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PA TAX LAW NEWS

## GOVERNOR'S BUDGET PROPOSAL MAINTAINS CAPITAL STOCK/FRANCHISE TAX PHASE-OUT BUT ASKS RETAILERS TO PAY MORE *by James L. Fritz*

Governor Corbett has proposed a Pennsylvania 2012-13 budget that would hold spending flat overall while dealing with pension cost increases and other mandates. The business community, in general, would fare well because the Governor proposes to maintain the phase-out schedule for the Capital Stock and Franchise Taxes. However, larger retail vendors would take it on the chin because the Governor would essentially eliminate the 1% discount they currently receive for collecting sales taxes on behalf of the Commonwealth.

**Sales Tax Discount Cap**

As proposed by the Governor, a retail vendor's sales tax discount would be capped at $250 per month ($3,000/year). Thus, retailers making up to $5,000,000 of taxable sales per year would essentially continue to receive their full collection compensation ($5,000,000 x 6% = $300,000 tax x 1% = $3,000). However, larger retailers making sales many times that amount would receive only $3,000/year, regardless of the fact that their costs are much greater. Capping the discount would save the Commonwealth $41.3 million/year. Although the Governor has pledged not to increase taxes, the Secretary of Revenue has indicated that the administration views the discount as a "fee" paid by the Commonwealth and doesn't believe it is receiving value for the compensation paid. The retailers probably would like to see how the Department calculates the value of retailer efforts to determine taxability; administer exemption claims; collect, account for and remit the tax; and, deal with the Department's audits!

**Capital Stock/Franchise Phase-Out**

The Capital Stock and Franchise Tax rate was reduced to 1.89 mills on January 1, 2012 and is already scheduled to be reduced to 0.89 mills on January 1, 2013, with full elimination in January 2014. The business community views this as an onerous tax because it is collected even when companies lose money and is imposed on top of perhaps the highest Corporate Net Income Tax in the country. Apparently the Governor agrees and sees the maintenance of the phase-out as a major factor in encouraging businesses to invest in Pennsylvania. We will see over the next few months whether the Legislature also will maintain the phase-out schedule, or will push it back as has been done before in order to maintain revenues for state-funded programs.

**Tax Credits**

Major tax credit programs would remain at current levels under the Governor's budget proposal.

| | | |
|---|---|---|
| Educational Improvement | - | $75 million |
| R&D | - | $55 million |
| Job Creation | - | $10.1 million |
| Film Production | - | $60 million |

**Pressure on State-funded Programs**

The budget assumes a 3.8% growth in tax collections, but this comes on the heels of adjustments reducing predicted current-year revenues by $719 million. Projected 2012-13 receipts include $6-7 million from the addition of a use tax line on annual personal income tax returns. The budget also assumes collections of $42.8 million resulting from online sellers complying with the Department of Revenue's recent bulletin asserting a sales tax collection obligation by many such sellers.

Many state-funded programs would take hits as money had to be found to fund increased pension contributions and other

