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PA TAX LAW NEWS

PA SUPREME COURT AFFIRMS SALES TAX EXEMPTION FOR "CHEP" PALLETS

by Sharon R. Paxton

On October 16, 2012, the Pennsylvania Supreme Court affirmed the Commonwealth Court's decision in *Procter & Gamble Paper Products Company v. Commonwealth*, 29 A.3d 1221 (Pa. Cmwlth. 2011), in which the Commonwealth Court ruled that "CHEP" pallets qualify as exempt "wrapping supplies."

P&G Paper rents pallets from CHEP USA. Following use, the pallets are returned to CHEP, which reconditions and then reissues the pallets. At audit, the Pennsylvania Department of Revenue assessed Use Tax on P&G Paper's payments for use of the pallets. On appeal, the Department's Board of Appeals and the Board of Finance and Revenue rejected the company's claim that the pallets are exempt "wrapping supplies," on the basis that the pallets are taxable as "returnable containers." The Commonwealth Court endorsed P&G Paper's argument that the pallets, themselves, are not "containers" and constitute exempt "wrapping supplies." ■

Companies which have paid tax but have not filed refund claims should contact a member of the McNees SALT Group for assistance in filing claims.

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PROMOTING EMPLOYMENT ACROSS PENNSYLVANIA ACT

by James L. Fritz

On October 25th, Governor Corbett signed Act 206 of 2012, which will permit qualifying companies to retain (or obtain a rebate of) 95% of the PA Personal Income Tax withheld from new employees. The bill's prime sponsor was Rep. Kerry Benninghoff (Centre/Mifflin).

To qualify, a company must create 250 new jobs within five years (of which, 100 must be created within two years). The company must provide health insurance and pay 50% of the premium. The new jobs must pay at least 100% of the county average wage. The period during which the company may receive benefit varies from seven to ten years based on the percentage over the average wage:

100%	-	7 years
110%	-	8 years
120%	-	9 years
140%	-	10 years

Benefits are **not** available to many organizations and industries, including the following: Gambling Industry, Religious Organizations, Retail Establishments, Educational Establishments and Service Providers, Public Administration Organizations, Utility Companies, and Food Service and Drinking Place. Tax delinquents also are not eligible.

A 100% claw-back applies if the company fails to fulfill its agreement with the Dept. of Community and Economic Development. A 66% claw-back applies if the company relocates out-of-state within three years after the final benefit year and a 33% claw-back applies for moving within 3-5 years. ■

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FUEL TAX UPDATE

by Sharon R. Paxton

Motor Fuel Tax Bulletin 2012-01 – Responsibility for Collection and Payment of Alternative Fuels Tax

The Department issued Bulletin 2012-01 to remind persons who are, or plan to be, engaged in the sale or use of alternative fuels (such as compressed natural gas) of Pennsylvania's licensing, tax, and reporting responsibilities related to alternative fuels.

"Alternative fuels" include natural gas, compressed natural gas, liquefied natural gas, liquid propane gas and liquefied petroleum gas, alcohols, gasoline alcohol mixtures containing at least 85% alcohol by volume, hydrogen, hythane, electricity and any other fuel used to propel motor vehicles on the public highways other than gasoline or diesel. For purposes of determining the tax rate applicable to each alternative fuel, the alternative fuel is first converted to a gasoline gallon equivalent. Note: Biodiesel is not an alternative fuel; biodiesel is treated the same as petroleum-based diesel for tax purposes.

The point of taxation for alternative fuels is at the retail or end-user level. Since most alternative fuels have many uses other than as vehicle fuel, they do not qualify as an "alternative fuel" for tax purposes until they are placed into a vehicle. The statute defines an alternative fuel "dealer-user" as "any person who delivers or places alternative fuels into the fuel supply tank or other device of a vehicle for use on the public highways." In the case of fuel sales by a retailer, where the fuel is placed into the vehicle at a retail pump, the retailer must report and pay the tax (which it collects from its customers). When a trucking company purchases alternative fuels in bulk and fuels its trucks from bulk storage tanks as needed, the trucking company must obtain an alternative fuels license and report and pay the applicable tax for the fuel placed into its vehicles.

