

# PA TAX LAW NEWS

## PA ADOPTS “NO TAX INCREASE” BUDGET FOR 2010-11

By James L. Fritz

For the first time in years, Pennsylvania has adopted an “on time” budget! And, notwithstanding continued softness in revenue collections, the budget includes no general tax increases – in fact, no tax bill was passed as part of this year’s budget process! However, we do expect the General Assembly and Governor Rendell to work toward adoption of a natural gas severance tax sometime this Fall. And, if the federal government fails to appropriate an additional \$800 million for Pennsylvania’s Medicaid program – money anticipated in the new PA budget - legislators soon could be back at the budget table.

The good news for companies doing business in Pennsylvania is that a number of tax proposals fell by the wayside in the budget process. Proposals to either eliminate or cap the sales tax vendor’s allowance had garnered some support. The Governor and some legislators had favored expanding the sales tax base to include many services consumed by business, and had proposed eliminating the bad debt refund provision and exemptions such as direct mail advertising materials, returnable containers, public utility equipment and wrapping supplies. With the Commonwealth facing a multi-billion dollar structural deficit next year due to loss of federal stimulus funds and due to increased pension funding obligations, these and other tax proposals will almost certainly be put back on the table by one or another of the participants in next year’s budget process.

The Governor’s long-sought proposal for combined reporting

of corporate net income taxes may also be back on the table next year, regardless of the winner of this fall’s gubernatorial election, inasmuch as it also has its legislative backers.

On the downside, a number of companies advocating single sales factor apportionment will have to wait another year.

At this point, the advance betting on next year’s budget cycle almost universally anticipates the most difficult budget battle in decades. Although the business community seems to have skated through the 2010-11 budget process relatively unscathed, we urge companies who would be significantly impacted by possible tax changes to immediately assess their public affairs strategies. Companies which wait until the battle is joined next Spring will be too late to the table. Having a significant impact on the legislative process requires advance planning and laying the groundwork through advance contact with key legislators, legislative staffers and Governor’s Office staff. We can assist you in evaluating your risks and developing a plan to protect your interest in next year’s budget process. ■



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## PA TAX AMNESTY EXCEEDS TARGET BY \$71 MILLION

By James L. Fritz

On June 21st, Governor Rendell announced that Pennsylvania's first general tax amnesty program in 14 years brought in \$261 million, significantly exceeding its budgeted goal of \$190 million. The Department of Revenue expended considerable effort in contacting taxpayers with outstanding balances, urging them to participate. And, we saw much greater than usual flexibility from the Department in helping taxpayers under audit to conclude their audits in a manner permitting them to submit part or all of their audited liability through the amnesty program.

Now that the general amnesty is over (see article below for new escheat amnesty program), the Pennsylvania Department of Revenue is vowing to step up enforcement against those who did not take advantage of the amnesty program. According to Governor Rendell, "[t]he Department ... will more frequently garnish the wages of people who owe back taxes, hold more corporate officers personally accountable

for taxes their businesses owe, issue more citations against businesses operating without sales tax licenses and publish all tax liens for public view." The amnesty legislation also provided an additional 5% penalty for those who did not participate.

We note that in the past the Department has assessed corporate officers without making a specific determination as to whether those officers were actually in control of tax reporting and payment – issues that we then successfully addressed on appeal. In addition, although the general amnesty program is over, the Department still will consider requests for collection compromises on liabilities which are beyond the formal appeal period. In the past, we have been able to negotiate compromises based both on inability to pay the full amount and on explanations of why the tax wasn't due in the first instance. Collections compromises may become a bit harder to obtain in the future, but we fully expect that the process will remain available in appropriate circumstances. ■

## PA ANNOUNCES AMNESTY PROGRAM FOR UNCLAIMED PROPERTY

By Sharon R. Paxton

On June 16, 2010, Pennsylvania Treasurer Rob McCord announced the Pennsylvania Treasury's Holder Amnesty Program. Under this program, all penalties and interest will be waived for delinquent holders who voluntarily come forward, including companies that missed the April 15 unclaimed property filing deadline, first-time filers and companies with gaps in their reporting history that would like to come into compliance. The Treasurer reminded "holders" of unclaimed property that writing these items off as income does not relieve a company of its obligation to report unclaimed property.