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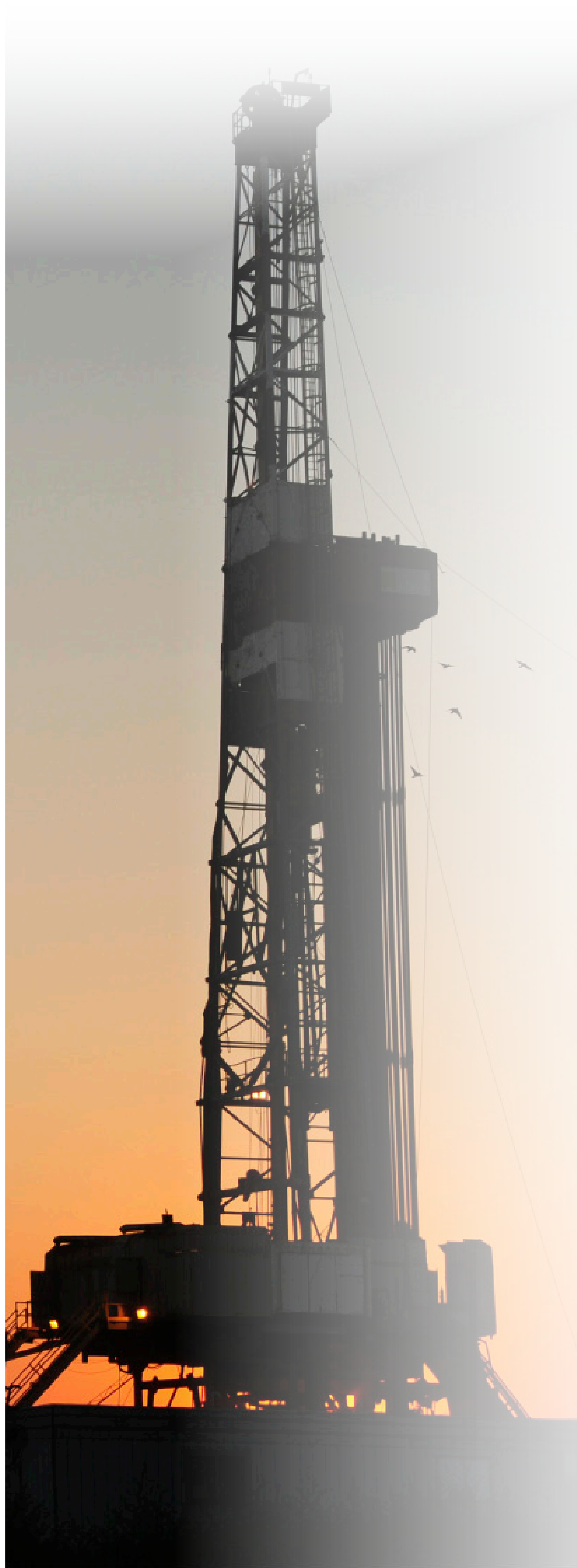

# MARCELLUS SHALE IMPACT FEE ENACTED

*by Randy L. Varner*

On February 8, 2012, legislation containing the Marcellus Shale impact fee was sent to Governor Corbett for his expected signature. The enactment of the impact fee ends several years of debate and contention surrounding the generation of revenues from Marcellus Shale natural gas.

The legislation allows counties that contain "unconventional gas wells" (like those contained in the Marcellus Shale region) to enact an "unconventional gas well fee." A county wishing to do so must do so within 60 days of the enactment of the legislation. If a county neglects to enact the fee, a majority of municipalities within the county may vote to override the county's decision and impose a fee.

If enacted, a fee is imposed on every unconventional gas well in a county, regardless of when those unconventional gas wells were drilled. For purposes of the legislation, all existing wells at the time of the enactment of the legislation are deemed to have been drilled in the year prior to enactment. The fees to be imposed vary depending upon the annual average price of natural gas (subject to adjustment depending on changes in the Consumer Price Index).

| Year of Well | Fee Range |
|---|---|
| 1 | $40,000-$60,000 |
| 2 | $30,000-$55,000 |
| 3 | $25,000-$50,000 |
| 4-10 | $10,000-$20,000 |
| 11-15 | $5,000-$10,000 |

The fee is due to be paid to the Pennsylvania Public Utility Commission each April 1, with reports being due each September 1 and April 1. The fees will be deposited in the Unconventional Gas Well Fund ("Fund"). Distributions from the Fund are earmarked for counties and municipalities that contain wells (in those counties that have enacted the fee), and other state and local agencies including county conservation districts, the Pennsylvania Fish and Boat Commission, the Public Utility Commission, the Pennsylvania Department of Environmental Protection, the Pennsylvania Emergency Management Agency, the Office of State Fire Commissioner and Pennsylvania Department of Transportation.

Leaders estimate the total fees generated in year one will be in the neighborhood of $180 million, followed by an increase to $211 million in year two. ■

Randy L. Varner practices in the State and Local Tax group.
*rvarner@mwn.com / 717.237.5464*

## PROPERTY TAX REASSESSMENTS COMING!

*by Randy L. Varner*

The Pennsylvania counties of **Allegheny, Lehigh**, **Lebanon** and **Erie** will be conducting countywide reassessments in 2012. The reassessment notices from Allegheny County have already started to be sent to property owners, and issuance of those for Lehigh, Lebanon and Erie will begin at the end of February.

