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# PA TAX LAW NEWS

## FUEL TAXES INCREASED TO SOLVE TRANSPORTATION FUNDING SHORTFALL *by James L. Fritz*

After years of effort by multiple administrations and after overcoming difficult political hurdles in the Pennsylvania House of Representatives, the Commonwealth has finally addressed its steadily worsening transportation funding problem. Seemingly dead after falling one vote short on November 18th, the House reversed itself on a bipartisan vote of 104-95 on November 19th, in support of increased funding. On November 21st the General Assembly sent HB 1060 to Governor Corbett and on November 25th he signed it into law as Act 89 of 2013.

Under HB 1060/Act 89, the 12 cents per gallon Liquid Fuels and Fuels Taxes will be eliminated and the revenue will be replaced by an increase in the Oil Company Franchise Tax ("OCFT"). Furthermore the current cap on the OCFT will be lifted over a five-year period. In all, PA taxes on gasoline are expected to rise by approximately 28 cents per gallon over that period.

In addition to fuel tax increases, HB 1060/Act 89 provides for numerous fine increases and for registration, license and other fee increases. After December 31, 2014, a county may impose an additional vehicle registration fee of $5 per vehicle, to be collected by the state and distributed to the county for local transportation purposes. An $8 per day fee on vehicle rentals at the Philadelphia International Airport will support construction of a facility to be used by customers of rental car companies.

The "average wholesale price," which serves as the base for the Oil Company Franchise Tax, will increase as follows:

2013 - $1.25 per gallon
2014 - $1.87 per gallon
2015 & 2016 - $2.49 per gallon
2017 & later - greater of $2.99 per gallon or the actual average wholesale price for the twelve month period ending on prior September 30th

The OCFT millage rate will be as follows:

| | Gasoline | Diesel |
|---|---|---|
| 2014 | 217.5 | 272.5 |
| 2015 | 202.5 | 257.5 |
| 2016 | 201.5 | 256.5 |
| 2017 | 194.5 | 249.5 |
| 2018 & After | 192.5 | 247.5 |

According to HB 1060/Act 89, approximately 9,000 of the 40,000 miles of Pennsylvania's state roads are in poor condition and 4,400 of the 25,000 state-owned bridges are structurally deficient. In addition, 2,189 bridges over twenty feet in length owned by counties and local governments are structurally deficient.

PennDOT indicates that by the fifth year of the phase-in, the following additional annual amounts will be generated:

- $1.3 billion for state roads and bridges
- $480-495 million for public transportation
- $237 million for local roads and bridges
- $144 million for multi-modal funding
- $30 million for dirt, gravel and low-volume roads
- $86 million for PA Turnpike expansion ■

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## ALSO IN THIS ISSUE

## PA SUPREME COURT UPHOLDS REJECTION OF TOWNSHIP BUSINESS PRIVILEGE TAX

*by Randy L. Varner*

On October 29, 2013, the Pennsylvania Supreme Court declined to hear an appeal from a February 2013 Commonwealth Court decision holding that a township business privilege tax applied only to transactions within the township. (See our June 2013 newsletter for an article on *Giles & Ransome, Inc. v. Whitehall Township*, 645 C.D. 2012 (Pa. Cmwlth., February 11, 2013).

Whitehall Township had issued a Business Privilege Tax ("BPT") assessment on Giles & Ransome, Inc. which included in the base the gross sales of three salespeople who occasionally used an office in the township, but were not assigned to any particular office and not managed by anyone in the township. Giles & Ransome is a heavy equipment dealer in the eastern part of Pennsylvania and parts of New Jersey and Delaware. The record showed that the salespeople spent nearly all of their time in the field visiting customers over a multi-county area and that all sales orders were approved or rejected outside the township. The township argued that these sales should be included in the BPT base, even though the township ordinance imposes tax only on "the actual or whole gross volume of business transacted by such taxpayer within the territorial limits of the Township." Whole or Gross Volume of Business is further defined by the ordinance as "the gross consideration credited or received for or on account of sales made, services performed, rentals of property, and/or other business transactions, within the territorial limits of the Township. . . ." Giles & Ransome argued that the plain words of the township ordinance only permit tax to be imposed on transactions occurring within the territorial limits of the township, and since the evidence in the record made clear that all sales were approved or rejected outside of the township at Giles & Ransome's corporate headquarters, the tax did not apply to sales made to customers located outside of the township.

