

*Prepared by the Fiscal Analysis Division of the Indiana Legislative Council.

**Governor's economy program, ADA flat grant transfer to General Fund, reversion from Port Commission.

***MTA (Indianapolis) payment, loss from tax changes, added welfare costs.

The warning signal in the table lies in the relationship between total revenue and total appropriations in the two years. In fiscal 1970, revenues are less than eight million dollars above appropriations while in fiscal 1971, appropriations exceed revenues by 21 million dollars. The unappropriated surplus at the end of fiscal 1971 is estimated to be 34.3 million dollars—a level which probably should not be reduced given the fact that the Indiana Constitution prohibits debt financing for general fund purposes.[8]

As to the outlook for the next biennium, a reasonable estimate of economic growth and changes in state tax revenues calls for total revenue in the 1971-73 biennium to be in the neighborhood of 1,620 million dollars (assuming no tax changes). It is, of course, much more difficult to predict the level of appropriations since these can be controlled by the General Assembly. Thus, historical growth rates must be the guide in assessing the probable future demand on state funds.

From 1955 to 1965 total state general fund expenditures increased about 16 per cent per year.[9] This period included the most rapid rates of

8. IND. CONST. art. X, § 5.
9. The percentage figure was calculated by the Indiana State Budget Agency.

growth in school populations and also embraced the period when state taxes were raised three times.[10] From 1966 through 1971 total general fund appropriations grew 52.5 per cent (an annual average of about ten per cent), with the increase from 1970-71 again being ten per cent. If we project this ten per cent per year increase into the fiscal 1971-73 biennium, total appropriations for these two years would be 1,697 million dollars. Thus, estimated appropriations exceed revenues by 77 million dollars in the 1971-73 biennium.

### *The Property Tax Relief Problem*

Because the local property tax base has not grown fast enough to satisfy demands to meet the costs of schools, welfare, and other local governmental operations, property tax rates have soared throughout much of Indiana. Although the problem of property tax relief received much attention in the 1969 General Assembly, it is still unresolved and is certain to be a prominent issue again in 1971.

In the 1969 legislative session, a number of proposals were considered to relieve property tax rates. These ranged from authorizing local sales and income taxes[11] to making substantial amounts of state tax funds available to local governments.[12] Some of the alternatives now being considered by interim legislative study committees, and their fiscal impact, are as follows:[13]

| | | |
|---|---|---|
| (1) | $1000 Homestead Exemption | $ 60 million |
| (2) | Property tax credits for those over 65 | 20 million |
| (3) | State appropriations to reduce property taxes by 20 per cent | 200 million |
| (4) | Have the state absorb total costs of welfare and 50 per cent of local school costs | 200 million |
| (5) | Eliminate business inventory taxes | 85 million |

No matter which alternative, or group of alternatives, is selected, it is clear that non-property taxes will need to be increased if local property taxes are to be reduced. As indicated above, it is doubtful if the state general fund can continue to support its traditional activities without new revenue, let alone launch a massive attack on the local property tax.

## The Indiana Business Tax Structure[14]

### *State Taxes prior to* 1963

10. Taxes were raised in 1957, 1961 and 1963.

11. H.B. 2037 and H.B. 2038.

12. H.B. 1546.

13. See Agenda, Meeting of the Senate-House Joint Committee on Taxation, December 17, 1969.

14. For further information on this topic *see generally* C. Bonser, H. Kiesling, D. Patterson, and D. Swartz, *Business Taxation in Indiana,* Report of the Commission on State Tax and Financing Policy (1966).

