

PA TAX LAW NEWS

HAVE YOU FILED YOUR GROSS RECEIPTS TAX REFUND CLAIMS? *by James L. Fritz*

If your company pays Pennsylvania Gross Receipts Tax and you have not recently filed assessment appeals and/or protective refund claims, you should consider doing so immediately! Pending court appeals and a recent Pennsylvania Department of Revenue bulletin highlight a number of issues that you should be keeping in your sights and which you should be addressing through assessment appeals and refund petitions.

Subject to certain limited exceptions, Pennsylvania imposes tax on gross receipts “received” from, among other things:

- Telephone messages transmitted wholly within the state
- Telephone messages transmitted in interstate commerce, originating or terminating in PA and billed to a PA service address
- Mobile telecommunications service messages sourced to PA under 4 U.S.C. § 117
- Sales of electric energy within PA

Bad Debts Bulletin

For some time, the Department of Revenue has insisted on taxing bad debts. The Department has done so notwithstanding the fact that such amounts have not been received by the company and the statute clearly taxes only amounts “received.” Facing imminent litigation, the Department issued Pennsylvania Corporation Tax Bulletin No. 2011-02 on July 20, 2011, discussing accepted accounting methods and explicitly recognizing a “deduction” for bad debts.

Companies which have included bad debts in their reported gross receipts or have been assessed by the Department on bad debt amounts should immediately determine what appeals and refund claims may be timely filed and make those filings!

Unfortunately, the issuance of the Department’s bulletin may not signal the end of this issue, as we have seen indications that Revenue Department auditors intend to insist that taxpayers provide onerous bad debt documentation detail, failing which they will assess tax on

the bad debts. The Department’s characterization of this as a bad debt “deduction” which must be affirmatively documented by the taxpayer is in error. Bad debts are simply amounts which have not been “received” and need not be included in reported taxable gross receipts. Taxpayers, of course, must maintain auditable records. But, the Department bears responsibility for auditing those records and developing a factual basis for any under-reporting it believes should be assessed.

Other Issues Pending Litigation

As the Department has never issued regulations explaining its interpretation of the Gross Receipts Tax statute, it should come as no surprise that many cases are now pending in Pennsylvania’s Commonwealth Court, contesting the inclusion of many types of charges and fees in the tax base. Telecommunications companies are preparing to litigate the taxability of private line charges, directory assistance charges, voicemail and features charges, and a number of other types of charges. We are advising companies to at least file protective appeals and refund claims to maintain their options pending the outcome of this lead litigation. Generally, we can file appeals and refund petitions, and then arrange to have action on them deferred at one of the administrative boards or in court, pending the ultimate resolution of a case which was filed earlier and involves the same issues.

If you have any questions concerning how to protect your company’s rights regarding Pennsylvania’s Gross Receipts Tax, Jim Fritz may be reached by phone at (717) 237-5365 or by e-mail at jfritz@mwn.com.



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UPCOMING SALT SEMINARS

October 18 & 25 – Lancaster & Altoona

The McNees SALT Group will be presenting “Pennsylvania State & Local Taxes 2011” in Lancaster on October 18th and in Altoona on October 25th.

The Altoona seminar is being co-sponsored by the Pennsylvania Society of Public Accountants (PSPA).

Topics will include:

- Recent PA Developments: Sales & Use Tax, Corporate Taxes, Personal Income Tax, Fuel Taxes, Unclaimed Property and Local Taxes.
- State Tax Implications of Multistate Transactions
- Understanding PA Production-Based Exemptions
- Real Estate Tax Assessment Appeal Pointers
- Alternative Strategies for Resolving State Tax Issues
- Business Privilege Taxes - The New Battleground?
- Tax and Technology - Dealing with the Digital Age

Registration details concerning the Lancaster seminar may be accessed at the “Newsroom/Events” tab of the McNees website: www.mwn.com.