The Commonwealth Court agreed with Giles & Ransome that the township could not tax the extra-territorial sales of the salesmen. Relying on a plain reading of the ordinance, the court noted that this was not a case that needed a "base of operations" analysis; but rather, the ordinance specifically restricted the imposition of tax to only those transactions within the territorial limits of the township. Since the record contained no evidence that the sales to outside customers in any way occurred within the township, the court concluded that the township's assessment was improper.

The take away from this case is that the language of the ordinance always should be examined closely. Often, taxing jurisdictions, especially those using contingent fee auditors, are unreasonably aggressive and issue assessments that go well beyond what their ordinances will support. They often base their positions on cases applying tax ordinances with much different language than their own. The *Giles & Ransome* case stands for the proposition that Pennsylvania appellate courts will not allow taxing jurisdictions to exceed what their own ordinances permit. ■

If you have questions about business privilege or mercantile taxes, please contact Randy L. Varner or another member of the McNees SALT Group. [Editor's Note: This case was argued by Randy Varner.]

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## UNCLAIMED PROPERTY - CHALLENGE TO DELAWARE'S AUDITING PROCEDURES

*by Sharon R. Paxton*

Many companies are particularly susceptible to significant unclaimed property exposure in Delaware because holders of property for which the owners' addresses are unknown generally must report and remit such property to their state of domicile (state of incorporation for corporate entities), which often is Delaware. Delaware has been using a contingent fee contract auditor, Kelmar Associates, LLC, to conduct unclaimed property audits on the state's behalf, and has developed a reputation for being very aggressive in its unclaimed property auditing procedures. Select Medical Corporation ("SMC"), a Pennsylvania-based operator of hospitals and rehabilitation centers that was incorporated in Delaware, filed an action in the U.S. District Court for the District of Delaware earlier this year, seeking to enjoin Delaware officials from enforcing their request for payment of about $300,000 demanded as alleged unclaimed property owed to the state for years covered by a voluntary disclosure agreement submitted by SMC. *See Select Medical Corp. v. Cook, et al.*, Case No. 1:13-CV-00694 (D. Del. Apr. 17, 2013).

Through voluntary disclosure, SMC had reported approximately $17,000 to Delaware and approximately $300,000 to other states for the years 1997-2001. Kelmar Associates then conducted an audit

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## PA SALES TAX RULING CLARIFIES COMPUTATION OF TAXABLE PURCHASE PRICE FOR TRACTOR TRAILERS *by Sharon R. Paxton*

The Pennsylvania Department of Revenue has ruled that the Federal excise tax imposed by Section 4051 of the Internal Revenue Code on certain commercial vehicles is not to be included in the taxable purchase price for sales tax purposes, if the excise tax is separately stated and identified on the invoice. Sales and Use Tax Ruling No. SUT-13-001.