For the 30 year period beginning with the fiscal crisis of 1933, Indiana's state government relied on the Gross Income Tax as its primary source of income. The Indiana Gross Income Tax, a curiosity among public finance experts for many years, was regularly indicted as a classic example of what to avoid in state taxation. The tax may be more accurately described as a transaction or turnover tax. The 1933 act levied a tax on the entire gross income of all Indiana residents and on all gross receipts derived from sources within the state.[15] The only major exemption from the tax was created by the courts when they denied Indiana the right to tax gross receipts derived from interstate commerce.[16]

The tax was originally levied at two rates—.25 per cent on receipts from manufacturing, mining, agriculture, and wholesaling,[17] and one per cent on retail receipts, gross receipts from the sale of public utility services, interest, rent, dividends, sales of property, and wages and salaries.[18] All taxpayers were allowed one 1,000 dollar deduction from gross receipts in arriving at taxable receipts.[19] The first major changes to the law, made in 1937, included the allowance of a 3,000 dollar deduction for retailers[20] and a provision for taxing financial institutions on gross earnings instead of gross receipts.[21] Financial institutions benefiting were state banks, trust companies, building and loan associations, brokers, dealers in commercial paper, finance companies, dealers in securities, and persons engaged in the business of lending money or credit. National banks were wholly exempt from the tax. Insurance carriers were also given a special form of gross earnings tax status,[22] and the tax rate on receipts from display advertising was reduced to .25 per cent.[23]

In 1941, retailers, launderers, and dry cleaners succeeded in having their tax rate reduced to .50 per cent.[24] This was the only substantive change in the tax until 1949 when, in order to finance a soldiers' bonus, the rates were increased by .125 per cent.[25] In 1954, the rates reverted to the pre-1949 levels,[26] and in 1957, faced with a deficit budget, the

15. Since the tax was levied on actual transactions or sales, intracompany sales or transfers were exempt.
16. Freeman v. Hewit, 329 U.S. 249 (1946); J. D. Adams Mfg. Co. v. Storen, 304 U.S. 307 (1938).
17. Ch. 50 § 3 (1933), Ind. Acts.
18. *Id.*
19. *Id.* § 5.
20. Ch. 117 § 5 (1937), Ind. Acts.
21. *Id.* § 1(n).
22. *Id.* § 1(p).
23. *Id.* § 3(b).
24. Ch. 140 § 2(c), (d) (1941), Ind. Acts.
25. Ch. 277 (1949) Ind. Acts.
26. *Id.* The 1949 act specifically provided for termination of the tax in 1954.

legislature again revised the rate schedule of the gross income tax[27] and introduced withholding on wages and salaries.[28] This was to be the final change in the tax until 1963. The results of the 1957 changes were that wages, salaries, sales of property, property income, and other types of personal service receipts were taxed at the rate of 1.5 per cent.[29] Sales of agricultural products, manufacturers' sales of products, sales by dry cleaners and launderers, and wholesale and retail sales were taxed at .375 per cent.[30] Financial institutions, wholesale grocers, and grain dealers were taxed at 1.5 per cent of all their gross earnings.[31] The one thousand dollar deduction was retained for all taxpayers.[32]

The most serious objections to the tax arose from the manner in which it treated business firms. The flaws typically pointed out included multiple taxation,[33] advantages to vertically integrated concerns,[34] capricious taxation of the consumer,[35] unequal exemptions,[36] discrimination against high turnover-low markup enterprises,[37] and unfair tax treatment of service industries.[38]

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27. Ch. 300 (1957), Ind. Acts.
28. Ch. 302, § 1 (1957), Ind. Acts.
29. Ch. 300 § 1(g) (1957), Ind. Acts.
30. *Id.* §§ 1(a)-(d).
31. *Id.* § 1(g).
32. *Id.* § 2.
33. Multiple taxation is the direct result of a comprehensive turnover tax applied to the gross sales of all business firms, and it is likely to lead to tax pyramiding. For example, a manufacturer sells a product to a wholesaler for $100 and, given a two per cent tax rate, pays $2.00 tax on his gross receipts. The wholesaler, adding his markup of twenty-five per cent, then sells the product to a retailer for $125 and pays $2.50 in tax. Finally, the retailer adds another twenty-five per cent markup, sells the product for $156.25, and pays $3.12 tax. Thus, the value of the product at the manufacturing stage ($100) is taxed three times, and the value added by the wholesaler ($25) is taxed twice. If, as is considered likely under a gross receipts type of tax, the tax paid at each successive stage of the production and marketing process is passed on in the form of higher prices, multiple taxation occurs and the tax pyramids—that is, a tax is levied on the total tax paid prior to a particular stage in the process.
34. Because a turnover tax is applied only to actual sales made to independent firms, vertically integrated concerns have a distinct tax advantage because they perform intermediate production and distribution functions and avoid transactions with other firms. In the extreme case, products of a fully integrated firm would be taxed only once—when the sale was made for ultimate consumption.
35. Assuming that the tax is passed on, the amount of tax finally borne by the consumer is capricious (a violation of the neutrality principle) depending upon the number of independent production and distribution stages through which the product passes.
36. A major objection often voiced against the tax in Indiana was that sales made in interstate commerce by firms operating in Indiana were (as a result of court rulings) exempted.
37. Given two firms with the same net profit, the firm which accrues the profit via a high volume, low markup policy will pay more tax than the firm with a low volume, high markup policy.
38. Receipts from the sale of business services were taxed four times higher than the proceeds from the sale of tangible personal property.

