



PA GOVERNOR'S BUDGET PROPOSAL PRESERVES CAPITAL STOCK/FRANCHISE TAX PHASE-OUT

by James L. Fritz

Pennsylvania Governor Tom Corbett has proposed a FY2014-15 state budget that includes no new taxes and no mainstream tax increases. This would preserve the phase-out of the Capital Stock and Franchise Taxes on the stretched-out schedule adopted last year:

Tax Year Beginning In	Tax Rate
2013	0.89 mills
2014	0.67 mills
2015	0.45 mills
2016	0.00 mills

While no tax increases are included in the proposal, the Governor did propose a shortening of the general Abandoned and Unclaimed Property (Escheat) holding period from 5 years to 3 years. This would produce a one-time revenue increase of \$150 million.

In addition, the Governor has proposed to allow additional leasing of state forest and park lands for the purpose of natural gas drilling. This drilling would occur by horizontal drilling from pads outside the state forests and parks. This leasing activity is estimated to produce an additional \$75 million in FY 2014-15.

The Commonwealth's total operating budget (including federal funds and miscellaneous funds) would be set at \$71.8 billion. The General Fund budget would increase by 3.3%, to \$29.4 billion. General Fund spending would break down as follows:

Spending Category	Amount /Percentage
Pre K-12 Education	\$10.3 B / 35.0%
Medical Assistance & Long-term Care	\$6.7 B / 22.8%
Other Human Services	\$4.7 B / 16.0%
Higher Education	\$1.6 B / 5.5%
Corrections / Probation & Parole	\$2.2 B / 7.5%
Debt Service	\$1.2 B / 4.1%
Other	\$2.7 B / 9.1%

The Governor's Office estimates total General Fund revenues for FY2014-15 at \$30.5 billion. The revenue sources break down as follows:

Revenue Source	Percentage of Total Revenues
Personal Income Tax	40.5%
Sales & Use Taxes	31.1%
Corp Net Inc / Cap Stock & Franchise Taxes	9.5%
Gross Receipts Tax	4.3%
Cigarette Tax	3.1%
Non-Tax Revenues	2.6%
Other Taxes	8.9%

One factor which could have a major impact on whether or not the Governor's proposals under go substantial changes in the legislative process is whether or not the General Assembly follows the Governor's lead on pension funding. According to the Governor's Office, without any changes, contributions to the state employee and school pension funds would increase by more than \$600 million in FY2014-15. The Governor proposes adjustment of the funding formula to generate savings of \$170 million for the Commonwealth and \$131 million for local school districts and other local education agencies. "Kicking the can down the road" may seem an appealing proposition in an election year, but it remains to be seen whether this proposal will be able to garner majority support in the Pennsylvania House and Senate. ■

Additional information on the Governor's budget proposal is available at: www.portal.state.pa.us/portal/server.pt/community/current_and_proposed_commonwealth_budgets/4566.

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SHOPPING GUIDES AND INSERTS

by Sharon R. Paxton

The Department of Revenue has ruled that the purchase, by the distributor, of certain shopping guides and advertising inserts for such guides are subject to Pennsylvania Sales and Use Tax. The shopping guides at issue are free to consumers and are delivered either through display racks or by carrier. The Department determined that the shopping guides do not qualify as “newspapers” or “magazines.” In addition, the guides do not qualify as “direct mail advertising materials” because they are not distributed through the United States Postal Service. **Sales and Use Tax Ruling No. SUT-13-002 (December 27, 2013).** ■



DOCUMENTATION REQUIREMENTS FOR SALES OF FUEL OIL, KEROSENE, NATURAL GAS AND PROPANE

by Sharon R. Paxton

For sales tax purposes, fuel vendors are required to obtain valid exemption certificates for all exempt nonresidential sales of fuels that are not subject to fuel taxes. Although the residential use of fuel is not subject to sales and use tax, the Department has issued an Information Notice advising vendors that exemption certificates (stating that the fuel is being purchased solely for the purchaser’s own residential use) should also be obtained to support exempt residential sales of such fuel, except for the following types of sales: (1) the product is delivered to a single residence and is billed to an individual at that residential location’s mailing address, (2) the sale of less than 11 gallons of kerosene, unless purchased through a commercial account or the vendor has reason to believe the purchase is not for residential use, and (3) the sale of propane gas in 20 pound tanks, unless purchased through a commercial account or the vendor has reason to believe the purchase is not for residential use. **Sales and Use Tax Information Notice 2014-01 (January 24, 2014).** ■