Online registration for the Altoona Seminar is available through the “Professional Education & Events/Course Catalog & Registration” tab at PSPA’s website: www.pspa-state.org.

Other SALT Seminar Activity

Jim Fritz recently co-presented state tax update seminars for the Pennsylvania Bar Institute in Mechanicsburg and Philadelphia.

Randy Varner will be co-presenting a Mid-Atlantic State Tax Update on November 10th at the 2011 Advanced Tax Institute co-sponsored by the Maryland State Bar Association, Inc. and the Maryland Association of CPA’s.

Bert Goodman and Randy Varner will be presenting on Real Estate Assessment law at the Pennsylvania Bar Institute’s 15th Annual Real Estate Institute in Philadelphia on December 7th and 8th.

PHILADELPHIA COMMON LEVEL RATIO DROP RESULTS IN OPPORTUNITIES FOR SIGNIFICANT PROPERTY TAX SAVINGS; LANCASTER COUNTY POSTPONES 2012 COUNTYWIDE REASSESSMENT *by Randy L. Varner*

Philadelphia CLR Drop

The State Tax Equalization Board recently dropped the Philadelphia Common Level Ratio (“CLR”) from .32 to .181. This significant drop means that many properties in Philadelphia are over-assessed and results in an opportunity for Philadelphia property owners and others responsible for paying Philadelphia property taxes to significantly reduce their bottom line property tax bill by filing an appeal. **The Philadelphia appeal deadline is October 1, 2011.**

This drop in CLR has enormous significance for Philadelphia property owners and others responsible for paying Philadelphia property taxes.

By way of illustration, consider a property that is assessed at \$1,000,000. Last year, using the .32 CLR, the imputed fair market value of this property was \$3,125,000 ($\$1,000,000 / .32$). Now, with this year’s .181 CLR applied, the imputed fair market value has jumped to \$5,524,862 ($\$1,000,000 / .181$). That represents almost a 77% increase in imputed fair market value!

Assuming that the property was properly assessed at \$1,000,000 last year, then the fair market value of the property was actually \$3,125,000. Further assuming that the fair market value remained the same this year and using the new CLR of .181, the appropriate assessed value (the value on which millage rates are applied for determining taxes) for the property should be \$565,625 ($\$3,125,000 \times .181$) rather than \$1,000,000. A timely filed appeal is the only way for a property owner to obtain reduction of an assessed value - which in our example would result in almost a 44% reduction in taxes.

Obviously, it is highly unlikely that a property’s value has increased any significant amount - much less 77% - overnight, especially in this economy. Unless property owners appeal the current assessed value, it is almost certain that they will be paying far too much in Philadelphia property tax.

It is critical that those who own property in Philadelphia or who are responsible for paying Philadelphia property taxes immediately consider an appeal. Again, the appeal deadline is October 1, 2011.

Lancaster County 2012 Reassessment Postponed

Recently, Lancaster County decided to postpone its scheduled 2012 countywide reassessment. The commissioners have now set 2017 as the target year for the next countywide reassessment. This means that those who pay property tax in Lancaster County must pay particular attention to their assessments to make sure that their tax bill is fair, given the extended amount of time that will accrue between countywide reassessments. Members of our group can help you analyze your current assessment for Lancaster County, and all counties in Pennsylvania.

If you have any property tax related questions, please feel free to contact Bert Goodman (bgoodman@mwn.com), Randy Varner (rvarner@mwn.com) or Tim Horstmann (thorstmann@mwn.com).

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GOVERNOR SIGNS INTO LAW THREE BILLS AFFECTING OIL AND GAS DRILLING, REAL ESTATE TAXATION

by Timothy J. Horstmann

On July 7th, Governor Corbett signed into law House Bills 143, 144, and 562. House Bill 143 amends the Pennsylvania Farmland and Forest Land Assessment Act of 1974 to permit property owners under preferential assessments to lease a portion of their property for non-coal surface mining use. A property owner making such a lease would only be assessed roll-back taxes on that portion of the property which was leased.