A particularly stinging rebuke was leveled at the Gross Income Tax by John F. Due in 1961, when he said:

> The present tax is an archaic, amateurish levy that tries to catch everything; it represents in part the revival of the form of tax that was strongly condemned by Adam Smith two centuries ago and is just as objectionable now as it was then. Its only virtue is stable revenue at a low tax rate; it fails to conform with the most elementary concepts of tax equity and economic neutrality. One of the most devastating commentaries which can be made on the tax is the fact that while other states have sought urgently for new revenue sources in recent decades and many states have studied the tax, no other state has ever copied it or even seriously considered doing so.[39]

In 1963, having been faced for several years with an expanding school age population, demands for local property tax relief (following a recodification of the property tax laws and a reassessment), burgeoning requirements for capital and operating funds at the state level, and a dwindling state surplus (in July, 1963 it reached 4.5 million dollars), the General Assembly enacted the most substantial changes in Indiana's tax structure since 1933.[40]

The 1963 legislation represented a clear departure from the gross income tax—at least as far as most taxpayers were concerned. The essential elements of the package were a two per cent sales tax,[41] and a two per cent tax on individual and corporate adjusted gross income.[42] The gross income tax on individuals, unincorporated businesses, and qualifying small business corporations (Subchapter S corporations under the Federal Internal Revenue Code) was repealed.[43] However, the gross income tax on corporations (other than Subchapter S corporations) was retained, at a one-third increase in rates, as a minimum alternative to the corporate net income tax.[44]

Thus, the gross income tax rates on corporations are now two per cent on service receipts and .50 per cent on receipts from the intrastate sale of tangible property.[45] By adding the two per cent corporate net income tax, the legislature reached income from the interstate operations

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39. J. Due, Reform of the Indiana State Tax Structure (1961).
40. Ch. 30 (1963 Spec. Sess.), Ind. Acts.
41. *Id.* at § 1.
42. Ch. 32 (1963 Spec. Sess.), Ind. Acts.
43. Ch. 30 (1963 Spec. Sess.), Ind. Acts.
44. *Id.*
45. *Id.*

of firms doing business in Indiana. The net income tax incorporated the "Massachusetts formula"[46] for determining Indiana's share of the total net income of multistate business. The formula requires calculating the arithmetic means of three ratios:

$$\frac{\text{Value of Property in Indiana}}{\text{Total Value of All Property}}$$

$$\frac{\text{Value of Wages and Salaries Paid in Indiana}}{\text{Total Value of All Wages and Salaries Paid}}$$

$$\frac{\text{Value of Sales Within Indiana}}{\text{Value of Total Sales}}$$

The resulting ratio is multiplied by the net income of the firm. The product of these two factors represents the state's share of the firm's income. Net income under the law is defined as corporate net income for federal tax purposes, less interest received from the federal government, plus deductions taken under the federal law for charitable contributions and for the state and local taxes.[47] An amendment to the act of 1965 changed the law to require only the "add-back" of state income taxes and local property taxes.[48] The provision relating to the add-back of charitable contributions was retained intact.