Prior to the ruling, there was some confusion regarding the taxability of these Federal excise tax charges. The Department's regulations relating to sales of motor vehicles specifically provide that "Federal Excise Tax" is included in the amount of the purchase price "since it is not a tax at the retail level." 61 Pa. Code § 31.44(a)(1). The regulations which generally address the computation of the taxable purchase price of tangible personal property provide for inclusion in the taxable purchase price of "[c]harges, whether or not separately stated, representing reimbursement to the vendor for expenses paid by the vendor, such as manufacturer's excise tax…." 61 Pa. Code § 33.2(a)(6). The Department determined that these provisions reflect a difference in tax treatment between a Federal excise tax imposed at the manufacturer's level and a Federal excise tax imposed at the retail level. That is, the regulations imply that Federal excise taxes imposed at the manufacturer's level are included in the taxable purchase price, while Federal excise taxes imposed at the retail level are not included in the taxable purchase price. Since the Department determined that the excise tax imposed under Section 4051 is a tax imposed on the purchaser at the retail level, it determined that such taxes are not subject to sales tax as long as they are separately stated and identified on the invoice. If the Federal excise tax is not separately stated and identified, but is included in the total purchase price paid by the buyer, the amount of the Federal excise tax included in the single charge is subject to sales tax under the Department's ruling. ■

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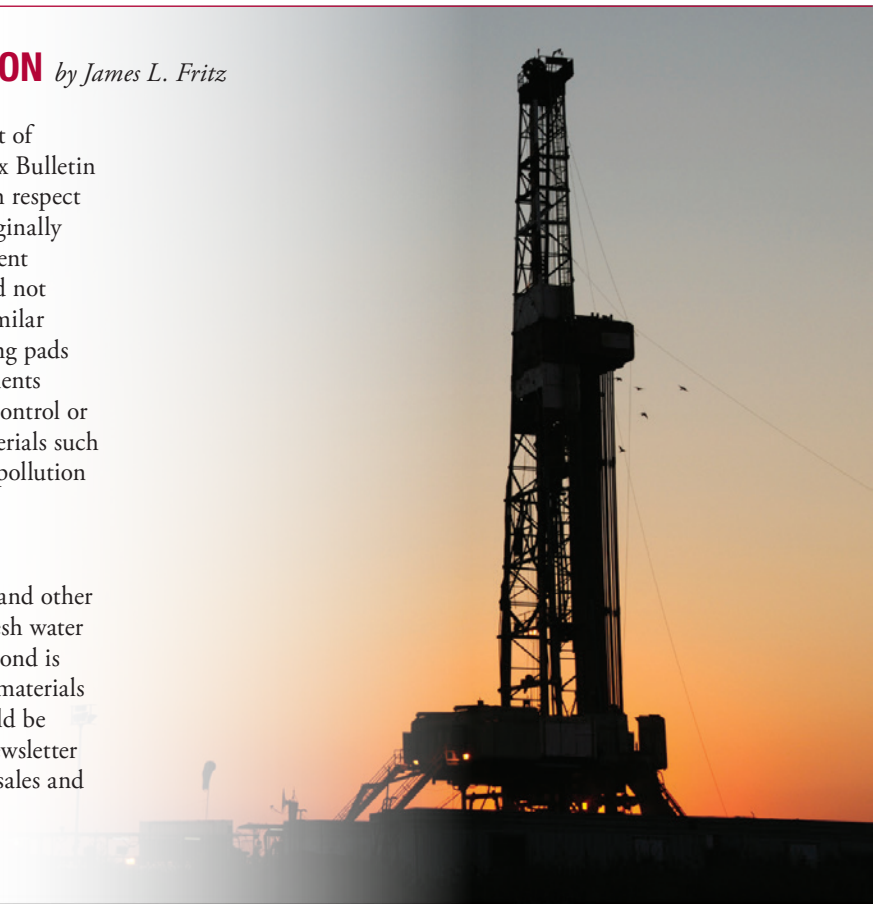
## SALES TAX - MINE SITE PREPARATION *by James L. Fritz*

On November 15th, the Pennsylvania Department of Revenue updated and reissued Sales and Use Tax Bulletin 2012-01, addressing sales and use tax issues with respect to drilling site preparation in the Marcellus Shale. As originally issued on April 16, 2012, the bulletin stated that equipment used to build drill rigging pads was taxable but tax would not apply to foundation materials, such as sand, stone and similar materials. As updated, the bulletin adds that where rigging pads are constructed in accord with certain statutory requirements applicable to containment for unconventional wells, "to control or abate pollutants generated in the mining operation," materials such as liners, sand and gravel would be excluded from tax as pollution control devices.

