



RECENT PA SALES TAX GUIDANCE CONCERNING NATURAL GAS AND OTHER MINING ACTIVITIES

by Megan F. Luck

With all of the natural gas mining activity in Pennsylvania, the Department of Revenue has issued various guidance on what machinery, equipment and supplies falls within the "mining" exemption under Pennsylvania's sales and use tax. Over the last few years, the Department has issued Sales and Use Tax Bulletin 2012-01 concerning mining site preparation activities and published other information concerning natural gas mining in a question and answer format on its website. We previously summarized this guidance in our July 2012 newsletter, available at www.mwn.com/pubs/xprPubSearch.aspx?xpST=PubSearch. Most recently, the Department issued Sales and Use Tax Information Notice 2014-02 (9/22/2014), which is available on the Department's website at www.revenue.state.pa.us. In addition to compiling some of the guidance previously issued, Notice 2014-02 addresses various additional natural gas mining topics. Following are a few of the new examples the Department has given as either taxable activities or exempt mining activities.

Exploration activities qualifying as mining

Mining, as defined in the Department's regulation, includes certain exploration activities. The Department sets forth the following examples of exempt exploration property and services: seismic exploration services; exploratory well drilling services; seismic imaging services; and seismic data.

Exempt Mining Equipment

The Department also has identified numerous examples of exempt mining machinery, equipment and supplies. In addition to standard mining machinery and equipment, the Department identifies certain remote control and accompanying monitoring equipment, and certain lighting equipment and supplies used to light production activities, as exempt.

Materials used in the construction of storage ponds are exempt from sales and use when used in the construction of "holding ponds, tanks and other containment vessels for fluids that are pumped from the well hole and reused in fracturing multiple wells."

The Notice points out that, under the Department's mining regulation, "property used to remove trees and clear ground preparatory to extraction activities" is taxable; however, machinery and equipment "such as bulldozers, graders, fill, seedlings, grass seed, shrubs, stone, concrete and soil nutrients used in backfilling and reclamation of directly used mining facilities" is exempt when such backfilling and reclamation is required by law.

Mine Management and Administration

The new information notice also identifies certain taxable mine management and administration activities, including "[c]ommunication devices used for managerial direction and supervision." On the other hand, "[c]ommunication devices such as handheld radios used predominantly in mining activities such as work coordination among production employees of equal authority," are exempt from tax.

Please contact the author of this article or another member of the McNees SALT Group if you have questions regarding what machinery, equipment and supplies fall within the "mining" exemption under Pennsylvania's sales and use tax.

Megan F. Luck practices in the State and Local Tax and Business Counseling groups.
mluck@mwn.com / 717.237.5416



IN THIS ISSUE

Focus on Pennsylvania Corporate Taxes.....	page 2
Fritz and Varner Named to Selected Lawyer Lists.....	page 3

Application and Sale of Restricted Tax Credits	page 4
Machinery and Equipment Exclusion from Real Property Taxation	page 4

FOCUS ON PENNSYLVANIA CORPORATE TAXES *by James L. Fritz*

With the November 4th election of Democrat Tom Wolf as Pennsylvania's next Governor, Pennsylvania corporate taxpayers face an interesting budget season in 2015. During the campaign, Wolf advocated for a severance or extraction tax on Marcellus Shale natural gas mining activities. He also asserted that further action should be taken to "close the Delaware loophole," beyond the addback provisions scheduled to take effect in 2015 under Act 52 of 2013 - presumably combined reporting.

While one might anticipate a stalemate between the new Democrat governor and enlarged Republican majorities in the PA House and Senate, we are mindful that both parties will have to deal with serious public policy challenges potentially requiring additional revenues. A \$50 billion pension fund deficit has contributed to multiple debt rating downgrades and the General Assembly and Governor sooner or later are going to have to stop "kicking the can down the road." And, both Governor-elect Wolf and many legislators on both sides of the aisle seem committed to eliminating or reducing local school property taxes - requiring replacement revenues from other tax sources. Add these factors to the Independent Fiscal Office's recent report that the Commonwealth faces a nearly \$2 billion shortfall for FY 2015-16, and one would anticipate a very active budget season upcoming.