All corporations, whether operating solely intrastate or interstate, are subject to both taxes, with the stipulation that the gross income tax liability is to be applied as a tax credit against net income tax liability. Except in rare instances, the use of this credit arrangement means that corporations operating almost exclusively within the borders of Indiana will continue to pay the gross income tax since .50 per cent of the firm's gross receipts will normally exceed two per cent of its net income. (A wholly intrastate corporation would require a ratio of net income to gross receipts greater than twenty-five per cent before two per cent of its net income would exceed .50 per cent of its gross income.) Corporations which do extensive business in interstate commerce will most likely find that two per cent of their apportioned net income exceeds .50 per cent (or, even two per cent) of their gross receipts that would be taxable by Indiana under the gross income tax.

In terms of revenue to the state, the Gross Income Tax still supplies

46. For information concerning the origin of the "Massachusetts Formula" see Bonser, *supra* note 14, at 69.
47. Ch, 32, § 103 (1963 Spec. Sess.), Ind. Acts.
48. Ch. 233 § 1 (1965), Ind. Acts.

the dominant proportion of state corporate taxes. In 1969 the Corporate Gross Income Tax produced about 150 million dollars while the "overage" from the Corporate Net Income Tax was approximately 10 million dollars.[49] Thus, an analysis of the impact of Indiana's corporate tax structure is essentially an analysis of who pays how much of the Gross Income Tax. According to the most recent figures available, (1964 returns), the answers to this question are:

(1) Intrastate corporations, which make up approximately 85% of all corporations filing Indiana tax returns, pay 55.4% of the gross income tax. When the overage from the net income tax is added to the total, intrastate corporations pay 52.3% of the total tax.

(2) The calculation of gross income tax liabilities as a percentage of gross receipts for sixteen gross receipts classes revealed that the slope of the effective tax rate curve is negative —low gross receipts classes pay a higher tax than do high gross receipts classes. The reason for this pattern is that large corporations have a greater proportion of their receipts taxable at the lower tax rate (.5%) than do the small corporations, and a larger share of their receipts are non-taxable. This is true of both intrastate and interstate corporations.

(3) The distribution of the gross income tax among net income classes (U.S. taxable) shows a more pronounced pattern of regression than does the distribution by gross receipts classes. This result is mainly explained by the fact that the low net income classes had a smaller ratio of net income to gross receipts than did the higher net income classes.

(4) The impact of the gross income tax varies considerably among principal business activity classifications, depending upon the various industries. Within the intrastate group, the retailing industry was the major taxpayer. The manufacturing industry dominated the interstate category.

(5) Interstate manufacturers are the major group affected by the addition of the corporate net income tax. The industries most affected are the chemical, transportation equipment, motor vehicles, primary metals, and the electrical machinery industries.[50]

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49. Figures were provided by the Indiana Legislative Council.

50. C. Bonser, Analysis of Major Business Taxes Levied by Indiana 18-19 (1966).

The local property tax on business firms was originally meant to be a form of "benefits received" taxation.[51] The relative amount of real and personal property owned by the local business firm was a measure of the benefits the firm received from local fire and police protection and other governmental services, relative to other property owners in the taxing jurisdiction. As both the business firms and local government grew and changed form, the property tax system became less and less relevent to its early objectives. Businesses became state- and nation-wide, and cities and towns added new functions while changing their boundaries.

Today's major complaint regarding local business property taxes concerns the *personal* property tax (machinery, equipment, and inventories). This tax is extremely capricious in its effect upon various industries. For instance, manufacturing, service industries and retailing firms carry widely varying amounts of inventories, leading to substantially different amounts of tax liabilities in the same taxing jurisdiction. The relative differences in taxes paid on inventories by these concerns bears no relationship to relative benefits received from governmental services, nor, for that matter, to relative ability to pay taxes. A similar situation exists within the manufacturing category, where capital/output ratios differ significantly, thus requiring quite different amounts of property taxes to be paid on machinery and equipment. If the personal property tax paid by business firms is passed on to consumers in the form of higher prices—as seems likely in most cases—the result of the above mentioned variance in tax responsibilities is that the tax becomes in essence a capricious, regressive, and uneven sales tax.

