Casino Must Add Back Out-of-State Taxes, Indiana DOR Rules

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A multistate casino was required to add back to its Indiana income any federal deductions it took for taxes paid to other states when those taxes were based on income, the state Department of Revenue ruled.

In a letter of findings, the DOR determined that under IC section 6-3-1-3.5(b), the casino must add back to its income for Indiana income tax purposes any deductions taken for payments of out-of-state taxes as long as the taxes were measured by income, regardless of what the specified tax or fee was called in the other states.

“Whether the states [denote] that tax as an excise tax, a privilege tax, or a casino table fee, the statute pays no mind to these artifacts of the tax’s origin or the manner in which the state chose to label the tax,” the DOR wrote, adding that “if the tax is ‘based on or measured by income,’ Indiana law requires that the tax be added back” (quoting IC section 6-3-1-3.5(b)).

The letter, dated August 13 and published in the November 24 *Indiana Register*, stated that the casino, which was not identified by name, operates “gaming, racing, and video gaming facilities in multiple states, including an Indiana gaming facility.” The DOR audited the casino’s 2015, 2016, and 2017 state and federal corporate income tax returns. The auditor found that when the casino prepared its federal income tax return, it deducted the amount of state taxes it had paid in the multiple states where it operates, but when it prepared its Indiana income tax return, it did not add back those taxes to its income.

The auditor assessed the casino with additional state corporate income tax. The casino protested, arguing that the auditor had improperly added back excise tax and nontax payments from other states that were not related to the casino’s income. It also argued that the addback violated the U.S. Constitution and that the auditor failed to address the state’s policy regarding the state riverboat wagering tax.

In the letter of findings, the DOR agreed with the auditor, finding that “Taxpayer’s argument fails at each level of consideration.” The DOR rejected the casino’s distinction between the different types of tax paid in other states, concluding that they all relate to income. Relying on IC section 6-3-1-3.5(b), the department explained that the casino was required to add back for Indiana corporate income tax purposes any federal deduction the casino took “based on or measured by income and levied at the state level by any state of the United States.” The DOR clarified that this included various excise and privilege taxes, as well as casino license fees, when the taxes and fees are based on revenue and income.

“IC section 6-3-1-3.5(b) contains no ambiguity and requires no elaborate construction,” the DOR noted, concluding that the “out-of-state gambling taxes cited here are plainly and obviously being

measured by those casinos' 'income' and that archaic designations as 'fees,' 'excise taxes,' or 'privilege taxes' are irrelevant."

The DOR also rejected the casino's argument that adding back excise taxes paid to other states violated the state and U.S. constitutions. The casino had claimed that there "is no connection between Indiana and the out-of-state transactions" and that the income it would be forced to add back — the tax paid in those states — "is not rationally related to the values connected with Indiana."

The DOR concluded that as long as the tax in question is measured by income, the tax may be added back. It explained that "there is nothing in the provision which suggests that Indiana is imposing a tax on" out-of-state gambling income and that the casino had not proved that "the addback provision resulted in an Indiana tax that was out of proportion or distortive of Taxpayer's Indiana activities."

The DOR conceded that "Governmental fees not measured by or based on income should not have been added back," but that the casino "has not yet pointed out which of these unrelated one-time fees are or were the subject of its protest." The DOR noted that "to the extent that Taxpayer can explain clearly which of these charges were not tied to or measured by the out-of-state casinos' income, the Department recognizes its responsibility to correct those specific errors."

The DOR also declined to overrule the state tax court's 2004 decision in *Aztar Indiana Gaming Corp. v. Department of Revenue*, which found the state's riverboat wagering tax to be "a tax based on or measured by income" and therefore required to be added back. The DOR explained that for it to overrule the case "would constitute a ~~brazen~~ overreaching of the Department's authority and would constitute an unwarranted interference with the ~~responsibility of and~~ authority of the Indiana judiciary" (strike-throughs in original).

Regardless of the DOR's reluctance to take official action on the *Aztar* case, the DOR noted that it "agrees with the Tax Court's decision and reasoning as set out in that decision."

The DOR agreed to abate the negligence penalty against the casino, noting that while "the Department disagrees entirely with Taxpayer's interpretation of Indiana's addback provision" and "finds that Taxpayer's interpretation is aggressive and skirts the edge of simple reasonableness, Taxpayer's interpretation does not rise to the level of negligence."

Natalie Rodriguez, communications manager for the DOR, provided an emailed statement regarding the letter of findings' strike-throughs: "The intent was to remove those words because it was draft language, but the edits didn't make it to the final copy, which is why it presents as strikethrough text. It doesn't change anything within the" letter.

Mark Loyd of Dentons told *Tax Notes* in a November 29 email that the casino's constitutional argument was "particularly interesting" and "reminiscent of the taxpayer's successful argument in *Hunt-Wesson Inc. v. Franchise Tax Bd. of Cal.*," a U.S. Supreme Court decision from 2000. He noted that if the casino appeals to the state tax court, "taxpayers should keep an eye on this case."