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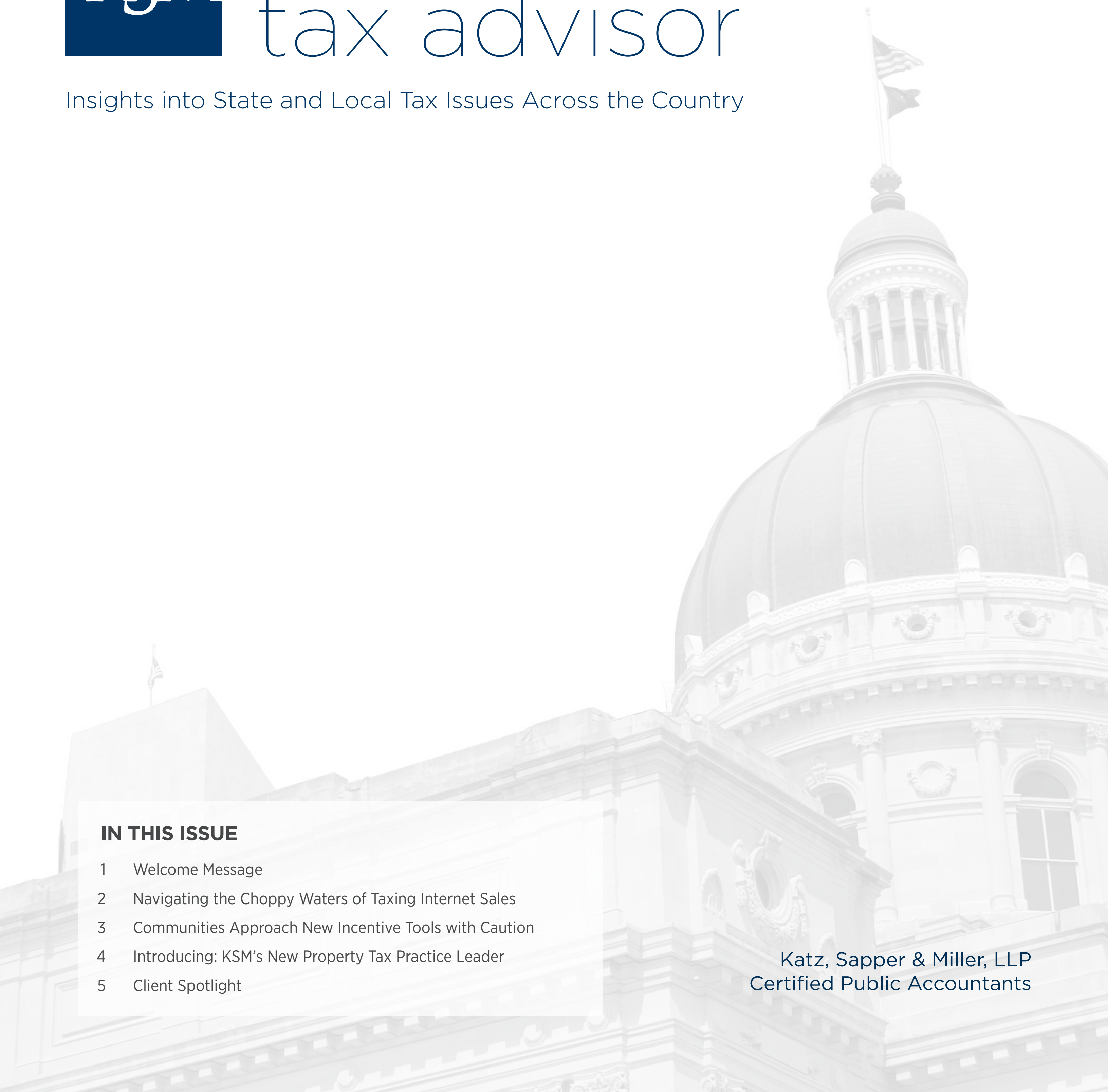
Insights into State and Local Tax Issues Across the Country



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Welcome Message

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While Katz, Sapper & Miller's State and Local Tax Practice is multistate in nature, you will find that this inaugural issue of the *State & Local Tax Advisor* has a decidedly Indiana flavor to it. Lisa Leventhal Weinstein's economic development article discusses new tools available to local officials in Indiana to aid in their efforts to attract businesses. Chad Miller's introduction as our new property tax practice leader makes notable mention of the upcoming reassessment in Indiana. Even Donna Niesen's piece on the impact of the Internet on sales tax collections nationwide finds its genesis in the ongoing saga involving Indiana and its relationship with dot-com giant Amazon. Lastly, our profile on client and friend John Paugh and his business, Carter Logistics, is a national success story that finds its origins in the Central Indiana community of Anderson.