Perhaps the most serious problem with the personal property tax on business is the virtual impossibility of administering the tax fairly. While we can assign values to local real property with some degree of confidence, local assessors find it very difficult to assess the complex machinery of large industrial corporations. As a result there is typically a negotiated settlement or "compromise value" for tax purposes.

In view of the problems with the personal property tax, its only justification is its ability to generate substantial revenue.[52] It now appears, however, that a national movement is underway that will substantially lessen the reliance of local communities on the business personal property tax. As states compete more actively with each other for industrial development, the personal property tax is being reduced or

51. For more information concerning the origin of "benefits received" taxation see R. NETZEL, ECONOMICS OF THE PROPERTY TAX (1966).

52. Currently the personal property tax generates about $350 million per year.

eliminated in state after state. Among Indiana's chief competitors, Kentucky now exempts machinery from taxation, and Wisconsin, Michigan and Ohio allow tax credits against property taxes on inventories.

INDIANA TAX REVISION—THE ALTERNATIVES

It now appears inescapable that the 1971 session of the Indiana General Assembly will be, in the terms of legislators, a "tax session." Indeed the 1969 session probably would have restructured the state's tax system had the various philosophical, partisan, and business interest positions been able to coalesce as they had in 1963.[53]

In the view of this writer, the compromise objectives of any new revenue program in 1971 will be:

(1) A substantial move toward the provision of non-property tax revenues for local governmental needs.

(2) Additional property tax relief aimed at specific groups, *e.g.*, retired persons and disabled.

(3) Concessions to the business community in the form of reduced personal property taxes.[54]

(4) Increased state General Fund revenues for the support of state functions.

(5) Substantial overhaul of the gross income tax—net income tax method now used to tax corporations operating in Indiana.

The alternatives open to the General Assembly to meet these objectives are really rather limited. With regard to taxes on individuals, the options are:

(1) Authorize local communities to levy county-wide sales and/or income taxes to partially replace the local property tax.

(2) Increase the rates on the state-wide income and/or sales taxes and return the funds to the local communities for property tax relief.

53. See note 1 *supra*.

54. Before such concessions can be made, an amendment to the Indiana Constitution may be necessary, depending upon the taxing technique utilized. Some lawyers believe a tax credit could be employed without a constitutional amendment. Others believe this would be merely a matter of form over substance. In any event a constitutional amendment allowing the taxation of property at different rates has already passed one legislative session.

(3) Increase tobacco and alcoholic beverage taxes as a means of supplementing the state general fund.[55]

The alternative ways of approaching the property tax replacement problem generated considerable debate during the 1969 legislative session. However, the dispute mainly revolved around philosophic and not substantive differences in the proposals. The issues involved in the solution of the business tax problem, however, are more economic than philosophic. In the first place, business firms do not agree as to the method of lowering business property taxes. Some favor the elimination of all inventory taxes while others express a preference for a percentage reduction in total personal property taxes (including machinery and equipment). The particular composition of a firm's assets, of course, dictates its position on this matter. Secondly, if business property taxes are to be reduced in conjunction with an increase in business non-property taxes, there is considerable disagreement within the business community (which was apparent in the 1969 legislative session) concerning which state business non-property taxes should absorb the increase. Some believe that it would be a mistake to raise the Corporate Gross Income Tax because of its defects described earlier in this article. Indeed, any business tax reform measure should substantially eliminate the one major flaw remaining in Indiana's state tax structure—the Corporate Gross Income Tax. However, when we look to the other tax now levied on corporations (the Corporate Net Income Tax) as a source for business property tax and Gross Income Tax replacement, we again encounter the interstate industrial development competition problem. Those corporations which are most affected by a corporate net income tax (manufacturing concerns) are the same types of industries the state is trying to persuade to locate in Indiana. To replace the gross income tax revenue alone—to say nothing of property tax replacement—would require a corporate net income tax three to four times higher than the current two per cent rate.

To demonstrate more explicitly the shifts in business tax liabilities that would accompany any change to a new method of taxing Indiana business and industry, two tables are reproduced here from the earlier cited 1966 study.[56] While the tax yields are somewhat outdated, they do illustrate the difficulties involved in arriving at a compromise solution satisfactory to all segments of the Indiana business community. The figures in the two tables (Table 2 for intrastate corporations and Table

55. Although this option could be enacted alone, either of the above alternatives could (and probably would) include this provision.