House Bill 144 also amends the Act of 1974 to clarify that the portion of land which becomes subject to roll-back taxes due to oil or gas drilling is determined from the time a well production report is first due to the Department of Environmental Protection. The legislation also clarifies that the roll-back tax will be due in the year immediately following the year in which the well production report is provided to the county assessor.

House Bill 562 amends the Agricultural Area Security Law to include a statutory definition for the term “contiguous acreage.” Under this definition, land owners with property divided by a stream, public road, bridge or railroad will be eligible for farmland preservation. The legislation also adds to the existing right to mine and remove coal from property subject to agricultural conservation easements the right to mine and remove non-coal minerals, such as natural gas. ■



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INTERNET RED LIGHT DISTRICT DOMAIN



Our firm’s Intellectual Property Group recently published an alert which may be of interest to some of our readers and certainly would be useful reading for someone in almost every company. As of September 7, 2011, the Internet Corporation for Assigned Names and Numbers (ICANN) began offering .xxx domain registrations.

The registry is operated by a Florida-based company whose intent is to create designated domains for adult content. Because any string ending with .xxx can be purchased, the launch of .xxx represents an opportunity for domain squatters and trademark infringers.

If your company does not take action to protect its interests, your company’s trademark could become associated with a .xxx domain and website. Our Intellectual Property Group’s article discusses the options available to your company to prevent this from occurring. The article may be accessed at www.mwn.com under the “Publications” tab. ■

PA TAX COLLECTIONS LAG

by James L. Fritz

Pennsylvania’s governor and legislators may be glad they didn’t spend all of last year’s surplus in adopting the 2011-12 General Fund budget inasmuch as collections for the first two months of the fiscal year have lagged projections. The following results were reported for August:

| | |
|---|---------------------------|
| Total General Fund: | \$-63.1 million (-3.4%) |
| Sales Tax: | \$-15.7 million (-2.1%) |
| Personal Income Tax: | \$-55.2 million (-6.9%) |
| Corporate Taxes: | +\$ 3.7 million (+6.6%) |
| Inheritance Tax: | \$- 5.1 million (-6.8%) |
| Realty Transfer Tax: | \$ - 4.5 million (-13.8%) |
| Motor License Fund: (gas & diesel taxes) | +\$19.3 million (+7.5%) |

WHO WILL PAY FOR NECESSARY IMPROVEMENTS TO PENNSYLVANIA'S TRANSPORTATION INFRASTRUCTURE? *by Sharon R. Paxton*

In April 2011, Governor Tom Corbett established a Transportation Funding Advisory Commission ("Commission") to develop a comprehensive, strategic proposal for addressing Pennsylvania's transportation funding needs. In early August, the Commission released its report, which includes modernization initiatives and a recommended funding package, as well as proposed legislative action and follow-up studies. There is broad support in the business community for the Commission's recommendations. However, as of early September, Governor Corbett has not disclosed which of the Commission's recommendations he will support. The Commission's recommendations include a fuel tax increase as a primary funding mechanism, and Governor Corbett has to this point opposed any increases in state taxes.

Few dispute that Pennsylvania's transportation infrastructure is in urgent need of repair and reinvestment. The Commission's report notes that 5,205 bridges in the state are rated as "structurally deficient" and 8,452 miles of Pennsylvania highway are in need of rehabilitation or reconstruction. Public transportation has also experienced serious financial challenges. Per the Commission's report, the state's underinvestment in transportation infrastructure is due in large part to rising construction costs and the limitations of tying funding revenues to fuel consumption. The fuel tax, which is a key component of transportation funding, has been generating less revenue per vehicle over time due to advances in vehicle fuel economy.

While Pennsylvania's transportation infrastructure problems and funding challenges have been under evaluation for several years, the state has yet to successfully adopt a short or long term plan for the adequate funding of transportation infrastructure. After Pennsylvania's second application to toll I-80 was rejected by the United States Department of Transportation in April 2010, Governor Rendell called for a Special Session of the Legislature to focus on Pennsylvania's transportation funding needs. Several bills were introduced with various transportation funding options, but none of those bills contained a comprehensive funding plan and none were enacted.