The bulletin continues to advise that equipment used in construction of ponds or other facilities, as well as liners and other materials used in such construction, are taxable where fresh water or other raw materials will be stored. However, where a pond is used to store pollutants generated in drilling operations, materials used in the construction of the pond, such as liners, would be exempt as pollution control devices. See our July 2012 newsletter for a review of other guidance concerning application of sales and use tax to drilling activities in the Marcellus Shale. ■



# ASSESSMENT OF ENVIRONMENTALLY CONTAMINATED REAL ESTATE *by Bert M. Goodman*

The Pennsylvania Commonwealth Court's recent decision in *Harley-Davidson Motor Company v. York County Board of Assessment Appeals* (Pa. Cmwlth. Ct. decided on October 30, 2013), demonstrates the importance of establishing a proper basis for the valuation of property which has suffered environmental contamination.

The taxpayer owned a property in York County, consisting of 229 acres of land and buildings containing approximately 1,400,000 square feet. The United States Government used the Property as the York Naval Ordinance Plant until 1964 when American Machinery and Foundry Company ("AMFC") purchased the property. The Navy had used the location to make bomb casings. AMFC subsequently merged with Harley-Davidson and in 1973 motorcycle production commenced on the property.

As a result of the prior owners' use, the property had significant environmental impacts consisting of soil and groundwater contamination as well as hazardous materials buried on the property. Pursuant to a 1995 Settlement Agreement between the taxpayer and the United States Government, environmental cleanup costs were allocated 47% to taxpayer and 53% to the United States.

Harley-Davidson appealed to the York County Board of Assessment Appeals in 2004 and subsequently appealed to the York County Court of Common Pleas where a trial on the issue of valuation was held. At the trial the taxpayer presented evidence on the environmental issues. The taxing authorities presented rebuttal witnesses on the issues. Both parties presented expert appraisal witnesses who testified to the impact of the contamination issues on the valuation of the property.

The taxpayer's appraiser testified as to the cost to cure the environmental problems on the property under the assumption that a potential buyer of the property would deduct that amount from any offer to purchase the property. The trial court disagreed with this approach and accepted the approach of the taxing authorities' expert who adopted a 5% "stigma" devaluation factor. The taxpayer appealed this issue to the Pennsylvania Commonwealth Court.

The Commonwealth Court reversed the decision of the trial court in regard to its determination of the credibility of the taxing authorities' expert - specifically the expert's stigma reduction in valuation due to environmental degradation of the property. Following the case of *Herzog v. McKean County*, 14 A.3d 193 (Pa. Cmwlth. 2011) the Commonwealth Court held that the trial judge improperly failed to enumerate his reasons for finding one expert credible over another. In this case the trial court did not specifically enumerate its reasons for accepting the 5% stigma devaluation factor rather than using a cost-to-cure methodology

In *B.P. Oil Co. Inc. v. Board of Assessment Appeals of Jefferson County,* 633 A.2d 1241 (Pa.Cmwlth. 1993) the Court held that environmental contamination is relevant to determining the fair market value of real estate. It is up to the fact finder to determine the correct methodology in calculating the reduction in value caused by the extent of the environmental problems. The trial court must find this number from the testimony of the experts and can make this determination in a vacuum of evidence.

In order for the trial court to accept an expert's testimony it must have some basis of credibility. In the case at bar the Pennsylvania Commonwealth Court stated the following:

> "Rather than apply a cost-to-cure method the trial court accepted Camins' (taxing authority expert) application of the 5% stigma devaluation which was based upon the presumption that due to the Settlement Agreement, a purchaser would have no liability for remediation. Although there is reference in the trial court's opinion to Camins' reliance on his expert testimony regarding remediation costs, there is nothing the trial court's opinion how Camins came to the 5% devaluation figure and why the Court adopted it. In fact, as demonstrated below, it is clear from Camins' testimony that there was simply no supportable basis for the 5% figure…."