56. See Bonser, *supra* note 50.

TABLE 2[1]

Differential Tax Impact on Intrastate Corporations (By Principal Business Activity)*

| Principal Business Activity | Gross-Net Combination | | Gross Income Tax | | | Net Income Tax | | | Value-Added Tax | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Tax Liability ($000) | % | Tax Liability ($000) | % | % Change | Tax Liability ($000) | % | % Change | Tax Liability ($000) | % | % Change |
| Agriculture | $ 414 | 0.6 | $ 438 | 0.6 | 6.0 | $ 221 | 0.4 | –46.6 | $ 137 | 0.2 | –66.9 |
| Mining | 552 | 0.8 | 585 | 0.8 | 6.0 | 441 | 0.8 | –20.1 | 481 | 0.7 | –12.9 |
| Construction | 7,654 | 11.1 | 8,111 | 11.1 | 6.0 | 2,481 | 4.5 | –67.6 | 5,910 | 8.6 | –77.2 |
| Total manufacturing | 11,723 | 17.0 | 12,422 | 17.0 | 6.0 | 15,106 | 27.4 | 28.9 | 32,915 | 47.9 | 180.8 |
| Transportation, communication, utilities | 13,791 | 20.0 | 14,614 | 20.0 | 6.0 | 13,121 | 23.8 | –4.9 | 7,765 | 11.3 | –43.7 |
| Wholesale trade | 6,344 | 9.2 | 6,722 | 9.2 | 6.0 | 3,694 | 6.7 | –41.8 | 5,910 | 8.6 | –6.8 |
| Retail trade | 15,653 | 22.7 | 16,587 | 22.7 | 6.0 | 12,074 | 21.9 | –22.9 | 11,270 | 16.4 | –28.0 |
| Finance, insurance, real estate | 6,551 | 9.5 | 6,942 | 9.5 | 6.0 | 5,182 | 9.4 | –20.9 | 1,718 | 2.5 | –73.8 |
| Business services | 5,586 | 8.1 | 5,919 | 8.1 | 6.0 | 2,701 | 4.9 | –51.6 | 2,405 | 3.5 | –56.9 |
| Professional Services | 621 | 0.9 | 658 | 0.9 | 6.0 | 165 | 0.3 | –73.4 | 206 | 0.3 | –66.8 |
| Totals | $68,957 | 100.0 | $73,070 | 100.0 | 6.0 | $55,132 | 100.0 | –20.0 | $68,717 | 100.0 | –0.3 |

*Details may not add to totals because of rounding.

[1] *Ibid.*, p. 131.

TABLE 3[1]

Differential Tax Impact on Interstate Corporations (By Principal Business Activity)*