The Holder Amnesty Program will run until October 31. To participate in the amnesty program, a holder must sign a Voluntary Disclosure Agreement. The program is not available to holders that are currently under audit or self-audit with the Treasury Department or have been notified of a pending audit or self-audit.

Unclaimed property reporting requirements were addressed in the April 2010 issue of McNees's PA Tax Law News, accessible at: <http://www.mwn.com/pubs>. ■

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## PROPERTY TAX UPDATE: REAL ESTATE APPEAL DEADLINES APPROACHING

By Randy L. Varner

If your company owns real estate in Pennsylvania, you should carefully examine your current tax assessments to make sure you are not paying too much in County, School and Municipal real estate taxes.

Many property owners are finding that the fair market value of their properties has decreased over the past several years, while the tax assessment value of the properties has stayed the same. Property owners in such a situation should consider challenging their assessed values to bring them in line with the fair market value of the properties.

Because of the complexities of the Pennsylvania tax assessment process and tight annual deadlines (which vary among counties and circumstances--usually the deadline is either August 1 or September 1), property owners often miss opportunities for appeal. Since many counties base their assessments on a fraction of some historical value, a simple comparison of current market value and assessed value often will not give a proper indication of the fairness of your current assessed value. Let us help you review your current assessment and determine whether it should be challenged.

A court appeal isn't always necessary; we often work closely with county assessment offices to resolve disputes without the necessity of formal litigation. If litigation is necessary, however, we can draw upon our extensive experience across the state before county boards of assessment and county courts of common pleas.

### Recent Valuation and Exemption Developments

SR 250 (effective July 14, 2010): SR 250 directs the Legislative Budget and Finance Committee to conduct a comprehensive study of the current real property tax collection system in Pennsylvania. This study will address the impact of the consolidation of real property tax collection systems, including the costs and benefits associated with consolidation, and compare them to real property tax systems of other states. We will monitor the progress of the Committee and will report on its activities in future editions of this newsletter.

*Carpenter Technology Corp. v. Berks Cty. Bd. of Assmt. Appls.*, No. 1569 C.D. 2007; 1622 C.D. 2007 (Pa. Cmwlth. Ct. 04/06/2010 (unreported opinion)): It was appropriate for the trial court to formulate a price per square foot where the

parties' experts did not comply with the Commonwealth Court's remand directions. Further, the trial court did not commit an error in applying the common level ratio (CLR) to the fair market value to determine assessed value despite the parties' stipulation that the predetermined ratio would be used, in light of several pending Supreme Court cases on the use of ratios that were not decided prior to remand.

*CHF-Kutztown LLC v. Berks Cty. Bd. of Assmt. Appls.*, No. 1663 C.D. 2009 (Pa. Cmwlth. Ct. 04/13/2010): A non-profit corporation operating a housing project for university students failed to qualify as a purely public charity because it failed to donate or render gratuitously a substantial portion of its services. The taxpayer did not provide housing at actual cost and never knowingly rented to a student who could not afford to pay the rent. Further, the Court noted that the taxpayer made a significant profit from the property.

*In re: Appeal of William J. Mangan*, No. 1587 C.D. 2009, (Pa. Cmwlth. Ct. 04/22/2010 (unreported opinion)): The taxpayer failed to meet his burden of proving that the reassessment of his property violated the Uniformity Clause where the taxpayer failed to establish actual value. The taxpayer's expert presented comparable sales at the hearing. Although comparable sales can be used to establish market value, the appraisal must show the relative value of the comparable property by showing characteristic qualities to help the court understand the appraisal. The taxpayer's expert did not make such a showing. Without that evidence, the taxpayer could not meet his burden of proving that the assessment was not uniform.