Turning from the political front to tax compliance and appeals, taxpayers experience continuing issues with the Department of Revenue's new computer system (numerous confusing computer-generated notices), await guidance from the Department on the application of new sales factor sourcing rules effective for the current year under Act 52 of 2013 and continue to deal with the usual spread of legal issues in corporate tax appeals.

All we can say about the **Department's computer system** is that we have little optimism for a quick fix and are thankful for the helpfulness of certain staff at the Department who will spend time on the phone resolving these issues.

On the **sales factor sourcing** front, we note that a confidential draft notice was circulated to practitioner organizations for comment some time ago and we are hopeful that the Department will (make a number of revisions and) issue final guidance soon.

On the appeals front, we note that the Pennsylvania Supreme Court will hear oral argument in the spring on Verizon's **Gross Receipts Tax** appeal. Argument will be limited to whether receipts from nonrecurring charges (installation, repairs, etc.) should be excluded, as was held below by the Commonwealth Court. No argument will be heard on the issues of receipts from

private lines and directory assistance, which were held taxable below.

Otherwise, we are seeing the usual issues. See our September 2013 newsletter for an extensive listing of such issues. Here are some issues from corporate tax decisions recently published by the Board of Finance and Revenue (many of which are now before the Commonwealth Court):

Corporate Net Income Tax

- **Nonbusiness Income.** Whether patent royalties constitute nonbusiness income even though derived from transactions in which the company regularly engages?
- **Unrelated Assets/Multiformity.** Whether income from patent royalties and other intangible sources should be excluded as income from Unrelated Assets or as income from a Multiform division operating separately from the company's Pennsylvania activities?
- **Equitable Apportionment.** Whether a taxpayer is entitled to Equitable Apportionment in order to reflect the proper attribution of income (including royalties and other intangibles income) to Pennsylvania?
- **Withholding Credit.** Whether a corporate partner's receipt of Schedule NRK-1 showing withholding credit should be sufficient for the partner to receive credit where the Revenue Department is not able to locate documentation definitively transferring credit to the partner?
- **Sales Factor - Futures Contracts.** Whether receipts from sales of futures contracts should be included in the sales factor denominator?
- **Nexus.** Whether a corporation has nexus with Pennsylvania as a result of an ownership interest in a Delaware statutory trust owning an undivided interest in a Pennsylvania power plant?
- **Costs of Performance.** Whether sale of a statutory trust ownership interest is subject to income-producing activity/costs of performance analysis as a sale of intangibles?





Franchise Tax

- **Unconstitutional Distortion-Factor Representation.** Whether a taxpayer is entitled to factor representation where dividends from subsidiaries are included in book income and the value of subsidiaries is included in net worth, but the property, payroll and sales of the subsidiaries are not reflected in the apportionment factors?
- **Equitable Apportionment.** Whether special apportionment is required to fairly reflect value attributable to Pennsylvania where dividends from subsidiaries are included in book income and the value of subsidiaries is included in net worth but the property, payroll and sales of the subsidiaries are not reflected in the apportionment factors?
- **Multiformity/Unrelated Assets.** Whether a taxpayer is entitled to exclude value attributable to investments in subsidiaries and various intangible assets where the investment assets are managed by a multiform division or are otherwise unrelated to the company's Pennsylvania business activities?
- **Manufacturing, Processing, R&D.** Whether production of specialized inks, dyes, coatings and chemicals for use in dye sublimation printing ribbons and bar code ribbons is manufacturing? (granted by BF&R) Whether finishing of plastics constitutes exempt "processing"? (granted by BF&R) Whether lab activities developing such products constitutes exempt R&D? (granted by BF&R)

Gross Receipts Tax (Telecom)

Whether the following types of revenues are from the transmission of messages and thereby taxable:

