

Taxpayers Who Pay a Cancelled Tax Should Get Refunds: *Armour v. City of Indianapolis*

By
Joseph Henchman & Laura Lieberman

Executive Summary

- When Indianapolis reduced its sewer tax in 2005, the city forgave all future payment obligations by those who were paying the tax in installments. Taxpayers who paid it up front were given no refund.
- The Indiana Supreme Court upheld the City's arbitrary refund policy, arguing that it is conceivable that such a policy would administrative burdens and help the poor.
- Courts must evaluate whether claimed justifications have any rational connection to the stated policy, particularly where there is a strong perception of unfairness and arbitrary action.
- If allowed to stand, the Indiana decision will undermine business certainty, tax compliance, and respect for the law.

Introduction

The Tax Foundation today filed a brief with the U.S. Supreme Court, asking them to hear an appeal from an Indiana decision to give tax refunds to some taxpayers but not others.

The case involves the Indianapolis city sewer tax, which taxpayers had to pay either (a) in full or (b) in installments. In 2005, the city reduced the tax and forgave all future obligations by taxpayers paying in installments. Taxpayers who paid in full requested a prorated refund but were denied. The Indiana Supreme Court upheld the City's refusal in a 3-2 decision, holding that it did not violate constitutional guarantees of equal protection.¹

Our brief urges the U.S. Supreme Court to take the case and reverse that conclusion.

Joseph Henchman is Vice President of State & Legal Projects at the Tax Foundation and Laura Lieberman is Law Clerk at the Tax Foundation.

¹ *City of Indianapolis v. Armour*, 946 N.E.2d 553, 560 (Ind. 2011).

Indianapolis's Action in This Case is Arbitrary and Irrational

The City justifies its unequal refund policy by pointing to its interest in administrative convenience and relief for the poor, notwithstanding the high cost associated with engaging in refund processing at all as well as the cost associated with dividing otherwise identical taxpayers into disparate groups. Further, the policy does not benefit poor taxpayers exclusively or even primarily; if poor taxpayers do benefit disproportionately, it is only by chance.

The decision of the court below failed to evaluate the City's stated justifications adequately. Rather than finding a rational link between (1) the social goal of providing the less fortunate with tax relief to (2) the act of denying refunds to certain taxpayers, the court below only merely discussed the legitimacy of helping the poor as a governmental interest and assumed that this justifies the City's policy of treating pay-in-full taxpayers disparately than pay-in-installments taxpayers. The two dissenting judges in the decision below correctly noted that there was "nothing to explain why the City treated differently residents who elected to pay their assessments in a lump sum versus those who elected to pay in installments" and that "[t]he stated purpose in Resolution 101 simply fails to express any connection to the" denial of relief to petitioners."²

The Indiana Supreme Court Provided No Limit to Government Action

More distressingly, the decision of the court below fails to acknowledge any due process or equal protection boundaries on governmental interests. In doing so, the court selectively cited U.S. Supreme Court's precedents to suggest that the "rational basis" test is no limit on arbitrary governmental actions.³ This reasoning is disconcerting because it could conceivably uphold any governmental action justified by administrative cost concerns. The scope of discretion that the court below gave the City government signals that any violation of the Equal Protection Clause is permissible if the authorities claim there is a governmental interest.

Courts Arizona, Michigan, Ohio, and the District of Columbia have determined that selective tax treatment such as at issue in this case violates equal protection guarantees.⁴ These cases conclude that arbitrary tax

² *Id.* at 570-71 (Rucker, J., dissenting).

³ *See, e.g., id.* at 561, *citing FCC. v. Beach Communications, Inc.*, 508 U.S. 307, 15 (1993) ("[I]t does not matter what the actual policy reason was, so long as a legitimate reason can be conceived."); *id.* at 561, *citing Nordlinger v. Hahn*, 505 U.S. 1, 15-16 (1992) (quoting *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522, 528-29 (1959) ("[A] policy reason is sufficiently plausible if it 'may reasonably have been the purpose and policy' of the relevant government decisionmaker.")).