*Fisher v. Bd. of Revision of Taxes*, No. 2203 C.D. 2008 (Pa. Cmwlth. Ct. 06/14/2010 (unreported opinion)): The taxpayer failed to meet his burden of establishing a lack of uniformity since he failed to present evidence of current market values of comparable properties. The taxpayer failed to demonstrate that the Board deliberately discriminated against him in the application of tax or that the Board's action had a discriminatory effect. ■

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## LETTER RULING IMPACTS HIGHWAY CONSTRUCTION INDUSTRY

By Sharon R. Paxton

The Pennsylvania Department of Revenue has ruled that certain contractual arrangements commonly used in highway construction projects will not be respected by the Department for sales and use tax purposes (Ruling No. SUT-10-002). Under the ruling, a Bulletin 15 bridge beam supplier (that is not also a PennDOT approved contractor) that enters into a “supply and erect” subcontract with a prime construction contractor or with an erection subcontractor, and then subcontracts all of the erection work back to that contractor, will be treated as a mere “vendor” of bridge beams and not as a construction contractor. Under the ruling, the bridge beam supplier will be required to collect sales tax on the total sales price of the beams from the contractor performing the erection services (rather than to pay sales or use tax only on the cost of materials it uses to fabricate the beams). Similarly, the contractor performing the erection services will be required to pay sales or use tax on the full purchase price of the beams that it erects. This ruling has broad significance for the highway construction industry because the Department’s analysis applies not only to contracts for the erection of bridge beams, but also to contracts for the installation or erection of other components.

If the parties to such a contractual arrangement take the position that the material supplier is a construction contractor rather than a “vendor,” the Department may attempt to collect the tax due on the total sales price of the materials from either the material supplier or from the contractor actually performing the erection services. Thus, from a tax

standpoint, it would be advisable for a material supplier to collect sales tax on the entire sales price of the materials from the contractor performing the erection services (or at least to seek contractual indemnification from the contractor in the event of a tax assessment against the supplier). Similarly, it would be prudent for contractors to require material suppliers to include sales tax in their quotes to avoid a tax exposure that was not factored into the bid price.

This letter ruling reflects the Department of Revenue’s legal position but does not carry the weight of a court decision. An audit assessment issued against a material supplier (for failing to collect the appropriate tax from the contractor performing the erection services) or a contractor (for failing to pay the appropriate tax) who has entered into such an arrangement can obviously be appealed. In addition, contractors who have entered into such contractual arrangements and paid sales tax to the supplier on the total price of the materials have a right to challenge the Department’s position through the filing of refund claims for sales tax paid.

The contractual arrangements addressed in the ruling also have implications that go beyond tax consequences (such as compliance with PennDOT requirements). For questions concerning the tax consequences of highway construction contracts, please contact a member of the McNees State and Local Tax Practice Group. For advice concerning general contracting issues, please consult a member of McNees’s Construction Law Group. ■

## IFTA COMPLIANCE TIPS

By Sharon R. Paxton

The International Fuel Tax Agreement (IFTA) audit procedures employed by the PA Department of Revenue when a motor carrier lacks proper mileage records or proof of fuel purchases almost guarantee a substantial assessment, even for a carrier with modest operations. While we have resolved many IFTA audit assessments by negotiated settlement after an appeal to the Commonwealth Court, a carrier willing to implement strict procedures can limit its tax exposure in the event of an IFTA audit by following the guidelines discussed below. Under IFTA, all mileage and fuel records must be maintained for a period of four years from the due date of the IFTA return, or the date the IFTA return was filed, whichever is later.