In a 118-page Transportation Study Final Report issued in May 2010, the Pennsylvania State Transportation Advisory Committee ("TAC") discussed a myriad of existing and additional funding sources that could be used to fund the state's transportation system. While the TAC determined that Pennsylvania's current transportation funding structure is neither adequate in revenue yield, nor structurally sustainable over the long term, the TAC stopped short of recommending a specific revenue scenario. Governor Corbett's Commission has built upon the work of the TAC to develop a recommended funding package for sustainable transportation in Pennsylvania.

Governor Corbett's Commission was encouraged to consider all funding options (other than raising the flat gas tax at the pump, leasing or changing the ownership structure of the Pennsylvania Turnpike, and changes in Federal assistance or law) and to develop the best combination of potential funding sources to produce a sustained \$2.5 billion increase to annual transportation funding. The funding package recommended by the Commission would utilize five primary funding sources:

- Capping and/or moving a portion of State Police costs to the General Fund
- Indexing vehicle and driver fees to the Consumer Price Index, with the fee increases for commercial vehicle registrations to be phased in incrementally over four years
- Uncapping the Oil Company Franchise Tax over five years (This tax is based on application of a fixed millage rate against the variable Average Wholesale Price ("AWP") of gas and diesel, up to an AWP ceiling set in 1983. The actual AWP is now more than double the ceiling.)
- Redirecting certain Act 44 contributions received from the Pennsylvania Turnpike from highway and bridge funding to public transit
- Increasing various fees and fines, as well as implementing various modernization and cost saving initiatives, to benefit the Motor License Fund

The "modernization and cost saving" proposals recommended by the Commission include, among other things, biennial registration, an eight-year driver's license, elimination of registration stickers, optional third-party non-CDL driver's license skill testing, automated work zone speed enforcement, advertising within the state right-of-way, moving the point of fuel taxation to the terminal (rack), service patrol advertising, dedication of 2% of existing sales tax revenue to transit, increasing the local transit match, allowing licensed liquor establishments to operate small games of chance, and the consolidation/regionalization of transit delivery.

Other, more complex, ideas considered by the Commission, which would require enabling legislation, include authorizing local governments to raise revenue to support transportation investment, passing public-private partnership legislation, and amending Act 44 of 2007 to enable tolling authority on Pennsylvania interstates with toll revenue to be dedicated exclusively to the corridor from which it was collected. (Although the Commission did not recommend the tolling of any interstate, it did recommend the enactment of enabling legislation now to take into account the fact that tolling is mileage-based, rather than based on fuel consumption, and that federal laws could change in the future. It further recommended that the tolling operator be unspecified, so that the private sector could participate if the public-private partnership law were passed.)

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PENNSYLVANIA'S TRANSPORTATION INFRASTRUCTURE *(continued from page 4)*

Finally, the Commission determined that alternative highway funding options and development of a comprehensive Commonwealth Freight Movement Plan for rail freight and trucks merit "detailed investigation through dedicated studies" and may become important factors in future transportation funding scenarios. Alternative highway funding options to be further examined would include energy-based charges and usage-based charges, such as expanded tolling, logistics fee, freight charges and vehicle miles traveled fees.