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PROPERTY TAX NOTES

by Randy L. Varner



- The *Commonwealth Court in Douglass Village Residents Group v. Berks County Board of Assessment Appeals*, No. 921 C.D. 2013 (1/27/2014), held that garages and decks in a mobile home park should be assessed to the landowner. The court noted that the Consolidated County Assessment Law authorizes the assessment of “all mobile homes and house trailers” and makes no reference to decks, garages or support structures. Therefore, in order for the support structures to be taxed as part of the mobile homes, they, too, would have to be mobile. Since they are not, the court held that they must be taxed to the landowner, regardless of who paid to have them installed.
- Act 114 of 2013, effective February 16, 2014, creates a statutory definition of “high tunnel” and exempts “high tunnels” from taxation.
- The Commonwealth Court in *In re: Appeal of Council Rock School District*, No. 354 C.D. 2013 (11/8/2013) (unreported opinion), held that the trial court improperly applied obsolescence and depreciation factors in determining a property’s fair market value. This case is noteworthy because the Commonwealth Court rarely picks apart a trial court’s findings of fact in an assessment case.
- The Pennsylvania Department of Revenue has released a revised common level ratio for Philadelphia County. Effective January 1, 2014, the common level ratio factor is 1.00. **Pennsylvania Bulletin, Vol. 44, No. 5, 2/1/2014.** ■

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PA ISSUES ON APPEAL - SALES AND USE TAX (PART 2)

by Sharon R. Paxton

In our last issue of PA Tax Law News, we published the first part of a list of Sales and Use Tax issues recently raised in tax appeals filed with the Commonwealth Court. This list is intended to help readers identify issues for which there may be an opportunity to obtain additional relief through a court appeal when they have not been successfully resolved at the administrative appeal levels. Many issues raised before the Commonwealth Court are ultimately resolved through negotiated settlement.

Part 1 of this article addressed, among other things, computer software and services, miscellaneous nontaxable services, construction contract issues, out-of-state transactions, the resale exclusion, wrapping supplies, direct mail advertising materials and various production exclusions. Additional issues under appeal are set forth below. You should keep in mind that, in addition to the merits of a particular legal position, the ultimate outcome of an individual appeal may depend on the specific facts involved and the adequacy of the supporting documentation submitted in support of the taxpayer's position.

Sales Tax Bad Debts

Vendors and utility companies that have remitted sales tax to the Department of Revenue may claim a refund of the tax when their customer receivables have been written off as uncollectible. Finance companies also may file such claims under certain circumstances when the bad debts relate to sales made by affiliates or pursuant to a private label credit card arrangement. Court appeals may involve documentation requirements for sales tax bad debt refund claims.

Medical Supplies and Therapeutic Medical Equipment

Issues on appeal include whether a supply is "disposable" and whether equipment is used for therapeutic versus diagnostic purposes.

Medical Scanning Systems as Nontaxable Manufacturing Equipment

The issue of whether medical scanning systems, such as MRIs and CT scanners, qualify for the manufacturing exclusion is currently on appeal to the Pennsylvania Supreme Court.

Keystone Opportunity Zones

Issues on appeal include whether certain items (e.g., laptop computers) satisfy the requirement that property be used "exclusively" in a KOZ to qualify for exemption.

Purchase of Fractional Aircraft Interests

At least one taxpayer has challenged the imposition of tax on fractional aircraft interests on the basis that the purchases occurred outside PA, the aircraft were hangared outside PA and the disputed "services" do not constitute a taxable "use" of tangible personal property. The Department imposed tax because flights regularly flew into and out of PA.