Property owners should review a notice of reassessment carefully. In addition to examining the reassessed value, scrutiny should be given to the property description, location, acreage, etc. on the notice. During a countywide reassessment, every property in a county is reassessed. Because of the sheer volume of the undertaking, mistakes will happen.

With respect to analyzing valuation, the "new" reassessed value should be compared with the imputed fair market value of the "old" assessment in order to determine if the new reassessed value is appropriate. In general, to determine the imputed fair market value of the "old" assessment, take the "old" assessment and divide it by the common level ratio for your county published at www.steb.state.pa.us. Broadly speaking, property values have not gone up over the last several years, especially for commercial and industrial properties. So, if the reassessed value indicates a rise in fair market value, an appeal may be in order.

There are some traps for the unwary in the reassessment process. First, the appeal process can often be confusing given that most counties will run both informal and formal appeals. Even if a taxpayer chooses to go to an informal hearing, it is crucial that a formal appeal be filed as well. Strictly speaking, the filing of an informal appeal does not negate the need to file a formal appeal. Second, reassessment notices often include information about the tax load under the "old" assessment and the load under the "new" reassessed value. While the tax comparison can be helpful, it is not dispositive. For instance, an appeal may be warranted even though the taxes will stay the same or will go down if the property happened to be over assessed under the "old" assessment. Further, taxpayers should be aware that even though the amount by which a taxing jurisdiction can raise millage rates in the first year after reassessment is capped, there is nothing in the law limiting the amount of increase in a subsequent year.

Finally, taxpayers should analyze the reassessment quickly so that the appropriate professionals can be engaged. Appraisers, for example, are often in very high demand in areas undergoing a reassessment.

If you own or lease property in the counties undertaking countywide reassessments and have questions about the process, or if you would like assistance in analyzing your reassessment, please feel free to contact any of the following members of the State and Local Tax group: Randy Varner at rvarner@mwn.com, Bert Goodman at bgoodman@mwn.com or Tim Horstmann at thorstmann@mwn.com. ■

## BIPARTISAN PUSH FOR ROYALTY ADDBACKS *by James L. Fritz*

On January 25th, Pennsylvania House Members Dave Reed and Eugene DePasquale, together with 62 bipartisan cosponsors, introduced legislation (HB 2150, PN 3019) to disallow deductions under Pennsylvania's Corporate Net Income Tax (CNI) for royalties paid to affiliated entities. Reed is Chairman of the House Majority Policy Committee; DePasquale is the endorsed candidate for the Democratic nomination for Auditor General, Pennsylvania's statewide fiscal watchdog office. Although it is not clear at this point whether this legislation may gain support in the PA Senate or the Governor's Office, we believe it should be taken seriously because of the degree of bipartisan support in the House.

In its present form, the bill provides for addback of royalties paid to affiliated entities. Additional revenues generated by the addback would be used to (a) phase-down Pennsylvania's 9.99% CNI rate to 6.99% by 2019; (b) immediately implement single sales factor apportionment (current weighting is 90%); and (c) over a period of years, eliminate the current cap on net loss carryforwards. The rate-reduction, single sales factor and elimination of the loss cap are tax reforms long sought by Pennsylvania's business community.

The bill currently provides an exception to addback where the transaction is "directly related to a valid business purpose" and attempts to provide a credit for tax paid to another state (not a foreign country) by the affiliate receiving the disallowed royalty payment. These provisions almost certainly will be subject to various amendments before the bill comes up for final passage.

For further details on this legislation and actions being taken by PA businesses with respect to it, please contact Jim Fritz at jfritz@mwn.com or another member of the McNees SALT group. ■

## PA UNCLAIMED PROPERTY FILINGS DUE APRIL 16

*by Sharon R. Paxton*

The deadline for filing a 2011 Abandoned and Unclaimed Property Report with the Pennsylvania Treasury Department is April 16. Holders of unclaimed property can request a 30 or 60-day extension of the filing deadline, but the Department will not grant extensions for two consecutive years. Although not statutorily required, it is good practice for businesses that have no reportable unclaimed property for the year to file negative reports with the Department. Unclaimed property reporting requirements are explained in more detail in a White Paper available on the McNees website (www.mwn.com).