In keeping with this predominantly Hoosier theme, I thought I would use this space to discuss a couple of "local" items that have drawn extensive national coverage – Super Bowl XLVI and Indiana's passage of right-to-work legislation – and their impact on Governor Mitch Daniels' last year in office and eventual legacy.

During his inaugural campaign in 2004, Governor Daniels' platform spotlighted a number of issues focused on tax and economic development. Where these items began as campaign themes, they emerged as the cornerstones for many legislative initiatives that the governor championed and eventually signed into law. Support for the state's transition to daylight savings time was rooted in the proposition that Indiana would become a less confusing business place for companies in other time zones. Likewise, various tax initiatives such as the creation of an expanded exemption for research and development expenses promised a positive impact for companies doing business and investing in Indiana.

It seems fitting, then, that hosting the Super Bowl and passing right-to-work legislation, two highly visible events, have occurred during the governor's eighth and final year in office. With the Super Bowl, even critics of Indianapolis being selected as the host city would concede that the home town's performance was an unqualified success. The cooperative weather notwithstanding, the high marks bestowed upon Indiana in general and Indianapolis in particular reflect the outside world's newfound confidence in the city and state's collective ability to deliver remarkable results in front of an international audience. The governor and his economic development team now hope to leverage this freshly acquired goodwill into a powerful calling card for economic development projects before the magic of the moment threatens to dissipate.

The controversy surrounding right-to-work hasn't stopped the Daniels Administration from touting its passage to companies looking to locate in Indiana.

In contrast to the non-partisan good vibe derived from hosting a Super Bowl, right-to-work, a law that prohibits the payment of union dues as a condition to employment, has brought acclaim from its proponents and derision from its critics. Supporters point to the looks that Indiana expects to receive from growing companies and site selectors that otherwise would pass on the state. Critics assert that right-to-work will cause a long-term decline in wages. This leaves a landscape with state and local economic officials touting Indiana as the Midwest's indisputable leader in a laundry list of economic development categories, and skeptics and opponents, whether agreeing or disagreeing, sure to argue, "At what cost?"

Criticisms aside, the governor and his administration will bring much fanfare to what it believes is a winning one-two combination of a signature event and landmark legislation, and the benefits they expects them to bring. With Super Bowl XLVI still fresh in people's minds, the state knows the world has been watching, and now hopes that it starts calling.

Navigating the Choppy Waters of Taxing Internet Sales

By Donna L. Niesen, CPA
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While the economy starts to show signs of life, the fact is that most state and local budgets are still in dire straits. With the term "tax increase" still radioactive in most political circles, state governments continue to look for other ways of raising revenue. A particularly trendy topic these days is imposing a sales tax collection requirement on out-of-state and Internet vendors.

Indiana has a view of ground zero in this debate, courtesy of its relationship with Internet giant Amazon. In 2008, the state entered into an economic development-driven arrangement with the online retailer. In order to attract a warehouse facility to Central Indiana, the state agreed that its Department of Revenue would not require Amazon to collect tax on its sales into the state, despite the fact that, by law, its physical presence in and nexus with Indiana would otherwise require it to do so. Since that time, Amazon has added or announced multiple distribution sites in the state, with talk of yet another facility coming to Southern Indiana. With the no-tax arrangement between the two sides remaining in place through each new deal, every announcement brings a renewed outcry from on-the-ground retailers accusing the state of giving Amazon preferential treatment.

The debate shifted in January when Governor Daniels announced that Amazon would begin collecting Indiana sales tax on Internet purchases under a deal reached between the company and the Department of Revenue. This agreement requires Amazon to collect tax on its Indiana sales beginning Jan. 1, 2014. Tax advocates and brick-and-mortar retailers find the start date too late, arguing that each day Amazon does not collect tax on Indiana transactions is another day the Internet vendor enjoys a competitive advantage.