Informational Notice Motor Fuel Taxes 2012-03 – Restrictions on Exemptions and Sales of Fuels and Liquid Fuels to or by Political Subdivisions in this Commonwealth.

Notice 2012-03 was issued on September 14, 2012 to remind political subdivisions of their responsibilities in the proper purchase and use of tax-free fuels. The notice also advises all exempt entities to maintain records which accurately reflect the proper purchase and use of such fuels.

The notice states that the tax exemption for gasoline and diesel delivered to a political subdivision is limited to fuel purchased and used for official purposes. Political subdivisions may not disperse tax-free fuel for personal use or any other use that is not for official political subdivision purposes. Also, political subdivisions may not sell tax-free fuels.

In the case of an exempt entity that purchases tax-paid fuel from a distributor for qualifying uses, a request for refund of the tax paid may be filed with the Board of Finance and Revenue on an annual basis. ■

DELAWARE & NEW JERSEY ABANDONED & UNCLAIMED PROPERTY DEVELOPMENTS

by Sharon R. Paxton

Delaware VDA's

Legislation adopted in July 2012 authorizes Delaware's Secretary of State (as opposed to the State Escheator) to enter into voluntary disclosure agreements with holders of unclaimed property who are not currently reporting any or all amounts or types of property, with reduced look-back periods. As a result of this legislation, eligible holders may limit the reporting of unclaimed property to 1996 or 1993, compared to the general obligation under Delaware unclaimed property laws to report such property back to 1981, or 1991 for those making voluntary disclosure agreements.

Many companies are particularly susceptible to significant unclaimed property exposure in Delaware because holders who fail to maintain owner address data generally must report and remit unclaimed property to their state of domicile (state of incorporation for corporate entities), which often is Delaware.

Holders that provide notice of intent to disclose by June 30, 2013, and enter into a disclosure agreement and pay by June 30, 2014, will not be required to report property from years before 1996. Holders that provide notice between July 1, 2013 and June 30, 2014, and enter into an agreement and pay by June 30, 2015, will not be required to report property from years before 1993. Also, the state's right to audit a company entering into a VDA is more limited under this new program, unless there is evidence of fraud or willful misrepresentation.

Companies that are already under examination or that have provided notice of voluntary disclosure or entered into a disclosure agreement on or before June 30, 2012 do not qualify for this program. However, holders involved in the standard VDA program prior to June 30, 2012 generally will be allowed to apply the same shortened look-back periods, provided payment is made by June 30, 2014 for the 1996 look-back period or June 30, 2105 for the 1993 look-back period.

New Jersey Stored Value Cards

On June 29, 2012, New Jersey's Governor signed legislation making several changes to New Jersey's unclaimed property law as it relates to stored value cards ("SVCs"). Under the new provisions, the dormancy period for SVCs issued on or after July 1, 2010 has been increased from two years to five years, and SVCs issued before July 2010 are not reportable as unclaimed property. The amount of a general purpose, reloadable SVC that is presumed abandoned is the value of the card, in money, on the date it is presumed abandoned. For all other SVCs, the amount presumed to have been abandoned is limited to 60% of the value of the card, in money, on the date it is presumed abandoned.

This legislation also established a four-year moratorium on enforcement of the law's data collection requirements (which require the issuer of a SVC to obtain the name and address of the purchaser or owner, and, at a minimum, to maintain a record of the zip code of the purchaser or owner). This moratorium provides time for the holder community to work with New Jersey to arrive at a mutually acceptable arrangement concerning data collection requirements. In addition, this legislation repealed the "place of purchase presumption," which, in instances where the address was not collected when an SVC was sold in New Jersey, created a presumption that the owner of the SVC was located in New Jersey. (This provision was found to be unenforceable by the United States Court of Appeals for the Third Circuit in *New Jersey Retail Merchants Association v. Sidamon-Eristoff*, 669 F.3d 374 (3rd Cir. 2012). On October 29, 2012, the United States Supreme Court denied New Jersey's petition for certiorari.)