Companies that have never filed unclaimed property reports with Pennsylvania, and companies that have not been granted voluntary compliance or participated in the Treasury Department's Self-Audit Program in the past ten years, may be able to obtain a waiver of interest and penalties by participating in the Department's ongoing Voluntary Compliance Program ("VCP"). The ten year restriction for participation in the VCP will be waived if the property type is new or associated with a merger or acquisition of a new company. To participate in the VCP, a holder of unclaimed property must come forward voluntarily (prior to an audit or self-audit initiated by the Treasury Department) and must report and remit all unclaimed property identified through a complete audit of its books and records for the last five reportable years (which includes records going back ten years from the current report year).

For advice concerning unclaimed property reporting obligations, please contact Sharon Paxton of the McNees State and Local Tax group. ■

Sharon R. Paxton is Vice-Chair of the State and Local Tax group.
*spaxton@mwn.com / 717.237.5393*

## COURT AFFIRMS INJUNCTION AGAINST NJ UNCLAIMED PROPERTY LAW *by Sharon R. Paxton*

In 2010, New Jersey's unclaimed property statute was amended to provide for the custodial escheat of stored value cards ("SVCs"). The New Jersey Retail Merchants Association, the New Jersey Food Council and American Express Prepaid Card Management Corporation filed a motion for preliminary injunction in the United States District Court against the New Jersey Treasurer and the New Jersey Unclaimed Property Administrator on the basis that enforcement of certain provisions of the 2010 changes ("Chapter 25") violated various constitutional provisions. On January 5, 2012, in *New Jersey Retail Merchants Association v. Sidamon-Eristoff*, 2012 WL 19385 (C.A. 3 (N.J.)), the United States Court of Appeals for the Third Circuit affirmed the District Court's Order which had granted, in part, and denied, in part, the issuers' motion for a preliminary injunction.

**Retroactive Enforcement**

The Court held that the SVC issuers had shown a reasonable likelihood of success on the merits of their Contracts Clause claim alleging that the retroactive enforcement of Chapter 25 substantially impaired the issuers' existing contractual relationships because it required SVC issuers to submit the value of SVCs in cash at the end of the abandonment period, even though the SVCs were redeemable only for merchandise or services under the issuers' contracts with their customers. Because the value of an SVC includes the issuer's expected profit or merchant fee, requiring issuers to turn over the entire value in cash would effectively transfer the issuers' expected benefits to state custody.

**Place-of-Purchase Presumption**

The Court also held that the SVC issuers had demonstrated a reasonable likelihood of success on their claim that Chapter 25's place-of-purchase presumption was preempted under federal common law. Under Chapter 25's place-of-purchase presumption, in all cases where the purchaser's address is unknown, the address of the place of purchase would be substituted for the address of the purchaser. Thus, if the address of the purchaser of an SVC purchased in New Jersey were unknown, New Jersey would be entitled to the unclaimed property. This place-of-purchase presumption is inconsistent with the priority rules established by the United States Supreme Court in *Texas v. New Jersey*, 379 U.S. 674 (1965), under which property is reportable to the state of the last known address of the owner or, when the address of the owner is unknown or is in a state which does not require reporting of the property, to the holder's state of incorporation or domicile. It would be impossible for an issuer to comply with both Chapter 25's place-of-purchase presumption and the federal common law rules in *Texas v. New Jersey*. Thus, the Court determined that the issuers had met their burden of showing that Chapter 25 is likely preempted. (The Court reached the same conclusion with respect to a Treasury Notice issued by New Jersey, which purported to apply the place-of-purchase presumption for issuers not domiciled in New Jersey only in cases where the issuer's state of domicile exempts SVCs from unclaimed property reporting.)