The Commonwealth Court in its analysis of the lower court record found that there was no credible testimony as to the 5% stigma factor but it was rather "**in essence a guess**." Therefore the stigma figure did not constitute the substantial evidence needed to support the lower court's finding of value. The Court reversed and remanded the case back to the lower court to determine from the record the impact of the environmental conditions upon the property's fair market value.

This case stands for the proposition that an appraiser must clearly articulate his reasons for his valuation of environmentally impacted property rather than merely picking a number out of the air and calling it a stigma factor. Much more must go into that determination, such as the underlying environmental problems and a study of how the real estate market would treat such a condition when these type of properties are exposed for sale.

Environmental problems do impact property valuation. It is incumbent upon a party to present adequate expert testimony to support its position; the conjecture or guess of an expert is insufficient to meet this burden. ■

For assistance in pursuing property valuation appeals, please contact Bert Goodman or another member of the McNees SALT Group.

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## BOARD OF FINANCE AND REVENUE CHANGES AWAITED *by James L. Fritz*

As this issue went to press we awaited official announcement of the Governor's two nominees, and the State Treasurer's designee, to the Board of Finance and Revenue. The Board was reconstituted by Act 52 of 2013 (see article in July 2013 issue of this newsletter for extensive discussion). At this writing, it was unclear whether the Governor's nominees would be confirmed before year-end, and begin their work reconstituting the Board on January 1st, or if they will be confirmed after the first of the year. In any event, the new members will begin hearing cases on April 1st and the old Board will continue to hear cases through March.

In the meantime, an ad hoc committee of which I am a member, representing the Pennsylvania Chamber and PICPA, has been reviewing draft regulations prepared by the Treasury Department for new procedures at the Board. These draft regulations are still in a state of flux and, in any event, will be subject to review, revision and formal adoption by the newly-constituted Board, when it is assembled. At that point, proposed regulations also will have to undergo the formal regulatory review process, which usually takes several months. In the interim, the Board likely will operate under temporary or informally-adopted procedures. To some extent, Act 52, by itself, mandates certain procedures - providing for participation by the Department of Revenue as a party, prohibiting ex parte communications, allowing for examination and cross-examination of witnesses, providing for publication of decisions, etc.

In general terms, we are urging that procedures before the reconstituted Board not be made unnecessarily complicated so that the historical informality and easily navigated process can be retained to the extent possible, in combination with the newly independent decision-making authority and increased transparency enacted in Act 52. The Board handles thousands of cases, including both small and large dollar disputes, in which some taxpayers are self-represented. We, of course, will be prepared to aggressively and cost-effectively represent our clients no matter what procedures are adopted. However, we believe the process should remain accessible and not be made so expensive to navigate that some taxpayers may effectively be precluded from participation. ■

## PA ISSUES ON APPEAL - SALES AND USE TAX (PART 1) *by Sharon R. Paxton*

In our last issue of *PA Tax Law News*, we provided a list of arguments raised in Pennsylvania Corporate Net Income Tax, Capital Stock Tax and Franchise Tax appeals recently filed with the Commonwealth Court. The purpose of this was to apprise readers of issues that are commonly raised in appeals to court, to help them identify issues for which there may be an opportunity to obtain additional tax relief through a court appeal (or, in some cases, through a compromise agreement implemented at the administrative appeal level). As with corporate taxes, there are numerous Sales and Use Tax issues that are commonly not resolved until after an appeal has been filed with the Commonwealth Court. Many issues raised before the Commonwealth Court can be resolved through negotiated settlement. In addition, issues that proceed to formal argument before the court provide opportunities for the filing of protective refund petitions by taxpayers with similar issues.