Indiana is not the lone voice in this debate, nor is it the loudest. As state and local budgets reliant on tax collections continue to suffer from the black hole of Internet sales evading taxation, Congress is increasingly being called upon to intervene. A bill currently under consideration in Washington, D.C., would allow states to require out-of-state sellers to collect tax on sales into states, thereby imposing a collection responsibility on retailers that do not otherwise have nexus in the state. To the surprise of some, among the companies supporting this legislation is Amazon, citing its multistate approach to a problem that Amazon must currently address on a state-by-state basis.

Adoption of a uniform, federal solution to the problem that states face in collecting sales tax on internet sales continues to gain steam.

As Capitol Hill ventures into this terrain, any action it might take may merit a look from the U.S. Supreme Court. In 1992, the high court held that a vendor must have a physical presence in a state in order to be subject to collection requirements. A technology revolution, six new justices, and 20 years later, the question is whether a federal law would prevail against a likely constitutional challenge.

For now, storefront sellers will continue to battle this issue with their virtual counterparts, and states will attempt to balance their economic development efforts with pleas from their corporate taxpayers for a level playing field, especially when they perceive that playing field creates a gap as wide as the Amazon.

Communities Approach New Incentive Tools with Caution

By Lisa Leventhal Weinstein
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Economic development officials are constantly searching for new tools to attract and retain businesses. In fact, the most common question localities ask us is, “What kind of creative deals are other communities doing?” It might be surprising, then, that in 2011 when the Indiana legislature gave local government two new programs to incentivize projects, the reaction was more guarded than exuberant.

The first program, an expansion of tax abatement options that localities can offer, allows communities to provide as much as 100 percent tax abatement on real and personal property over a 10-year period of time. Under the old law, the percentage of abatement was fixed based on the number of years of abatement awarded. The second program, commonly referred to as the local hiring incentive, permits localities to offer a refund of the local income tax generated by new jobs created, similar to the EDGE tax credit available at the state level.

With local government clamoring for new ways to attract projects, some wonder why there hasn’t been more excitement over these new tools. The reason stems from the fact that, while communities want to enhance their competitiveness for new deals, they fear that using these programs, even sparingly, will open a Pandora’s Box of incentive wars with neighboring communities and states.

Some creative localities have already discovered that use of these new tools can provide value to a project without increasing the cost to the community. A good example is found in the new tax abatement law. Now, a community has the ability to accelerate the abatement percentage provided in earlier years while limiting the total number of years of abatement. As an example, a company might be judging its return on investment over a five-year period. In this case, the new law would allow a community to award a higher percentage of abatement over that first five years, making the timing of the incentives more valuable to the business without costing the locality more.

These new tools will also allow localities to stay competitive with other states. For example, now when a community is competing with a state such as Ohio that can offer as many as 15 years of 100 percent abatement, an Indiana locality, if it desires, will be able to offer a more aggressive abatement package.

Indiana communities have been slow to embrace expanded tax abatement and the local hiring incentive, two powerful new tools that could help them against their out-of-state competitors.

As one might expect, arbitrary use of these new tools can produce undesirable long-term impacts for local government. Therefore, it is critical for communities to establish parameters upfront before considering incentive packages outside the norm. If specific units of local government act with irrational aggressiveness, it may inflate local incentives on a regional basis.

Further, if communities do not establish criteria to govern how and when to offer more aggressive packages, they subject themselves to arbitrarily dispensing incentives in a manner that attracts vulture projects – those where the objective of the company and its consultant is to hold communities hostage for the most incentives possible, without regard to the project’s impact on the locality.

Regardless, Indiana communities should view these new tools as a very welcome and positive development. If utilized the right way, more looks at projects and ultimately new jobs are likely to result.