Finally, the recent legislation expands the available reporting exemptions to include SVCs donated, or sold below face value, to charitable or educational organizations and cards redeemable for admission to various events and venues. New Jersey continues to exempt certain SVCs distributed under promotional or customer loyalty programs and SVCs issued by an issuer that in the past year sold SVCs with a face value of $250,000 or less. The legislation also added various consumer protections relating to SVCs. ■

FILED A PROPERTY TAX APPEAL, BUT DON'T HAVE AN APPRAISAL YET? YOU SHOULD STILL ATTEND THAT HEARING

by Timothy J. Horstmann

Owners of commercial and industrial properties in Pennsylvania seeking a reduction in their property tax assessments are generally advised to obtain a written appraisal of their property. But what should property owners do if their appraisal is not ready in time for the hearing scheduled by the county assessment office?

The first thing the property owner should do is contact the assessment office and request that the date of the hearing be moved. If a change in the hearing date is granted, property owners should request that the assessment office send written confirmation of the change.

However, many counties refuse to entertain requests for a change in the date of a hearing by property owners, and have adopted local rules of procedure stating as much.

The most likely result, therefore, is that the county will deny the request for a change in the hearing date. Consequently, property owners may be faced with the prospect of attending a hearing at which their primary and "best" piece of evidence – the appraisal – is not yet completed. While the owner is free to submit alternative evidence to support a reduction, the reality for most large commercial and industrial property tax appeals is that the assessment board likely will not grant a reduction absent an appraisal.

With property owners having the right to appeal the board's decision to the trial court in the county, some appellants may be tempted to not have anyone attend the hearing, wait for the expected decision denying relief which would have come anyway, and then appeal that decision to the trial court, at which time the appraisal likely will be ready. Choosing this approach might save the property owner a few bucks up front, but can create headaches down the road, resulting in greater expense and even the possibility of losing one's right to an appeal.

An appellant that fails to appear at a hearing scheduled by the assessment board risks having the board either issue a decision that indicates that the appellant abandoned the appeal or worse, not issue a decision at all. While this presumption of abandonment has no basis in the law for annual appeals, we are aware of county boards adopting policies under which they will refuse to issue decisions to appellants that have missed hearings in annual appeals, as well as appeals in connection with a county-wide reassessment, under the presumption that these appellants have abandoned their appeals.

Property owners therefore should always attend their appeal hearings before the boards to avoid any chance of their appeal being considered abandoned. It is recommended that the owner's counsel attend the hearing, in the event the school district or municipality appear at the hearing and seek an increase in the assessment on the property. ■

If you failed to attend your hearing, we can help, but you must act quickly. You should contact one of the attorneys of the McNees State and Local Tax Group right away.

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COLLECTING AND REMITTING PA SALES TAX ON MULTISTATE SALES TRANSACTIONS

by Sharon R. Paxton

A number of factors must be considered by sellers and purchasers when evaluating sales and use tax compliance for transactions involving multiple states. Among other things, a seller must consider the location of delivery to the purchaser (which may depend on the method of delivery), whether the seller has nexus with the destination state, and, if so, whether the property is taxable in the destination state. Sellers must also verify exemption certificates provided by purchasers who claim a tax exemption, which may require an analysis of another state's rules with which the seller is less familiar.

A purchaser must consider whether tax was properly collected by the seller, whether it is required to remit use tax on property when the seller did not collect tax, and the tax implications that arise when property is delivered in one state but will ultimately be used by the purchaser in one or more other states.

Common issues that arise in multistate transactions are discussed below, with an emphasis on Pennsylvania law.

Location of Delivery

For sales and use tax purposes, a sale occurs in the state where the property is delivered to the purchaser, which may be a location different than the purchaser's business address. This is a basic principle of sales and use taxation, but it is not uncommon for an auditor to discover that a seller has failed to collect Pennsylvania tax on a sale of property to an out-of-state customer where the customer picked up the property in its own truck at the seller's place of business. The fact that a nonresident purchaser will immediately transport the property to a location outside Pennsylvania for use outside the state does not change the taxable nature of the transaction. See 61 Pa. Code § 32.5(a), (b). Furthermore, delivery in the state to a purchaser's agent, other than an interstate carrier, constitutes delivery to the purchaser. See 61 Pa. Code § 32.5(b).