The list below identifies issues that are pursued in appeals to court. Pennsylvania's Sales and Use Tax laws are very complex, and this is by no means an exhaustive list of every issue that could possibly arise in an appeal. Obviously, some arguments are stronger than others, and the ultimate outcome of a particular case may depend on the specific facts involved and the adequacy of the supporting documentation submitted in support of the taxpayer's position.

1. Computer Services: Many cases contest the taxability of various "computer-related services." Services under appeal include separately-stated software support service fees, software support services included in software maintenance fees, computer consulting services, computer programming services, computer integrated systems design services, data processing services, information retrieval services, implementation and training services, web hosting services, remote help desk services, web design services, laptop encryption services, and others.

2. Computer Software: Arguments on appeal include the improper imposition of tax on "custom" software, software used in tax-exempt production operations, software hosted on servers located outside of PA and accessed remotely by PA users, and software loaded on a server in PA but accessed remotely by out-of-state users.

3. Taxation of Employee Cost Component of Help Supply Services and Interior Office Building Cleaning Services: Many taxpayers seek relief for tax imposed on the "employee cost" component of these services, in situations where relief is not granted at the administrative boards because such costs are not separately stated on the vendor's invoice and the vendor is not willing to disclose the "employee cost" and "service fee" percentages.

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## PA ISSUES ON APPEAL - SALES AND USE TAX *(continued from page 5)*

4. Other Services Not Specifically Enumerated as Taxable Services: Taxpayers regularly contest the taxability of a myriad of services on the basis that such services are not among those services that are specifically enumerated as taxable by the tax statute. The following list includes examples of services under appeal, but is by no means a comprehensive list of services which are arguably not subject to tax:

   - Advertising Services (market research services, design services, media advertising, etc.)
   - Landscaping Services (other than taxable lawn care services)
   - Snow Removal Services
   - Engineering and Other "Professional" Services
   - Waste Disposal Services (including charges for portable toilets)
   - Moving/Delivery/Hauling Services (not provided by a vendor in conjunction with the sale of taxable property)
   - Human-health Related Services
   - Security Monitoring and Security Services
   - Video Production Services
   - Digital Photography Services
   - Medical Transcription Services
   - Inspection and Testing Services
   - Public Relations Services
   - Storage and Warehousing Services (other than self-storage services)
   - Disaster Recovery Services
   - Installation Services (for property not purchased from installer)
   - Enhanced Telecommunications Services (voicemail services, email services, electronic publishing services, etc.)

5. Purchase of Nontaxable Construction Services: Many appeals assert that tax was improperly assessed or paid on property installed by a vendor on the basis that the property was installed pursuant to a construction contract because the property became a permanent part of the real estate upon installation (and is therefore taxable to the installer and not the purchaser). This argument can apply to numerous items installed by a vendor. Examples of transactions appealed by taxpayers to court as nontaxable "construction services" include, among other things, the installation of cabling for computer and communication systems, HVAC equipment, alarm systems, cabinets, lighting fixtures and equipment, refrigerated display cases and other types of installed equipment.

6. Repairs to Real Estate: Tax was improperly assessed or paid on nontaxable repairs to real estate. This issue could also be raised in conjunction with building maintenance contracts that include both taxable maintenance services and nontaxable repair services or other nontaxable services.

7. "Building Machinery and Equipment" Used in Contract Performed for Tax-Exempt Entity: The scope of items which qualify as tax-exempt "building machinery and equipment" ("BME") when used to perform a construction contract for a tax-exempt entity is often a subject of appeal. A determination as to whether a specific item constitutes "BME" under the sales tax statute is not always a "black and white" issue. One issue currently under appeal is whether nuts, bolts and washers qualify as "BME" because they are an indispensable part of exempt components or whether they constitute "fittings," which are specifically excluded from the definition of "BME."