Introducing: KSM's New Property Tax Practice Leader

By Chad M. Miller
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In this first edition of KSM's *State and Local Tax Advisor*, it is a pleasure to have this opportunity to introduce myself to the firm's clients and friends. As the leader of our property tax practice, I will be responsible for managing KSM's client service responsibilities in all areas related to property tax. After receiving my bachelor's degree in Business Administration from the University of Central Missouri, located in the small city of Warrensburg, Missouri, I moved to Central Indiana in 1999 and took my first job with the Hamilton County Assessor's Office, where I have acquired all 12 years of my experience in Indiana property taxation prior to joining KSM.

I began my career assessing houses in the Fishers/Geist area of Hamilton County. After a short time, I received a promotion to field appraiser for the Carmel area. This change in job responsibilities took me from assessing homes to commercial properties. After working in this market for seven years, I was fortunate to receive another promotion to become the real estate appraisal manager for the Fishers area. In this position, I assessed and defended the roughly 32,000 commercial parcels within all of Fishers. It was that experience that eventually led me to KSM.

With a deep background in commercial real estate property taxation, I look forward to working with our clients who may need assistance in this area. As part of my qualifications in this industry, I am an active member of the International Association of Assessing Officers (IAAO), a Level 3 certified Indiana Assessor-Appraiser, and Certified Tax Representative, in addition to having logged numerous hours of continuing education in the assessment field. I hope to leverage these skills to assist our clients in a variety of areas, such as real estate appeals, personal property tax and abatement compliance, Tax Increment Finance (TIF) analysis, and other property tax consulting projects.

In my short tenure with KSM, easily the most popular question I've been asked is, "Am I paying too much in property taxes?" Whether a business owns a building, or is a tenant with a triple net lease that requires the tenant to pay the property taxes as part of the lease, both owner and tenant should be asking this question. With information as easily accessible as a street address or property record card, we are normally able to provide a high-level review of the property's characteristics and taxes to determine if a real estate appeal is worth considering.

The combination of a reassessment year with dwindling local revenues promises to cause a big uptick in real estate appeals in 2012.

The window to file an appeal is extremely limited. In the state of Indiana, a taxpayer has only 45 days from receipt of their first Notice of Assessment to file an appeal. Depending on the locality, sometimes this notice comes in the form of a tax bill, or Form 11. A Form 11 is normally issued after a change in a property's assessed value. Notably, 2012 is a mandatory reassessment year in the state of Indiana, meaning that a high percentage of taxpayers can expect to receive an assessed value change for their property taxes to be payable in 2013.

If you believe we can be of service, please feel free to contact me. During my short time at KSM, it has been gratifying to experience firsthand the trust KSM's clients and friends have already shown me and our property tax practice. I would like nothing more than to be able to assist each and every one of our clients who has a need in this area.

Client Spotlight: John Paugh of Carter Logistics

John Paugh is the CEO of Carter Logistics, a global logistics solutions provider with operations in six states. John recently sat down with us to talk about his history with Carter, as well as the company's future.

KSM: John, let's start with how the business began. How did you get involved with Carter?

JP: My father was a GMC truck dealer (Duke's GMC in Anderson). I came back from college and started working for him and became the dealer for GMC in 1978. We had sold Will Carter of Carter Express several trucks and trailers. Heavy duty truck dealers recoursed the paper, so if the customers didn't pay for it, you got that equipment back. The early 1980s were not a good time to be getting equipment back, so I went to Will Carter and suggested I help him with the business. I bought a minority share, and we started making a little money. We operated Carter Express together for eight years. I bought him out in 1992. We also sold the GMC truck dealership in 1992. We found we were competing with our truck sales customers.

KSM: With Carter being a transportation company, did you ever actually drive the trucks yourself?

JP: No. When we were selling trucks, I used to do a lot of dealer trades. I would take one truck to a dealer and deliver another one back. But as far as actually pulling trailers and delivering freight, I never did that.

KSM: So, you've never had a CDL (commercial driver's license)?

JP: No, back then you didn't need one. It only required a regular driver's license.

KSM: When you talk about switching from truck sales to transportation, those are very different businesses. How did you adjust to that?