### Documentation of Fuel Purchases

A motor carrier must maintain proper receipts for all fuel placed into qualified motor vehicles. If fuel receipts cannot be produced, credit for the tax paid on such fuel purchases will be disallowed at audit. Records should include fuel data on each individual vehicle and be recapitulated in monthly fleet summaries, with separate totals for each fuel type. Fuel receipts should contain the date of purchase, the name and address of the seller, the number of gallons (or liters converted to gallons) purchased, the type of fuel purchased, the price per gallon (or liter), the unit number of the vehicle into which the fuel was placed, and the purchaser’s name. The Department will accept an invoice, a credit card receipt or verifiable microfilm/microfiche.

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In the case of bulk fuel facilities maintained by a carrier, detailed disbursement records should be maintained for each withdrawal, identifying the date, the number of gallons (or liters) withdrawn, the fuel type and the unit number of the vehicle into which the fuel was dispensed. Purchase records must also be maintained to verify that tax was paid on the fuel placed into the bulk fuel tank.

### Leasing Arrangements

Carriers entering into lease agreements should carefully review the Department's rules regarding reporting requirements for leased vehicles. All lease agreements should be in writing and should designate which party is responsible for reporting and paying the tax. It should be noted, however, that the obligation to report and pay fuel taxes pursuant to short-term leases of 29 days or less can be imposed on the lessee only in limited circumstances.

### Mileage Records

Mileage records should include distance data on each vehicle for each trip and be recapitulated in monthly fleet summaries. Acceptable source documents would include the date(s) of each trip, the origin and destination, the routes of travel,

beginning and ending odometer readings, total trip miles, distance by jurisdiction, and the vehicle unit number.

### "Extra" IFTA Decals

Motor Fuel Tax Bulletin 2008-01 issued by the Department provides that "[d]ecals that are purchased but unused during the registration year should be kept in the licensee's files for four years for auditing purposes." In the event of an IFTA audit, a company that disposes of unused IFTA decals will likely be assessed tax for each decal that is unaccounted for, with the tax computed by application of a 4.0 m.p.g. factor to the average miles traveled by the carrier's fleet during the relevant periods.

### Disposition of Decaled Vehicles

Carriers should also be sure to notify the Department's Bureau of Motor Fuel Taxes when a vehicle to which IFTA decals have been affixed is sold, traded or otherwise disposed of, or passes from the carrier's control through lease or otherwise. Motor Fuel Tax Bulletin 2008-01 provides that tax liability will remain with the licensee until the Bureau receives proper notification of disposition or loss of control of the licensed vehicle. ■

## PA NOTES

*By Timothy J. Horstmann*

**Sales & Use Tax - Building and Pole Signs:** The sale of a building or pole sign may qualify as a "construction contract," where the vendor installs the sign to become permanently affixed to the real estate. While no tax is required to be collected by the vendor, tax may still be due on any materials used by the vendor in the performance of the construction contract. Ruling No. SUT-03-043 (reissued April 21, 2010).

**Sales & Use Tax - Manufacturing of Electricity:** Purchases of natural gas, machinery, equipment, parts and supplies used directly and predominantly to produce electricity at a generating peaking power facility qualify for the manufacturing exclusion from PA Sales & Use tax. Ruling No. SUT-05-003 (reissued February 23, 2010).

**Sales & Use Tax - Installed MRI Equipment:** The Department of Revenue has reissued a ruling that installed magnetic resonance imaging (MRI) equipment remains tangible personal property, so that the vendor/lessor is required to collect sales tax on a lease to the ultimate consumer, and qualifies for the "resale" exclusion on the initial purchase of the equipment. [Note: This issue is currently being litigated by our

firm.] PA Ruling No. SUT-05-008 (reissued May 20, 2010).

**Amended Corporation Tax Return Regulations:** On June 19th, the Department of Revenue finalized its amended corporation tax return regulations. Among other things, the regs have been updated to recognize that Act 119 of 2006 replaced the archaic settlement process for corporation tax returns with a process of assessment akin to that used in other taxes. The amendments provide updated guidance on the filing of amended returns, and the procedure for the filing of a report of change following a change to a taxpayer's federal return.