8. Property Installed In Projects Where Owner is Entitled to Claim Production Exclusion: Contractors who provide foundations for exempt production equipment or who construct public utility facilities or other property (e.g., solar systems for the production of electricity) that qualifies for a production exclusion may be entitled to purchase materials on a tax-free basis by claiming the exclusion to which the purchaser is entitled. Exemptions are also claimed by taxpayers for materials used in the construction of property (e.g., sanitary sewer systems and water lines) for a non-exempt purchaser where the sewer system, etc. is ultimately transferred to a public utility.

9. Financial Institution Security Equipment: Numerous financial institutions regularly file appeals for tax assessed or paid on computer hardware and software, imaging systems and many other items on the basis that such items constitute tax-exempt "financial institution security equipment" because the items are used by the financial institution "for its protection or convenience in conducting financial transactions."

10. Outdoor Advertising Signs: It is commonly asserted that the Department of Revenue's regulation stating that "the erection of outdoor advertising boards or signs 'by permanent or semipermanent construction' is a construction activity" applies to various types of building signage.

11. Real Property Improvements Included in Capital Lease: Taxpayers have contested the imposition of tax on lease payments including charges for the lease of items which may qualify as part of the "real estate" for sales tax purposes.

12. Out-of-State Transactions: Many cases assert that tax was improperly imposed or paid on property that was delivered to a location outside PA or on services obtained outside PA or for which the "benefit" of the services was outside PA. In addition to property shipped to locations outside PA, examples include computer software "used" outside PA, remote access to computer hardware outside PA, placement services for an employee who will be working outside PA and printing services performed outside PA in certain circumstances.

13. Resale: Many cases assert that tax was improperly assessed or paid on property purchased for the purpose of resale. The resale exclusion includes more than straight sales of property or services (e.g., raw materials incorporated into products). One current issue which may be argued to the court is whether a subcontractor can claim the resale exclusion to obtain a refund of tax paid on property transferred to a prime contractor on the basis that the property retained its character as tangible personal property when installed by the subcontractor.

14. Special Resale: Companies that take delivery of materials or equipment in PA, and do something to those items before sending them to an out-of-state location may qualify for the "Special Resale" exclusion. The items do not have to be resold to a third party. Examples include delivery of computers in PA for the addition of memory or software before being sent to company locations outside PA and materials used to fabricate building components to be installed in buildings outside PA.

15. Manufacturing, Processing, Farming, Public Utility, Mining and R&D Exclusions: Numerous cases claim tax exclusion for machinery, equipment and supplies used to produce a tangible product or used in other activities that qualify for a production exclusion. Sometimes there is an issue as to whether a particular activity qualifies for a production exclusion (which is not always obvious). Even when a company's operations obviously qualify for a production exclusion, many appeals involve issues as to whether specific items are eligible for the exclusion – e.g., whether the taxpayer has proven that various items are used "directly" and "predominantly" in production operations. Commonly contested items include packaging equipment, process control hardware and software, forklifts and other material handling equipment, electricity and natural gas used in production operations, pollution control equipment, and safety equipment and supplies. Also, disputes often arise as to when a particular production process begins and ends.

16. Contractors Performing Services for Production Companies: A contractor performing services for a business engaged in manufacturing, processing, public utility, farming or mining operations may be able to claim the applicable production exclusion for equipment used to perform services for the production company when the production exclusion would apply if the services were performed directly by the production company.

17. In-House Printing/Photography/Imaging Operations: Appeals seek relief for tax assessed or paid on equipment used in "in-house printing" operations, when the taxpayer has a central copying area that handles high-volume copy jobs.

18. In-House Production of Electricity: Similarly, taxpayers can claim the manufacturing exclusion for equipment used to produce electricity for their own use (whether or not they are otherwise engaged in tax-excluded production activities).