- Directory Advertising (Granted by BOA Dkt. No. 1310191)
- Universal Service Fund
- Wire Maintenance
- Customer Premise Equipment
- Caller ID
- Local Number Portability
- Call waiting
- Voicemail
- Suspension/Restoral
- Bad Check Fees
- Finance Charges
- Service Order Fees
- Installation
- Direct Inward Dialing
- Paper Bill Fees
- Carrier Line Charges
- Cost Recovery Fees

- Remote Call-forwarding
- Toll Free Numbers
- PICC
- FEC Subscriber Line Charges
- Bad Debts

Procedure

- Whether the existence of a debit account balance bars filing of a refund claim to the extent of tax actually paid? (jurisdiction granted by BF&R.) ■



James L. Fritz is Chair of the State and Local Tax group.
jfritz@mwn.com / 717.237.5365

FRITZ & VARNER NAMED TO SELECTED LAWYER LISTS

Jim Fritz again has been selected for inclusion in the 21st Edition of *The Best Lawyers in America*, in the practice area of "Litigation and Controversy - Tax." Best Lawyers is the oldest and most respected peer-review publication in the legal profession. Since its inception in 1983, Best Lawyers has become regarded as the definitive guide to legal excellence.

Jim Fritz and Randy Varner have been selected for inclusion in the 2014 Select Lawyers of Harrisburg listing. Jim's listed practice area is "Taxation Law" and Randy's is "Real Estate Tax Assessment Appeals Law." Select Lawyers is a list of outstanding professionals who have attained a high degree of peer recognition for their achievements. The lawyers are nominated by their peers in an extensive survey process.



APPLICATION AND SALE OF RESTRICTED TAX CREDITS

by Sharon R. Paxton

The Pennsylvania Department of Revenue has issued detailed rules for the application and sale of various Pennsylvania tax credits. Corporation Tax Bulletin 2014-04 replaces Corporation Tax Bulletin 2011-03. The Bulletin covers the Research and Development Tax Credit, the Film Production Tax Credit, the Neighborhood Assistance Program Tax Credit, the Resource Enhancement and Protection Tax Credit, the Keystone Innovation Zone Tax Credit, the Keystone Special Development Zone Tax Credit, and the Historic Preservation Incentive Tax Credit.

Bulletin 2014-04 lists application deadlines for the various credits, as well as the taxes to which the credits may be applied, the carry forward period, the purchaser's liability offset limit (percentage of the purchaser's tax that may be offset by a purchased tax credit) and the waiting period, if any, before a tax credit may be sold. All of the tax credit programs require that an approved credit be applied first against the tax liability for the period in which the credit is approved. The unpaid tax liability for that period must be satisfied before any portion of a credit can be carried forward to future years, sold or passed through to the shareholders, members or partners of a Pennsylvania S corporation, limited liability company or partnership.

The Department will apply restricted credits before any cash payments. Taxpayers who are required to make quarterly estimated payments may use restricted tax credits to satisfy a quarterly liability.

Companies that qualify for any of the specified tax credits, or are considering purchasing tax credits from another taxpayer, should refer to the Department's Bulletin for more detailed information. ■

Sharon R. Paxton practices in the State and Local Tax group.
spaxton@mwn.com / 717.237.5393



MACHINERY AND EQUIPMENT EXCLUSION FROM REAL PROPERTY TAXATION

by Bert M. Goodman

One of the more interesting issues under Pennsylvania real property tax law is what constitutes an "industrial establishment," entitled to exclusion from taxation as real property under 72 P.S. Section 5453.201(a), of the Fourth to Eighth Class County Assessment Law. This Section reads as follows:

Machinery, tools, appliances and other equipment contained in any mine, mill, manufactory or industrial establishment shall not be considered or included as a part of the real estate in determining the value of such mine, mill, manufactory or industrial establishment.

In 2011, the General Assembly of the Commonwealth of Pennsylvania merged the Fourth to Eighth Class County Assessment Law and the Second Class A and Third Class County Assessment Law into the Consolidated County Assessment Law, 53 Pa.C.S.A. Section 8801 et seq. The above-cited statute was reenacted in substantially the same form at 53 Pa.C.S.A. Section 8811 (b)(1).