Pennsylvania sales tax does not apply to property that is actually delivered to a location outside Pennsylvania, or to a common carrier or the United States Postal Service for transportation to a point outside the state. A seller who has nexus with the destination state is, however, required to collect tax imposed by the destination state on non-exempt sales of property delivered to customers in that state. The degree of physical presence required to create a tax collection obligation in another state is not high. For example, a seller who directly or indirectly engages in regular solicitation activities in another state likely has an enforceable obligation to collect tax on behalf of that state, even when it conducts those activities through an independent contractor. A seller may also create a tax collection obligation in another state by delivering products to customers in that state in its own vehicles.

It is important to both sellers and purchasers that the delivery location be properly identified on the invoice or other supporting documentation, especially when the purchaser has multiple business locations and the billing address and delivery location may be in different states. If an invoice reflects a billing address in a particular state, an auditor will assume that the billing address reflects the delivery location in the absence of evidence to the contrary (such as designation of a different address as the "Ship To" location or attachment of shipping documents).

Drop Shipment Transactions

A "drop shipment" transaction occurs when a retailer accepts an order for products from a customer and then places the order with a supplier (manufacturer or wholesaler) and directs the supplier to deliver the goods directly to the retailer's customer. These transactions involve at least two sales transactions – the sale from the supplier to the retailer and the sale from the retailer to the consumer. These types of arrangements create numerous sales and use tax issues. Tax compliance is further complicated by the fact that there is little consistency among the states regarding the tax treatment of drop shipment transactions.

One of the most common issues that arises in drop shipment transactions is whether the supplier can accept a resale certificate from the retailer under the laws of a particular state. For example, some states do not permit a seller to accept a resale exemption certificate "in good faith" from a purchaser that is not registered to collect sales tax in the state. If the supplier cannot accept a resale certificate from the retailer, the supplier may be obligated to collect tax on the transaction.

Another potential issue arises when the supplier delivers property to a customer in another state in which the supplier has nexus. A number of states have statutes purporting to make a "former owner" of property liable to collect tax as the "retailer" when it delivers property to a consumer in the state. In some cases, the statutory tax collection obligation extends to deliveries to another person (e.g., a carrier) for redelivery to a consumer in the delivery state. See, e.g., Cal. Rev. & Tax. Cd. § 6007. When a supplier is required to collect tax on a drop shipment transaction because it has nexus with the delivery state, issues also arise as to the proper tax base (the amount the supplier receives from the retailer versus the amount paid by the consumer).

When delivering property to a consumer in Pennsylvania, a seller may accept a resale certificate from an out-of-state retailer that does not have a Pennsylvania sales tax license number. See Ruling No. SUT-99-134 (reissued February 16, 2010). The resale certificate must indicate that the retailer does not have nexus with Pennsylvania or that no taxable sales are made in the state.

Services To Tangible Personal Property

In Pennsylvania, sales tax generally applies to services to tangible personal property (repairing, altering, cleaning, etc.), absent a specific exemption. See 72 P.S. § 7201(k). Notwithstanding the fact that taxable services to tangible personal property may be performed within Pennsylvania, those services may be nontaxable if the serviceperson is obligated to deliver the property to a point outside Pennsylvania (or to an interstate carrier or the mails for transportation to a point outside the state). See 61 Pa. Code § 32.5(b).

continued on next page

Similarly, when a taxpayer obtains taxable services to Pennsylvania-based tangible personal property at a location outside Pennsylvania, and then brings the property back into the state, Pennsylvania use tax is due on those services (subject to any available credit for tax properly paid to the other state).