All motor vehicle operators would share the cost of increased funding for Pennsylvania's transportation infrastructure under the Commission's proposals. The Commission did not recommend tax and fee increases that are targeted exclusively at commercial

vehicle operators. It remains to be seen, however, whether any of the recommended "follow-up studies" might result in proposed funding options, such as freight charges, that are specifically directed at commercial vehicle operators. A full copy of the Commission's report is available at <ftp://ftp.dot.state.pa.us/public/pdf/TFAC/TFAC%20Final%20Report%20-%20Spread%20Version.pdf>. ■



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"MAIN STREET FAIRNESS ACT" WOULD BE INEFFECTIVE WITHOUT MEMBERSHIP IN STREAMLINED SALES TAX AGREEMENT *by James L. Fritz*

On July 29th, the proposed "Main Street Fairness Act" (MSFA) was introduced in the United States Senate (S. 1452) and House of Representatives (H.R. 2701). Subject to a "small seller" exception, the MSFA would allow qualifying states to require "remote sellers" (essentially internet-based and mail order sellers) to collect sales and use tax on "remote sales." The potential impact of this legislation in Pennsylvania, however, is complicated not only by uncertainties relating to passage by Congress, but also by the uncertainty of whether and when Pennsylvania would agree to join the Streamlined Sales Tax Agreement, which would be a precondition for remote collection authority under the MSFA.

Many "bricks and mortar" retailers in Pennsylvania support actions that would require remote sellers to collect tax. As a practical matter, many sales to PA customers by internet-based and mail order sellers escape state and local sales taxes in Pennsylvania. This gives remote sellers an effective price advantage over local retailers who not only collect sales and use taxes, but pay other local taxes and provide local employment. Of course, a purchaser from a remote seller is legally required to remit use tax directly to the Commonwealth on any untaxed purchases which would be subject to sales tax if purchased from an in-state vendor. Other than business taxpayers who are regularly audited, however, many taxpayers are either ignorant of their use tax obligation or simply ignore it.

In the United States Supreme Court's 1992 decision in *Quill Corp. v. North Dakota*, 504 U.S. 298, the Court ruled that a state cannot require a vendor to collect sales tax on sales to customers in that state unless the vendor has a physical presence in the state. This physical presence may consist of an office or other facility, visits by out-of-state based employees, or in-state activities on the company's behalf by an agent or other representative of the company. However, unlike prior

cases, this decision made clear that the United States Congress, under its Commerce Clause powers, could establish a different tax collection standard. The MSFA would do just that.

However, whether the MSFA would have significant potential impact on Pennsylvania's ability to enforce collection by remote sellers lacking current nexus is uncertain because it is far from clear that the General Assembly is ready to join the Streamlined Sales Tax Agreement, which would be required before MSFA would give Pennsylvania remote collection authority.

In February, members of the PA House Appropriations and Finance Committees heard testimony from a former Iowa legislator, currently representing the Main Street Fairness Coalition. He advocated for Pennsylvania to join the Streamlined Sales Tax Agreement and cited a study estimating that Pennsylvania loses more than \$700 million annually in uncollected tax on remote sales.

In May, the PA Senate Finance Committee heard testimony from several persons, including a representative of the PA Department of Revenue. The Department's representative indicated that a use tax reporting line will be added to 2011 Personal Income Tax returns, to encourage reporting by individuals who make purchases from remote sellers (although only minimal compliance is expected). He reported that the Department already collects more than \$370 million in use tax annually – nearly all from businesses. The Department sees little immediate benefit to joining the Streamlined Sales Tax Agreement, projecting lost revenues from adoption of the Agreement's definitions that would offset other revenue gains. The Department's testimony indicated that no real benefit would be realized until federal legislation is adopted to enable states to force remote sellers to collect tax. This, of course, raises the old "chicken and the egg" quandary.

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“MAIN STREET FAIRNESS ACT” (continued from page 5)

In other Senate Testimony, a Carnegie Mellon University professor said that a study he authored indicates an annual loss of \$254-410 million to Pennsylvania from uncollected taxes on remote sales. Another study provided to the Committee – prepared by three professors at the University of Tennessee in 2009 – estimated Pennsylvania’s 2012 state and local tax loss on e-commerce sales at \$345.9 million.