**Two-Year Abandonment Period/Data Collection Provision**

The Court determined that the issuers had failed to show a reasonable likelihood of success on their claims that (1) Chapter 25's two-year abandonment period is preempted by the federal Credit CARD Act of 2009 because it provides for an abandonment period shorter than five years, and (2) the data collection provision, which requires issuers to obtain the name and address of the purchaser or owner of each SVC issued or sold and to, at a minimum, maintain a record of the zip code of the owner or purchaser, is unenforceable on a stand-alone basis (independent of the place-of-purchase presumption provision). ■

## PA SUPREME COURT REJECTS "*SHEETZ* TEST" FOR SALES TAX PURPOSES

*by Sharon R. Paxton*

In a consolidated decision issued on December 21, 2011, the Pennsylvania Supreme Court reversed the Commonwealth Court's 2009 decisions in *Northeastern Pennsylvania Imaging Center v. Commonwealth* and *Medical Associates of the Lehigh Valley, P.C. v. Commonwealth*, which had held that MRIs and other medical scanning systems installed in the taxpayers' imaging centers became part of the "real estate" under the *Sheetz* test discussed below, so that the taxpayers were entitled to a refund of sales tax paid on their purchase and lease of installed scanning systems. The Supreme Court held that the scanning systems retained their identity as tangible personal property after installation, but remanded the cases to the Commonwealth Court for consideration of the taxpayers' argument that the Department of Revenue's denial of their refund claims violated the Uniformity Clause of the Pennsylvania Constitution because the Department had granted refunds to other similarly situated taxpayers. The Commonwealth Court did not address the Uniformity Clause issue because it had ruled in favor of the taxpayers on the merits.

More significant than the particular ruling in this case was the Supreme Court's holding that the "test" enunciated in *Commonwealth v. Beck Electric Construction, Inc.*, 403 A.2d 553 (Pa.

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## PA PURSUES ONLINE VENDORS

*by James L. Fritz*

Although the PA Department of Revenue has pushed back the deadline for compliance, the Department seems dead set on forcing certain online vendors to collect sales tax on sales to Pennsylvania customers.

In Sales and Use Tax Bulletin 2011-01 the Department set forth its interpretation of the law of nexus as applied to online vendors. In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) the United States Supreme Court held that, under the Commerce Clause of the U.S. Constitution, a vendor without physical presence could not be required to collect a state's sales and use tax. However, in *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960) the Court upheld Florida's right to compel the company to collect that state's tax because non-employee sales representatives regularly solicited orders in the state on the company's behalf.

The Department noted that many online vendors have affiliates performing activities in PA on their behalf, such as operating distribution or fulfillment centers. In addition, some online vendors pay other companies to provide website links enabling customers to purchase merchandise from the online vendor. In the opinion of the Department, these and other in-state activities on behalf of the online vendors are sufficient to establish nexus under the Supreme Court's rulings.

Initially, the Department indicated that it would pursue enforcement action against such online vendors who failed to register and begin collecting tax by February 1. On January 27, the Department extended its compliance deadline to September 1, indicating that a number of online vendors are willing to comply but needed more time to implement new tax collection processes. Revenue Secretary Dan Meuser indicated that online vendors who refuse to comply will "face a variety of escalating enforcement options over time …" and that there will be no more extensions. ■

## PA SUPREME COURT REJECTS "*SHEETZ* TEST" *(continued from page 5)*

1979), rather than the standard enunciated by the Commonwealth Court in *In re Appeal of Sheetz*, 657 A.2d 1011 (Pa. Cmwlth. 1995), *appeal denied*, 666 A.2d 1060 (Pa. 1995), applies for purposes of determining whether property that is attached to real estate becomes a permanent part of the real estate for sales and use tax purposes. This "realty-personalty" analysis determines whether a contract with a non-exempt entity for the sale and installation of property constitutes a "construction contract" (in which case the installed property is "used" by, and taxable to, the installer) or a sale of tangible personal property (in which case the installer claims the resale exclusion when purchasing the property and collects any applicable sales tax from the purchaser).

While the sales tax consequences of contracts with non-exempt entities depend on whether the property being installed becomes part of the real estate, neither the Sales and Use Tax statute nor the Department of Revenue's regulations define the term "real estate." The Department's regulation at 61 Pa. Code § 31.11 lists items that are presumed to become a permanent part of the real estate upon installation and items that are presumed to remain "tangible personal property," but that regulation contains no explicit test for determining whether an item becomes part of the real estate. Since the term "real estate" is not defined by statute or regulation, the parties in *Northeastern* and *Medical Associates* took the position that the common law doctrine of fixtures, as delineated in the *Sheetz* case, represented the proper standard.