Credit for Tax Paid to Another State

When property is initially delivered to the purchaser in another state but subsequently brought into Pennsylvania, Pennsylvania will grant credit for state sales and use taxes legally paid to the other state, provided that the other state grants similar tax credit for taxes paid to Pennsylvania. Pennsylvania will also grant credit for local sales and use taxes, provided such taxes are: (1) collected by the state, and (2) paid pursuant to the provisions of the state law which has been adopted by the local government. Claims for tax credit must be substantiated by evidence showing tax has been paid. Credit for taxes paid to another state will be applied first to state tax, then to local tax.

It is important to remember that Pennsylvania will grant a credit for sales or use tax previously paid to another state only if the Department of Revenue determines that the tax paid to the other state was legally required to be paid. For instance, with respect to property that is temporarily stored in another state prior to entering Pennsylvania, the Department of Revenue's Audit Manual indicates that a tax credit for sales or use tax paid to the other state will be recognized if that state taxes interim storage and has reciprocity with Pennsylvania. However, credit will not be allowed for tax paid to another state if that state does not tax interim storage because the tax paid to the other state was not "legally due."

Special Resale

In Pennsylvania, a special provision in the statutory definition of "resale" applies to "tangible personal property purchased or having a situs within this Commonwealth solely for the purpose of being processed, fabricated or manufactured into, attached to or incorporated into tangible personal property and thereafter transported outside this Commonwealth for use exclusively outside this Commonwealth." 72 P.S. § 7201(i)(3). This "special resale" exclusion allows taxpayers to manufacture or fabricate tangible personal property tax-free in Pennsylvania, then use or install it in a state where it would be subject to a lower tax rate, or would be entirely exempt.

Pennsylvania does not have an interim storage exemption. Therefore, without the "special resale" exclusion, Pennsylvania producers would have to pay Pennsylvania tax on materials and could be placed at a competitive disadvantage to out-of-state producers in low-tax or no-tax states. A classic example of a business that benefits from the "special resale" exclusion is a business that fabricates custom cabinetry or other building components to be installed in buildings outside Pennsylvania. But for the "special resale" exclusion, a company fabricating building components in Pennsylvania and installing them outside the state would owe Pennsylvania sales or use tax on the cost of the materials, even when the components are destined for installation in a state with a lower tax rate or no sales tax at all.

Under some circumstances, companies with offices in multiple states can also use the "special resale" exclusion to claim an exemption for property that is temporarily present within Pennsylvania so that the purchaser can perform some type of operation on the property prior to delivering the property to an out-of-state location for use outside the state. For example, if a company purchases computers in Pennsylvania, attaches additional hardware components, and then ships the computers to offices outside the state, the computers and components should qualify for the "special resale" exclusion. Similarly, since canned software is treated as "tangible personal property" for sales tax purposes, installing such software on a computer prior to delivering the computer to an out-of-state location should satisfy the statutory requirements for "special resale." The exclusion does not, however, apply in situations where a company has property delivered to Pennsylvania due to centralized purchasing operations, and then simply re-ships the property to business locations in other states. In order to qualify for the "special resale" exclusion, some operation must be performed on the property or it must be "attached to" or "incorporated into" other tangible personal property before being shipped outside the state.

An issue that sometimes arises when a business claims the "special resale" exclusion for moveable items is whether the taxpayer can demonstrate that the property transported to an out-of-state location will be used "exclusively" outside Pennsylvania. For example, the Department has taken the position that the "special resale" exclusion does not apply to laptops purchased for employees in other states on the basis that the laptops could easily be used in Pennsylvania. It is possible that almost any type of property could conceivably be brought back into Pennsylvania, depending on future circumstances. Therefore, in determining whether property will be used "exclusively" outside Pennsylvania, a more appropriate inquiry would be whether an item is intended to be used both in Pennsylvania and in other state(s) when it is purchased and shipped outside the state. If not, it should be considered to have been purchased and transported outside Pennsylvania for "use exclusively outside [Pennsylvania]." If the property is subsequently brought back into Pennsylvania for some reason, use tax could be due at that point. ■

For advice on multistate sales and use tax compliance issues, please contact Sharon Paxton or another member of the McNees State and Local Tax Group.