Bulk Sale Liabilities

There are appeal(s) pending in court contesting the applicability of the bulk sale statute to sales or transfers made by assignees for the benefit of creditors.

Responsible Party Assessments

Individuals can appeal responsible party assessments on the basis that they were not an "active and controlling" officer or agent of the business with the underlying tax liability. Such assessments become final and binding unless they are appealed.

Isolated Sales Transactions

With certain exceptions, items purchased in an isolated sales transaction are not subject to sales and use tax.

Taxation of Finance Amounts

Taxpayers have filed appeals contesting the imposition of tax on charges that are not part of the taxable purchase price of the property or services being financed.

Previous Determinations by BF&R or Department of Revenue

When the BF&R has ruled in favor of a taxpayer on a particular issue, the taxpayer may be able to rely on that determination to avoid an assessment (or denial of a refund) for a later period on a similar transaction under the Taxpayers' Bill of Rights. Equitable arguments are also raised by taxpayers in situations where the Taxpayers' Bill of Rights technically does not apply.

Royalty Fees

Taxpayer(s) have contested the taxability of royalty fees relating to the use of leased property, when the royalty fees were imposed under a separate contract, arguing that the fees were not part of the purchase price of the property.

Wearing Apparel

Taxpayers assert that tax was improperly assessed or paid on tax-exempt wearing apparel, footwear or clothing, such as work uniforms, "fancy" dresses and items that are not used only when engaged in sports.

Additional Issues for Audited Taxpayers

Penalty Abatement

Penalties are appealable on the basis that the taxpayer acted in good faith and without negligence or intent to defraud the Commonwealth. In most cases, at least some level of penalty relief can be obtained at some point in the appeals process.

Sampling Methodology

Taxpayers appeal issues relating to the Department of Revenue's

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PA ISSUES ON APPEAL - SALES AND USE TAX (PART 2) *(continued from page 3)*

sample selection, sample size, representativeness of a sample, the inclusion of statistical outliers in error rate calculations, de minimis error rates (less than .005), and the precision or reliability of sampled audit results.

Projection of Tax Overpayments

Taxpayers commonly seek to include tax overpayments within a test sample in the error rate calculations for an audit deficiency. The projection of such overpayments is often requested even if the overpayments relate to items which the Department of Revenue may view as taxable (when the taxpayer has a reasonable argument that the items are not subject to tax).

Computation of Interest

The Department often processes requests for credits for tax overpayments as separate refund petition(s). Taxpayers have filed appeals requesting that credits for tax overpayments be applied to reduce an audit assessment as of the date of each overpayment, which will reduce the interest due on the audit assessment.

Additional Issues for Vendors Audited for Sales Tax Compliance

Disallowed Exemption Certificates

Disallowed exemption certificates are often contested on the basis that the vendor accepted the certificates in good faith.

Alternative Proof for Untaxed Sales

When a vendor cannot locate exemption certificates for sales that were treated as exempt, the vendor may submit alternative documentation to support the exemption, either at the audit level or on appeal.

Customer Audited for Same Period

If a vendor made an exempt sale without obtaining an exemption certificate and cannot obtain alternative documentation, the vendor may pursue relief on the basis that its customer was also audited (to avoid the collection of tax by the Department twice on the same transaction).

Customer Remitted Use Tax

Similarly, a vendor may be able to obtain relief if it can provide evidence that the purchaser paid tax directly to the Commonwealth.

Failure to Pay Sales Tax on Uncollected Receivables

Taxpayer(s) have contested the assessment of sales tax on receivables that were not collected by the vendor. ■

Please contact a member of the McNees SALT Group if you would like to discuss any of the issues listed above or in Part 1 of this article.

Sales & Use Tax Seminar - Allentown / Bethlehem

On June 6th, Jim Fritz, Megan Luck and Sharon Paxton will present a full-day seminar on Pennsylvania Sales & Use Taxes for Lorman Education Services at the Hilton Garden Inn Allentown.

A complete agenda and a link to register at a discounted rate are available at:
http://www.lorman.com/392964?discount_code=A1724773&p=13389.

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