In *Sheetz*, the Commonwealth Court articulated a three-factor test for determining whether items become part of the real estate for property tax purposes. Under the *Sheetz* test, in determining whether items that are affixed to real estate, but can be removed without material injury to themselves or to the real estate, are realty or personalty, the following three factors must be considered: (1) the manner in which the item is physically attached or installed, (2) the extent to which the item is essential to the permanent use of a building or other improvement, and (3) the objective intention of the parties. The Supreme Court rejected use of the *Sheetz* test for sales and use tax purposes on the basis that *Sheetz* was a real estate tax case, which involved a different tax statute, and there is apposite Supreme Court precedent ("*Beck*") which addresses the issue of whether a contractor is a "user" of goods or a "vendor" entitled to claim the "resale" exclusion.

The *Beck* test has been characterized by the courts as involving a determination as to whether property is "easily" removable without damage to itself or to the surrounding real estate. The Supreme Court did not establish an independent "realty-personalty" test in *Beck*, however, but simply construed the Department of Revenue's regulations in effect at the time. While both the *Sheetz* and *Beck* tests require a consideration of the method of attachment to the real estate, the *Sheetz* test also takes into account whether an item is an integral part of the real estate, as it is currently being used. By way of contrast, some of the items that were held to remain tangible personal property in *Beck* were integral parts of the electrical systems of the buildings in which they were installed.

The Supreme Court purportedly relied on *Beck* to conclude that the medical scanning systems in these cases did not become part of the real estate after they were installed in the imaging centers. Nevertheless, the Court did not analyze the ease with which the scanning systems could be removed from the imaging centers or

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whether such removal would damage the real estate. Rather, after stating that the *Beck* test applied, the Court analyzed the character of the medical scanning systems by simply comparing those systems to other items listed in the Department's regulation that are found "in a medical setting." The Court essentially determined that the scanning systems remained tangible personal property because they were "more like x-ray equipment than a nurses' station."

Based on the Court's analysis in the *Northeastern* and *Medical Associates* cases, the tax treatment of items affixed to real estate remains unclear in the context of contracts with non-exempt entities. For example, the Court relied almost exclusively on its interpretation of the Department's regulation to conclude that the scanning systems remained tangible personal property. It is not clear, therefore, whether the *Beck* "test" involves anything more than an evaluation of the lists of presumptions in the Department of Revenue's regulation at 61 Pa. Code § 31.11. The presumptions listed in the Department's regulation apply "in the absence of satisfactory evidence to the contrary," but the Court has not articulated what evidence would be required to overcome these presumptions. To the extent the Court's decision stands for the proposition that any item that can be removed and replaced remains tangible personal property under the *Beck* test, then many items that are presumed to become part of the real estate under the Department's regulation, and under letter rulings issued by the Department, would presumably remain tangible personal property under the Court's analysis.

The taxpayers filed Applications for Reconsideration with the Supreme Court in early January, requesting, among other things, that the Court reconsider and clarify the parameters of the *Beck* test and the interrelationship of that test with the Department's regulations. As of the time this article was written, the Court had not yet acted on the Applications for Reconsideration.

Contractors and other taxpayers will need to carefully evaluate their tax compliance procedures in light of this decision. For advice concerning the tax implications of the Supreme Court's decision on contracts for the sale and installation of items affixed to real property, please contact Sharon Paxton or another member of the McNees State and Local Tax group. ■

## PA TAX NOTES *by Timothy J. Horstmann*

**Interest on Real Estate Tax Overpayments**

The Commonwealth Court has held that the provisions of the Local Taxpayer Bill of Rights apply to refunds of real estate taxes, requiring that interest be calculated from the date the overpayment was made. The court overturned prior precedent which had held that interest was only due from the date of the court's decision. *Appeal of Timothy and Laurie Sullivan*, No. 2190 C.D. 2010, ___ A.3d ___ (Pa. Commw. Ct. January 11, 2012).

**Real Estate Credits Not Required**

In an unreported opinion, the Commonwealth Court has affirmed the decision of the Allegheny County Court of Common Pleas dismissing a class action complaint filed by Allegheny County taxpayers. The taxpayers, invoking the Supreme Court's decision in *Clifton*, in which the county's base year system of assessment was declared unconstitutional as applied, sought a grant of tax credits as a result of alleged overpayments of tax. The Commonwealth Court held that the prospective remedy of a county-wide reassessment ordered in *Clifton* was all that was required. *White v. Allegheny County*, No. 257 C.D. 2011 (Pa. Commw. Ct. December 8, 2011) (unreported).