DEPARTMENT ISSUES TIMELY GUIDANCE ON OIL AND NATURAL GAS INTERESTS

by Randy L. Varner

On October 10, 2012, the Department of Revenue issued Informational Notice 2012-04, dealing with the Realty Transfer and Personal Income Tax treatment associated with the division and transfer of interests in oil and natural gas. While the Department does not break any new ground in the notice, the notice does provide a nice summary of the tax consequences surrounding these "Marcellus Shale" transactions.

Realty Transfer Tax

Initially, the notice tackles the Realty Transfer Tax ("RTT") issues. The notice provides that the assignment of a lease for the production or extraction of coal, oil or gas is not subject to RTT. If the assignment covers the reserved real estate under the royalty clause of an oil or gas lease, then that assignment is subject to RTT. An assignment of royalty income is a personal property interest and therefore is not subject to RTT.

Personal Income Tax

The real meat of the notice addresses the Personal Income Tax ("PIT") issues. The notice clarifies that if a mineral rights estate owner sells the mineral rights, the consideration less basis is taxable for PIT purposes and should be reported on Schedule D of the PA-40.

If both the surface rights and mineral rights are sold, the seller must allocate a portion of basis to the mineral rights estate. If this was not done when the seller originally acquired the property, an allocation must be made by taking the basis and multiplying by a fraction, the numerator of which is the FMV of the mineral rights estate and the denominator of which is the FMV of the entire real estate. The FMVs shall be determined as of the date the seller originally acquired the property. If an allocation cannot be made, a zero basis must be used.

A mineral rights owner who is the lessor under an oil or gas production lease may sell and assign his rights to income from future production payments under the lease. For PIT purposes, the sale and assignment are treated as anticipatory assignments of income. With respect to the assignor, he will be deemed to have received royalty income to the extent of the sales price. This income would be reported on Schedule E of the Pa-40 in the year in which the sale proceeds are received (no subsequent deduction will be permitted when the actual production payments are made to assignee).

With respect to the assignee, the tax treatment depends on whether the transaction is open (future production payments not readily ascertainable) or closed (amount readily ascertainable). The notice makes clear that open transactions will be very rare and will be handled on a case by case basis. There is a rebuttable presumption that all transactions are closed. For a closed transaction, each future payment is considered a partial non-taxable return of the assignee's basis and the remainder is taxable royalty income to be reported on Schedule E of PA-40. The taxable and non-taxable amounts are prorated based upon the amount of anticipated future payments and the assignee's basis.

Example: A lessor under a gas lease sells and assigns his right to future production payments for 10 years. The assignee agrees to pay $10,000 for the future payments. Therefore, the assignee will have a basis of $10,000 in the future payments. It is anticipated that that total amount of production payments over the 10 years will be 50,000 (1 yearly payment of $5,000 for 10 years). Therefore, by the time all future payments are made, the assignee will have recovered his basis plus an additional $40,000 of royalty income. The assignee's basis accounts for 20% of the future production payments and the taxable royalty income accounts for the remaining 80%. Therefore, the assignee must account for 20% of each production payment as a return of basis ($1,000) and the remaining 80% as taxable royalty income ($4,000).

If there is an open transaction, the assignee is permitted to use the cost recovery method and apply the production payments to recover the entire basis first, then anything beyond basis is taxable royalty income reportable on Schedule E of PA-40.

Finally, donative transfers of production payments are treated as an anticipatory assignment of future income to the assignor. When a production payment is made, the assignor is deemed to have received the payment and in turn, transferred the payment to assignee. Therefore, the assignor has royalty income in the year the production payment is made, and the subsequent transfer is a gift and not subject to tax. ■

As noted above, there is no new treatment contained in the notice; however, it is a helpful resource for those involved in these transactions. Please feel free to contact any member of the McNees SALT team should you have questions relating to the points raised in this article. In addition, McNees has a Oil and Gas Group that can assist should you or your company require assistance with respect to Marcellus Shale issues.

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