⁴ *See, e.g., Gosnell Development Corp. v. Arizona Dep't of Revenue*, 744 P.2d 451, 453 (Ariz. Ct. App. 1987) ("Under well-settled Arizona and federal law, taxing authorities treating taxpayers in the same class differently, as Gosnell has been treated, violate their rights to equal protection under the law."); *Armco Steel Corp. v. Dep't of the Treasury*, 358 N.W.2d 839, 243 (Mich. 1984) (citing *Beauty Built Construction Co. v. City of Warren*, 134 N.W. 2d 214, 236 (Mich. 1965)) ("Where an ordinance fails to include and affect alike all persons of the same class, and extends immunities or privileges to one part and denies them to others of like kind by unreasonable or arbitrary classification, the same is contrary to the equal protection guarantees of the State and Federal Constitutions."); *Washington Theatre Club, Inc. v. District of Columbia*, 311 A.2d 492, 495 (D.C. 1973) ("[I]f there is no substantial difference between the operation of these two organizations, [granting only one organization a tax exemption] would amount to an unfair denial of equal tax treatment to appellant."); *Perk v. City of Euclid*, 244 N.E.2d 475, 477 (Ohio 1969) ("A statute which confers special benefits upon delinquent taxpayers not equally available to nondelinquent taxpayers violates Section 2 of Article I of the constitution of Ohio [promising equal protection to its citizens] and is therefore void and of no effect.").

classifications resulting in unequal treatment violate constitutional protections. The U.S. Supreme Court should look to these cases as persuasive in interpreting the applicability of the Fourteenth Amendment to the City's action in this case.

If Allowed to Stand, the Indiana Decision Will Undermine Business Certainty, Tax Compliance, and Respect for the Law.

When governments act arbitrarily in their tax procedures, scarce taxpayer resources must be allocated to cumbersome compliance procedures. Without the ability to make reasonable predictions about tax climates and resource allocation, making important business decisions becomes more difficult and reducing business activity.

The decision of the court below effectively encourages unpredictable and arbitrarily targeted tax policy. Taxpayers are effectively taught that they should pay their taxes in installments whenever possible because they may “lose” less money than those who pay in full. Moreover, taxpayers who can afford to pay in full have even greater incentive to pay in installments, a decision made not for economic freedom but due to an uncertain legal climate.

The decision below emphasized that tax authorities can use taxpayers' probable economic statuses as a justification for arbitrary tax policy, a dangerous precedent. State revenue officials already often claim that their constitutionally questionable actions are justified by budget concerns. If the decision of the court below stands, they will be encouraged to push the limits even further. *See, e.g.,* Paul Frankel, *Retroactivity and Retained Refunds*, TAX FOUNDATION TAX POLICY PODCAST (Jul. 7, 2010), <http://www.taxfoundation.org/research/show/26493.html> (explaining government proclivities towards citing governmental interests in questionable ways).

This case is not an aberration in showing little regard for business certainty and scarce resources. In *Zoeller v. Aisin USA Manufacturing, Inc.*, 946 N.E.2d 1148 (Ind. 2011), the Indiana Department of Revenue sent a taxpayer an overpayment but later determined that their issuance of the refund was a clerical error. The Department proceeded to send out a series of notifications that cancelled the assessment, re-issued it, and altered the amount due, all after the statute of limitations had already passed.⁵ The Indiana Supreme Court upheld the Department's action. Decisions such as *Zoeller* and *Armour* suggest that some state officials are concerned neither with protecting taxpayers' rights nor with encouraging taxpayers to engage in productive economic activities. This in turn makes it less likely that taxpayers will feel that they are represented faithfully by their government.

For many citizens, paying taxes is one of the few ways that they interact with the government. Tax policy widely perceived as unusual and unfair threatens to foster a general disenchantment with the government, creating tensions between the law and citizens. By reiterating basic standards of equal refund treatment of a canceled tax, this Court will reduce the prevalence of a rising problem of arbitrary taxation practices.

The case is *Armour v. City of Indianapolis*, No. 11-161.

⁵ See Laura Lieberman, “Indiana Department of Revenue Rivals the Ministry of Silly Procedures in Tax Refund Case,” *Tax Foundation Tax Policy Blog* (Jul. 11, 2011), <http://www.taxfoundation.org/blog/show/27440.html>.

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National Press Building
529 14th Street, N.W., Suite 420
Washington, DC 20045
202.464.6200
www.TaxFoundation.org

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