**Expedia Not Subject to Philadelphia Hotel Occupancy Tax**

The Commonwealth Court, in a 5-2 decision, has affirmed the decision of the Philadelphia Court of Common Pleas, which held that Expedia was not subject to the Philadelphia Hotel Occupancy Tax, because it is not a "hotel operator." Expedia, an online vendor of discount hotel rooms, accepted reservations for Philadelphia hotels in exchange for various fees charged to its customers. The City sought to collect its Hotel Occupancy Tax on the fees that Expedia collected, on the ground that Expedia was a "hotel operator." However, under the Philadelphia Code, a "hotel operator" was defined to mean only those who "maintain, operate, manage, own, have custody of, or otherwise possess the right to rent or lease overnight accommodations in any hotel." The Commonwealth Court agreed with the trial court's finding that Expedia did not meet this definition, as it merely acted as a middleman between the hotel and the guest, and the hotel reserved all rights with respect to the actual renting of hotel rooms. *City of Philadelphia v. Tax Review Bd.*, No. 216 C.D. 2011, ___ A.3d ___, (Pa. Commw. Ct. February 2, 2012). ■

Timothy J. Horstmann practices in the State and Local Tax and Business Counseling practice groups.
*thorstmann@mwn.com / 717.237.5462*

## GOVERNOR'S BUDGET PROPOSAL *continued from page 1*

mandates. The State System of Higher Education's 14 universities would receive 20% less than in the current year while Penn State, Pitt and Temple would be cut by 30%. The Governor's Office seems to be maintaining that K-12 education would be level-funded, but the House Democratic Appropriations Committee asserts that actual funding would be decreased by more than $100 million.

Although some reduced appropriations to schools and local governments would be collapsed into block grants to give added flexibility, there very likely would be pressure to increase taxes at the local level to compensate for some state cuts. It seems obvious that the General Assembly will be pressured from many fronts to find additional revenues so that program cuts can be avoided and so that less pressure will be placed on school districts and local governments.

**Tax Administration**

The Department of Revenue would not escape budget cuts. The Department's general operations appropriation would be cut by 6%. The use of certified mail in mailing assessments would be eliminated for a cost savings of $750,000. The threshold for payment by electronic funds transfer would be reduced from $20,000 to $10,000 to speed cash flow and reduce costs by $100,000.

To enhance collections notwithstanding cuts in Department funding, the Department of Revenue would be given additional enforcement tools, including authority to attach bank accounts of delinquent businesses, increased penalties for failure to file pass-through entity information returns, and withholding at the source for certain non-wage income. The enhanced enforcement tools would be expected to yield additional revenues of $21.6 million. The Department of Revenue's "Enhanced Revenue Collection Account" augmentation would be increased from $4.3 million to $10 million, and extended through FY 2016-17. This expenditure would be expected to yield collections of $100 million in FY 2012-13.

The Board of Finance and Revenue's budget would be cut by 5%.

The State Tax Equalization Board, which monitors real estate tax uniformity, would be eliminated and its functions absorbed by the Department of Community and Economic Development.

While the Governor mentioned transportation funding needs in his budget message, he left specific proposals to be dealt with another day.

If your company requires assistance in determining how you will be impacted by the FY 2012-13 budget process, please contact any of the following members of our SALT group.

Jim Fritz, Chair
717-237-5365
jfritz@mwn.com

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

Sharon Paxton, Vice-chair
717-237-5393
spaxton@mwn.com

Tim Horstmann
717-237-5462
thorstmann@mwn.com

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

**McNees State and Local Tax group**

James L. Fritz, Chair
717.237.5365 / jfritz@mwn.com

Bert M. Goodman
610.240.0345 / bgoodman@mwn.com

Randy L. Varner
717.237.5464 / rvarner@mwn.com

Sharon R. Paxton, Vice-Chair
717.237.5393 / spaxton@mwn.com

Timothy J. Horstmann
717.237.5462 / thorstmann@mwn.com

Catherine E. Wright, Paralegal
717.237.5294 / cwright@mwn.com

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