**Realty Transfer Tax - Refund Applications:** An "application for refund" is an alternative method of seeking relief from Realty Transfer Tax, and is available to certain taxpayers in place of filing a formal petition with the Department's Board of Appeals. An application may only be filed where the tax was paid to a county Recorder of Deeds, and not as a result of an assessment. The application must be filed with the Department's Bureau of Individual Taxes within three years of the date of payment, and should be filed using its standard application form, available online. In the event that an application for refund cannot be processed due to lack of information, or is deemed unwarranted, the Department

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will transfer the application to the Board of Appeals for consideration. The Board will treat the application as a petition for refund filed as of the same date that the application was filed with the Bureau of Individual Taxes. Realty Transfer Tax Bulletin No. 2010-01 (June 4, 2010).

**Personal Income Tax - Withdrawal from Partnership:** Taxpayers claiming an abandonment of an interest in, or disassociation or withdrawal from, a partnership or a limited liability company that is taxed as a partnership may be required to submit supporting documentation of the abandonment to the Department of Revenue. Taxpayers who have received notices from the partnership or LLC that are inconsistent with their withdrawal are required to submit certain forms of documentation of their withdrawal, in the year in which the notice is received. Taxpayers who received notices prior to the issuance of the bulletin should immediately submit the required documentation. Taxpayers who have filed or will file petitions in connection with the withdrawal should instead enclose the documentation with their petition. Personal Income Tax Bulletin No. 2010-03 (June 14, 2010).

**Personal Income Tax - Military Spouses:** Under the Military Spouses Residence Relief Act, which was signed into federal law on November 11, 2009, military spouses may be entitled to relief from PA Personal Income Tax. Under the Act, qualifying spouses retain their non-Pennsylvania domicile, and consequently will not be liable for PA Personal Income Tax on certain types of income, where the spouse and the service member have the same out-of-state domicile, the spouse is in Pennsylvania solely to be with the service member, and the service member is in Pennsylvania complying with military orders. The Act applies retroactively to January 1, 2009. Personal Income Tax Bulletin No. 2010-01 (March 17, 2010).

**Personal Income Tax - Interest-Free Loan to Child:** Where an interest-free or below-market rate of interest loan is made by a parent to a child, the foregone interest from the loan will be treated as a gift to the child, and will be imputed as interest income to the parent. Ruling No. PIT-10-002 (June 7, 2010).

**Personal Income Tax - Partnership Investment Loss:** The Commonwealth Court, in an unreported opinion, has partially sustained a taxpayer's exceptions to an order of the court, at 985 A.2d 984, which affirmed an assessment of personal income tax and penalty in connection with the Department's disallowance of a partnership investment loss claimed by the taxpayer on his personal income tax return. The Court, however, did accept the taxpayer's claim for penalty abatement because he did not act negligently or with intentional disregard of the law, because he had relied on the advice of a national accounting firm and because he reported in a manner consistent with the reporting of income from the investment in prior years. *Hvizdak v. Commissioner*, 739 F.R. 2006 (June 8, 2010).

**Unclaimed Property - Bond Funds:** On April 28, 2010, the Pennsylvania Supreme Court determined that a local government is required to report only the principal, as opposed to principal and the interest earned thereon, of unclaimed bond funds to the Pennsylvania Treasury Department as unclaimed property upon expiration of the holding period. Any earnings that a local government unit earns on an unclaimed bond fund do not attach to the principal because the bondholders are entitled to receive only the principal amount of the bonds and have no ownership interest in the earnings of the fund. *Delaware County v. First Union Corporation*, 992 A.2d 112 (Pa. 2010).

Pennsylvania Revenue Department bulletins and letter rulings are available on the Department's website: [www.revenue.state.pa.us](http://www.revenue.state.pa.us). Regulations may be accessed at [www.pacode.com](http://www.pacode.com). Some court decisions are available at: [www.courts.state.pa.us](http://www.courts.state.pa.us). ■



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