| Principal Business Activity | Gross-Net Combination | | Gross Income Tax | | | Net Income Tax | | | Value-Added Tax | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Tax Liability ($000) | % | Tax Liability ($000) | % | % Change | Tax Liability ($000) | % | % Change | Tax Liability ($000) | % | % Change |
| Agriculture | $ 276 | 0.4 | $ 294 | 0.5 | 6.5 | $ 307 | 0.4 | 11.2 | $ 126 | 0.2 | –54.3 |
| Mining | 1,551 | 2.5 | 1,647 | 2.8 | 6.2 | 844 | 1.1 | –45.6 | 1,327 | 2.1 | –14.4 |
| Construction | 5,815 | 9.2 | 6,000 | 10.2 | 3.2 | 1,458 | 1.9 | –74.9 | 948 | 1.5 | –83.7 |
| Nondurable Manufacturing | 8,939 | 14.2 | 8,530 | 14.5 | –4.6 | 12,205 | 15.9 | 36.5 | 10,045 | 15.9 | 12.4 |
| Durable Manufacturing | 15,632 | 24.8 | 14,000 | 23.8 | –10.4 | 24,871 | 32.4 | 59.1 | 22,491 | 35.6 | 44.9 |
| Other Manufacturing | 9,758 | 15.9 | 8,883 | 15.1 | –9.0 | 15,813 | 20.6 | 62.1 | 14,594 | 23.1 | 49.6 |
| Transportation, communication, utilities | 9,762 | 15.5 | 9,353 | 15.9 | –4.2 | 8,597 | 11.2 | –11.9 | 4,738 | 7.5 | –51.5 |
| Wholesale Trade | 2,047 | 3.2 | 2,000 | 3.4 | –2.3 | 1,766 | 2.3 | –13.7 | 1,264 | 2.0 | –38.3 |
| Retail Trade | 5,267 | 8.4 | 5,471 | 9.3 | 3.9 | 3,761 | 4.9 | –28.6 | 3,854 | 6.1 | –26.8 |
| Finance, Insurance, Real Estate | 2,126 | 3.4 | 1,059 | 1.8 | –50.2 | 5,143 | 6.7 | 141.9 | 2,401 | 3.8 | 12.9 |
| Business Services | 1,675 | 2.7 | 1,471 | 2.5 | –12.2 | 2,073 | 2.7 | 23.8 | 1,200 | 1.9 | –28.4 |
| Professional Services | 89 | 0.1 | 59 | 0.1 | –33.7 | 77 | 0.1 | 13.5 | 63 | 0.1 | –29.2 |
| Totals | $62,938 | 100.0 | $58,825 | 100.0 | –6.5 | $76,763 | 100.0 | 22.0 | $63,178 | 100.0 | 0.4 |

*Details may not add to totals because of rounding.

[1] *Ibid.*, p. 132.

3 for interstate corporations) are based on a constant total yield from state levied business taxes ($131,895,000).

The taxes analyzed and the rates necessary to raise the constant yield of 131.9 million dollars (in 1963) were (1) the current gross income tax—net income tax combination (gross tax rates of two per cent on services and .5 per cent on tangible goods sales, and a two per cent tax on corporate net income tax), (2) a gross income tax with rates of 2.12 per cent on services and .53 per cent on tangible goods sales, (3) an eight per cent corporate net income tax, and (4) a value-added tax with a rate of 1.87 per cent.[57]

If Indiana had relied entirely on the gross income tax in the year analyzed, most business activity classifications would have paid less tax than under the gross-net combination. Tax reductions ranged from fifty to two per cent. Those industries that would have experienced tax increases are the categories that were least affected by the two per cent net income tax alternative, or are relatively hard hit by the gross income tax—retailing, construction, agriculture, and mining.

Exclusive reliance on either a corporate net income tax or a value-added tax would have shifted the tax burden in the direction of manufacturing concerns. Under the gross-net combination, manufacturers were responsible for 48.2 per cent of the total tax liability of the interstate corporations. Under a net income tax they would have been liable for 68.9 per cent of the interstate corporation total, and they would have paid 74.6 per cent under a value-added tax. However, a larger share of the increase under a value-added tax would be absorbed by the intrastate types of corporations than would be true under a net income tax. Thus, the interstate manufacturers would fare better under the value-added tax than they would under the corporate net income tax.

## Conclusion

The Indiana business tax structure has the potential for becoming the "roadblock" in the way of property tax relief and adequate funding of the state's needs. Traditionally, tax reform of the type and magnitude discussed in this article has been extremely difficult to bring about without the support of the majority of business (including agri-business) firms in the state. Yet, at this writing, it seems clear that the "business community," while in general agreement on the desirability of lowering

57. A value-added tax is essentially a tax on *gross* profits rather than *net* profits. The tax base can be arrived at by subtracting all purchases from other firms from total sales. Thus, the firm is taxed on its contribution to the value of a product. For further information, see Bonser, *supra* note 14.

property taxes, is still far from agreement on a compromise total tax "package." Furthermore, the reasons for this failure to agree on a program are serious enough to lead one to question whether compromise, in fact, is possible. Thus, the legislature may find it necessary to rely less on compromise within the business community and more on its own best judgment in order to arrive at a business tax package which appears to make sense in light of the state's total objectives.