On the other side of the coin, the Senate also heard testimony from e-commerce vendors. The Net Choice Coalition argued that changes to the collection rules are not necessary because Pennsylvania is already receiving much of the tax due on e-commerce sales through: (a) business use tax filings; and (b) collections by online retailers that have a physical presence in the state. The Coalition also argued against

participation by Pennsylvania in the Streamlined Sales Tax Agreement, arguing that the Agreement does not provide sufficient simplification. If Pennsylvania and other additional states joined the Streamlined Sales Tax Agreement and Congress passed MSFA, smaller Pennsylvania-based e-tailers could be harmed by added compliance burdens.

At this point, there is considerable doubt that Pennsylvania’s General Assembly will move with any haste to join the Streamlined Sales Tax Agreement. Adding the political posturing and other factors affecting legislation in the United States Congress, one suspects that it may be quite some time before Pennsylvania will be able to close the online sales tax collection gap. ■

PA NOTES by Timothy J. Horstmann

Pennsylvania Sales and Use Tax Ruling

No. SUT-06-014 (July 20, 2011). The Pennsylvania Department of Revenue has reissued its 2006 ruling regarding the provision of **computer consulting and programming services**. Such services are nontaxable in Pennsylvania unless they are provided as “help supply” services. Under the ruling, computer consulting and programming services remain nontaxable so long as the vendor’s employees that provide the service remain under the control of the vendor, not the customer. The presence in the service contract of a specified deliverable or finished product also supports a finding that the service is nontaxable, as help supply service arrangements typically do not have such requirements.

Pennsylvania Corporation Tax Bulletin

No. 2011-2 (July 20, 2011). The Pennsylvania Department of Revenue has announced that effective for tax years beginning January 1, 2011,

taxpayers subject to the **gross receipts tax** are required to file their tax reports using the same **method of accounting** used in reports filed with the Federal Energy Regulatory Commission or Federal Communications Commission, the Pennsylvania Public Utility Commission, or the Internal Revenue Service, in that order of preference. If a taxpayer must change its method of accounting as a result of this announcement, the taxpayer must restate its gross receipts in the transition year. Depending on the method of accounting required by the change, the taxpayer’s receipts reported in the transition year may increase.

Lebanon Valley Farmers Bank v. Commonwealth

No. 698 F.R. 2005 (Aug. 4, 2011). The Commonwealth Court has held that the application of six-year averaging in the calculation of **bank shares tax** is unconstitutional where a Pennsylvania bank has merged with an out-of-state bank or with a bank in existence for less than six years. After initially ruling that the averaging provision was

constitutional, the Court, upon reviewing exceptions filed by the parties, overruled its previous decision, and determined that on a prospective basis, a bank involved in a merger with an out-of-state bank shall calculate its bank shares tax as if it were a new entity. In the case of a bank that merged with a bank in existence for less than six years, the Court held that the bank should calculate its tax as if it had been in existence for the same number of years as the “younger” bank. The Court also found that the taxpayer in the case was entitled to relief on a retrospective basis, but did not specify a remedy. Instead, the Court ordered the Commonwealth to take the necessary steps to provide for a remedy in accordance with its decision.

Appeal of Collegium Charter School

No. 2354 C.D. 2010 (July 26, 2011). In an unreported opinion, the Commonwealth Court rejected the request of the Collegium Foundation for an **exemption from real estate taxes** for the tax year 2009.

During the period at issue, the Collegium Foundation leased the charter school property to the Collegium Charter School, a related entity and the named petitioner in the appeal, in exchange for market rents. (Subsequent to the filing of the appeal, the two Collegium entities merged, and there was no question that the property was exempt in 2010.) Among other things, the Foundation argued that it was entitled to the exemption under Act 104 of 2010, which retroactively exempted from real estate taxes all school property owned or leased by a charter school. However, the Court found that Act 104 could not be constitutionally applied in the case, as it had not become effective until after the lower court’s ruling and a tax lien was issued, which resulted in the accrual of a vested right to the taxing authority. Therefore, despite the clear mandate by the General Assembly, the Court found that the Foundation was not entitled under Act 104 to the tax exemption for the year in question.