BFC Hardwoods Inc. v Board of Assessment Appeals of Crawford County, 771 A.2d 759 (Pa. 2001), was the first Pennsylvania Supreme Court decision to discuss this statute in detail. Other cases had dealt with equipment located in mills and factories but none had explored the meaning of equipment located in an "industrial establishment" since the passage of the Act.

The facts of this case are complex because of the industrial process involved. BFC Hardwoods, Inc. was in the business of drying lumber in five specialized kilns known as "dry kilns." The Crawford County Board of Assessment Appeals assessed the kilns as taxable and refused to apply the above exclusion.

The kilns were used continuously and exclusively to remove moisture from pre-cut lumber to a greater degree than could be done by conventional open-air drying. This process made the wood suitable for commercial sale and use in a broad range of applications.

The facility included large insulated physical structures into which lumber was stacked for substantial time periods. High capacity heating systems were used to heat the lumber and draw moisture from the wood. Exhaust ventilation systems were designed to control airflow and eliminate saturated air from the enclosed structures. The dry kilns possessed additional specialized features including computer controls, monitoring equipment, interior skins of aluminum alloy, concrete flooring to support the heavy load, loading doors designed as movable walls and equipped to be hermetically sealed, system of fans integrated into false ceilings and bulkheads and baffles used to direct airflows. The ovens were assembled on



the property from pre-manufactured, pre-drilled components which could be disassembled for purposes of relocation.

The dry kilns lacked conventional services such as running water, sewage or heating. The taxpayer's expert testified that these kilns had no other use and were not suited to applications other than drying lumber. The BFC facility consisted of these ovens, storage buildings, an office and undeveloped real estate.

On appeal to the Crawford County Court of Common Pleas, the decision of the assessment board was affirmed. The lower court held that the dry kilns were not excluded from taxation because they were not contained in any "mill, manufactory or industrial establishment" and that the business of kiln drying did not meet the definition of "manufacturing" or "processing" in the Capital Stock Tax Act, 72 P.S. Section 7601-7606. The Pennsylvania Commonwealth Court affirmed the lower court in a memorandum opinion and allowance of appeal to the Pennsylvania Supreme Court was granted.

BFC argued the dry kilns qualified for exclusion because they were machinery contained in an "industrial establishment" and they were directly employed to accomplish a form of industrial processing.

The Pennsylvania Supreme Court stated that in order to qualify for this exclusion from taxation the following two requirements must be met: (1) the property at issue must constitute machinery, tools, appliances, or other equipment; and (2) the property must be contained in a "mine, mill, manufactory or industrial establishment."

In meeting these tests BFC contended that its facilities were an "industrial establishment." The Court agreed and stated:

Beginning with the latter of these criteria, while BFC does not purport that its facilities should be deemed to be a mine or mill and does not press the assertion that they constitute a "manufactory" its essential position is that the facilities do constitute an "industrial establishment." In defining this term, this Court has applied an approach emphasizing general usage and understanding. See, e.g. *North Side Laundry Co. v. Board of Property Assessment Appeals and Review*, 366 Pa. 636, 79 A.2d 419 (1951) (stating that the law can do no better than define an industrial plant as that establishment which the ordinary man thinks of as such). Under this approach, the Court has determined, for example, that a commercial laundry is an industrial establishment, see *id.*; *United Laundries, Inc. v. Board of Property Assessment Appeals and Review*, 359 Pa. 195, 58 A.2d 833 (1948), and the intermediate appellate courts have concluded that newspaper plants and TV stations also would qualify. See, e.g. *Messenger Publishing Co. v. Board of Property Assessment, Appeals and Review*, 183 Pa. Super 407, 132 A.2d

768 (1957) (endorsing the view of the common pleas court to the effect that it would seem that the ordinary man would think of a newspaper as an industrial plant, especially if one were to tell him that a laundry or carpet cleaning company are such for purpose here being considered.); *City of Pittsburgh v. WIIC-TV*, 321 A.2d 387 (Pa.Cmwth. 1974) (stating that the same ordinary man would think of a TV station as an industrial establishment, especially if one were to tell him that a newspaper plant is such for the purpose being considered).