19. Pallets and Other Wrapping Supplies: This exemption applies to supplies used to deliver personal property, such as pallets, nonreturnable containers, wire, mailing labels, etc. Pending court appeals include claims that hangers, paper covers and plastic wraps for clothing and modular housing frames or "undercarriages" qualify as wrapping supplies. Another issue on appeal is whether a company that is not in the business of selling personal property (e.g., a warehouse operator or a taxpayer using the supplies to deliver property for its own use) can claim the exemption.

20. Direct Mail Advertising Literature or Materials: Many cases claim this exemption for items that are sent through the United States Postal Service and are intended to create goodwill. Examples of items for which taxpayers claim an exemption include annual reports, calendars, pens, newsletters, brochures and other promotional materials, and event invitations, including envelopes and mailing list charges.

21. Subscriptions: Taxpayers often claim an exemption for subscriptions for materials that are published at regular intervals not exceeding three months and circulated among the "general public." The exemption also applies to printed advertising material circulated with a periodical regardless of where or by whom the advertising material was produced. Exemptions are claimed for publications that are not delivered in "paper" form, such as those delivered on a CD.

Please contact a member of the McNees SALT Group if you would like to discuss any of these issues. ■

*Due to space limitation, additional Sales and Use Tax issues will be discussed (as Part 2 of this article) in the next issue of PA Tax Law News.*

## UNCLAIMED PROPERTY - CHALLENGE TO DELAWARE'S AUDITING PROCEDURES *(continued from page 2)*

of SMC for the years 2002-2008 and found no under-reporting of unclaimed property based on a review of the company's principal disbursement account for that period. The Complaint filed by SMC alleges, however, that the auditor found a liability of almost $300,000 for the period 1997-2001 "based solely on an **estimate** calculated by extrapolating, inter alia, [SMC's] unclaimed property owed to **all** other states for the period 2002-2008." (Paragraph 52 of SMC's Complaint). SMC has asserted that an assessment based on estimation was inappropriate because it has actual records for the years for which the assessment was issued (and the auditor had declined to examine those records). Although the state eventually agreed to examine SMC's records for the period 1997-2001, the State Escheator did not withdraw his Demand for Payment. SMC then filed suit in the U.S. District Court for the District of Delaware challenging the state's Demand for Payment.

SMC has raised a number of other legal challenges in its complaint. Among other things, SMC has challenged the retroactive application of Delaware's extrapolation statute. Statutory authority for the state to use estimation procedures to determine unclaimed property liabilities was not enacted until 2010.

In addition, SMC contends that Delaware violated Federal common law by demanding that SMC report to Delaware property that was exempted by states with a priority claim to the property under Federal priority rules. SMC asserts that, by requiring the reporting of property exempted by other states pursuant to a business-to-business exemption provision, the Delaware officials have violated the U.S. Constitution by not giving full faith and credit to the other states' laws.

In response to SMC's request for injunctive relief, the Delaware officials have argued that no legitimate Federal question was raised in SMC's Complaint, and therefore the Federal court lacks jurisdiction over the case. The officials have also contended that SMC failed to exhaust the administrative and judicial remedies provided in the Delaware Escheat Law.

Assuming the case is not resolved by settlement, the court's decision in this case could impact unclaimed property audit procedures in other states, including Pennsylvania. Please contact a member of the McNees SALT group if you need assistance with unclaimed property reporting or with an unclaimed property audit. ■

## UPCOMING SEMINARS

### Sales Tax

Lancaster - January 22, 2014
Allentown/Bethlehem - June 6, 2014

Jim Fritz and Sharon Paxton will once again be presenting a full-day seminar on "Sales and Use Tax in Pennsylvania" in Lancaster on January 22nd. The program will be sponsored by Lorman Education Services.

For a 50% discount on registration, use the following link:
http://www.lorman.com/seminars/392067?discount_code=Y8956564&p=13389

Jim and Sharon will be joined by Megan Luck in presenting the same topic in the Allentown/Bethlehem area - tentatively on June 6th - stay tuned to the McNees and Lorman websites for additional details.