JP: You're right, freight is totally different. When you sell a freight contract, you can end up running that same contract for years. As a dealer, you have to continuously sell. It's a totally different business. I eventually decided to focus on driving trucks versus selling. If you have a franchised dealership, you've got an AOR, or area of responsibility. You will get a certain percent of that market, and that is all. With an ICC (Interstate Commerce Commission) number you can haul anywhere in the upper 48 states. We had grown our GMC truck store dramatically. When I came back [from college], our average market share was around seven percent, and we raised it to almost 30 percent. We had one of the largest market shares in the United States. I didn't feel we would ever sell more than 30 percent. As it turns out, it was a good choice because the Anderson market has shrunk.

KSM: The timing worked out well.

JP: Yes, I was lucky.

KSM: Considering we were in the midst of a recession when you took over the business in 1992, that must have created its own challenges.

JP: We were just so small at that time that I really didn't look at the market or the economy. It was always about utilization. We were able to keep our trucks busy, and we always seemed to be able to get enough business. Even if a customer went down to 80 percent usage, it didn't matter because we were able to find a customer that would use up that capacity.

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Client Spotlight

(continued)

We have only had one year in our history that we didn't have greater sales than the prior year, and that was 2009. It was the only year we lost money. Last year was our best sales year in history. We exceeded the previous year by 20 percent.

KSM: Listening to you reflect on your past and current successes, it makes me wonder if there were any quantum leaps that you can look back on now and say, "That was a key period for the business."

JP: Actually, one of them was when we started working with Katz. Shortly after we got with KSM in 2002, Andy Belser [KSM] and Norm Garvin [law firm Scopelitis, Garvin, Light, Hanson, and Feary] took us from an accrual basis to a cash basis, provided capital, and allowed us to grow.

KSM: As we emerge from this most current recession – one that was particularly rough on the transportation industry – I imagine it has been rewarding for companies like Carter that have persevered.

JP: Yes, it has been rewarding. We're still struggling with our profitability. We had to adjust our pricing so severely during the recession, but that's slowly starting to change. It looks like 2012 should be our best year, not just for gross sales but for net profit.

KSM: Apart from adjusting to the ebb and flow of the economy as we've discussed, what other challenges do you see in the coming years?

JP: I hate to be a pessimist, but to me the biggest hurdle that we have is legislation. We keep passing laws and taxes that have nothing to do with profitability. It's a wheel tax, or they raise unemployment or FICA, and it costs money just to keep the doors open. I think that's a real challenge and makes things difficult.

KSM: Switching gears, I know you've expanded into other states over the last few years. Can you talk a little bit about the facility you're about to open in Vandalia, Ohio?

JP: Yes, we're supposed to be open in April. Actually, it's supposed to be open now, but it blew down over Labor Day weekend. Last year was a terrible year for natural disasters. We had the tsunami, which shut down a lot of our customers. As soon as they recovered from that, we had the flood in Thailand. Obviously, our building blowing down is nothing compared to those disasters, but the timing was ironic that it all happened in the same year.

KSM: So, will Vandalia be a different operation for Carter, or just an extension of what you are doing in other places?

JP: No. It's similar. We are actually already operating that business today in a leased facility. The new facility will replace our leased building and be a lot more efficient. Even though the cost per square foot will increase dramatically, the new facility is going to be so much more efficient that our overall cost will be lowered. The new facility will provide growth potential for us. We currently only have half of it leased.

KSM: During site selection of the Vandalia site, you were pleased about the fact that designing your own facility would allow you to make the layout more efficient.

JP: That's correct. Plus, the location is good. It's right at the intersection of I-70 and I-75 in Dayton, Ohio. As you move off that intersection – east, north, south or west – you add miles to the system. So being right there is going to make us a lot more efficient.

KSM: But even with a brand new facility, in a service industry it still comes down to taking care of your clients. With Carter, sometimes that means clients asking you to develop and provide a new service offering.

JP: Yes, and we continue to do that. We just sold an account for Hitachi Power Tool, where we will be doing freight audit and freight pay. This is the first time we have provided this service. Getting into new services is especially true with 3PL (third party logistics). We might already be doing 60 percent of a customer's business, and they will say, "Look, you are already doing some other stuff for me, and I really don't want to handle this." So, they throw that additional work over the fence to us. In 2002, we got into the 3PL business, and it's now 30 percent of our business. Assets are still the main focus of our business, but every time we add a service, it gives us a better tool box. There's more value we can provide to our customers, and that's been good.