The Pennsylvania Supreme Court specifically found that BFC employed large-scale specialized implements to cause a substantial change in quantities of lumber by removing moisture more efficaciously than would be possible naturally and that its operation constituted an "industrial establishment," meeting one of the requirements of Section 201(a). The Court then found that the modern concept of machinery is effectively the apparatus essential to actual industrial operations and that a broad construction was consistent with the legislative policy of fostering business development in the Commonwealth. The Court found that the taxpayer met the second prong of the exclusion test and held that the BFC dry kilns constituted machinery and therefore the ovens were excluded from taxation.

It should be pointed out that the Court summarily disposed of the argument that the restrictive definition of manufacturing in the Capital Stock Tax Act was controlling. The Pennsylvania Supreme Court stated in this regard:

We agree with BFC that the decision is distinguishable as defining a set of exclusions for purposes of capital stock taxation crafted more narrowly than the exclusion prevailing under the Law for purposes of local real estate taxation.

In order to qualify for this exclusion from taxation a taxpayer is required to meet a two prong test promulgated by the Pennsylvania Supreme Court i.e. the property at issue must constitute machinery, tools, appliances, or other equipment, and the property must be contained in a mine, mill, manufactory or industrial establishment. Pennsylvania originally enacted this provision to help the Commonwealth attract new industrial business establishments and retain existing ones.

If you have questions about what may or may not be taken into account in valuing real estate for local Pennsylvania tax purposes, please contact the author or another member of the McNeese SALT Group. ■

Bert M. Goodman is Chair of the State and Local Tax group.
bgoodman@mwn.com / 610.240.0345





Solving State & Local Tax Problems

Please consider the McNees State and Local Tax Group whenever you require assistance with Pennsylvania and other state and local tax problems. Members of our SALT Group routinely advise companies of all sizes, individuals and nonprofit entities on state and local tax issues. We have handled more than 1,000 appeals involving Pennsylvania sales and use tax, corporate net income taxes, capital stock and franchise taxes, insurance taxes, fuels taxes, personal income and other state taxes. Members of our Group also have authored the leading treatise on Pennsylvania local real estate tax law and represented clients in local tax matters in 66 of the Commonwealth's 67 counties. Our services include:

- Dealing with State & Local Tax Auditors
- Assessment and Refund Appeals to the PA Department of Revenue Board of Appeals
- Appeals to the PA Board of Finance and Revenue
- Appeals to PA County and Appellate Courts
- Abandoned and Unclaimed Property (Escheat) Advice and Appeals
- Real Estate Valuation and Exemption Appeals before County Boards of Assessment and in PA Courts
- Obtaining Letter Rulings
- Negotiating Compromises – both in the appeals context and in the collections process
- Advice Concerning Legislative Approaches to Solving State & Local Tax Issues

Contact any of the following members of our SALT Group for assistance:



James L. Fritz
717-237-5365 • jfritz@mwn.com



Bert M. Goodman
610-240-0345 • bgoodman@mwn.com



Sharon R. Paxton
717-237-5393 • spaxton@mwn.com



Timothy J. Horstmann
717-237-5462 • thorstmann@mwn.com



Randy L. Varner
717-237-5464 • rvarner@mwn.com



Megan F. Luck
717-237-5416 • mluck@mwn.com

© 2014 McNees Wallace & Nurick LLC

PA TAX LAW NEWS is presented with the understanding that the publisher does not render specific legal, accounting or other professional service to the reader. Due to the rapidly changing nature of the law, information contained in this publication may become outdated. Anyone using this material must always research original sources of authority and update this information to ensure accuracy and applicability to specific legal matters. In no event will the authors, the reviewers or the publisher be liable for any damage, whether direct, indirect or consequential, claimed to result from the use of this material.