

Pennsylvania Tax Update

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THE TAX UPDATE IS A
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OF REVENUE

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FAST FACT:

Reducing the Capital Stock and Franchise Tax by one mill for tax year 2005 is a \$145 million tax break for businesses.

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www.revenue.state.pa.us

PENNSYLVANIA'S 2005-06 BUDGET

No New Taxes, Continuing Business Tax Phase-Out, Protecting the Most Vulnerable Citizens



Governor Rendell plans to continue to push for the business tax reform changes that did not make this year's budget.

Governor Edward G. Rendell recently signed the fiscal year 2005-06 state budget. The \$24.3 billion budget contains no new taxes and continues to protect Pennsylvania's most vulnerable citizens. Governor Rendell was challenged with maintaining a delicate balance between continuing health and social services in light of massive federal cuts to states, cutting state government's operating costs and continuing to reform and adequately fund public education.

"It's a budget we can be proud of," said Governor Rendell. "We preserved services without tax increases and established programs that invest in and strengthen the commonwealth's future."

Many factors were crucial to balancing this budget. The robust economy, the success of the job stimulus package, the record number of Pennsylvanians working, the low unemployment rate, better than projected state revenues and a smarter, leaner state government all contributed.

Other highlights of the 2005-06 budget include:

- Continuing and preserving health care and social services for the most vulnerable citizens, despite \$377 million cut-backs in federal fiscal relief funds;
- Securing and improving Pennsylvania's economic future through the passage of the Job Ready Pennsylvania package and approval of \$91 million in new state funds;
- Making historic progress in advancing early childhood education, high school reform and community college funding,

giving Pennsylvania children the competitive advantage they need through the public education they deserve;

- Aggressively addressing the state's most pressing environmental problems while simultaneously helping Pennsylvania win the race for new development and job creation through passage of the Growing Greener II initiative;
- Increasing enrollment in state-funded health insurance programs such as AdultBasic and the Children's Health Insurance Program (CHIP);
- Continuing business tax cuts by reducing the **Capital Stock and Franchise Tax**; and
- Depositing \$64 million in the state's Rainy Day Fund.

Despite the budget challenges, Governor Rendell maintained the phase-out of the Capital Stock and Franchise Tax (CSFT) in the 2005-06 budget, as recommended by his **Business Tax Reform Commission**. The 2005 tax rate is 5.99 mills and will drop to 4.99 mills in 2006. The CSFT on business assets will be eliminated Dec. 31, 2010.

Governor Rendell has promised to continue to push for the other changes to the business tax structure that did not make this year's budget, including:

- Reducing the Corporate Net Income (CNI) Tax rate from 9.99 percent, the third highest in the nation, to 7.9 percent.

PENNSYLVANIA'S 2005-06 BUDGET - Continued from page 1

- Closing CNI Tax loopholes that allow companies to shift money earned in Pennsylvania to other jurisdictions with lower or no taxes.
- Increasing the weight of the sales factor used to calculate the CNI Tax from 60 percent to 100 percent to encourage employers, especially manufacturers, to locate or expand in Pennsylvania.
- Uncapping Net Operating Loss deductions under combined reporting to encourage growth in biotechnology, start-up companies and cyclical manufacturing companies.
- Reforming the tax appeal process to provide for review by an independent panel before going to court.

At a recent meeting with the Harrisburg Regional Chamber of Commerce, Governor Rendell called the current business tax system "unconscionable" because most businesses do not pay the CNI Tax, largely because of tax loopholes. According to the Department of Revenue, 73 percent of businesses subject to the Corporate Net Income Tax reported zero liability in 2001. Under combined reporting, the Department estimates that legitimately about 45 percent of businesses will have zero liability, similar to what is reported at the federal level. By closing corporate tax loopholes, Pennsylvania can afford to lower business taxes and create a fairer business tax climate.

To view report,
please click here.

2005 STATE TAX SUMMARY
(Act 40 of 2005)

JOB READY PENNSYLVANIA UNPRECEDENTED INVESTMENT IN WORKFORCE

Included in the recently passed 2005-06 budget was Governor Rendell's Job Ready Pennsylvania package - an unprecedented investment in Pennsylvania's workforce. The \$91 million in new state funds will leverage \$2 billion in the commonwealth's workforce and education systems to ensure that workers have the skills needed to compete in the global economy. It will also increase options for students to receive post-secondary education and boost the skills of high school graduates.

Pennsylvania's economy set a new record in May with 6.045 million Pennsylvanians reporting that they are working—208,000 more Pennsylvanians are at work today than in January 2003. As businesses expand their payrolls, the unemployment rate has fallen to 4.8 percent in May 2005—the lowest in nearly four years.

"In order to keep the economy growing, Pennsylvania employers need to be able to find skilled workers to continue to expand their businesses and keep our unemployment rates low," said Governor Rendell. "Pennsylvania workers and young people just entering the workforce need more education and training than ever before."

Job Ready Pennsylvania will align local workforce spending with high priority industries and occupations, thus tying all education and training funding to employer needs.

Programs included in Job Ready Pennsylvania will:

- Address shortages in key occupations. (For example, it will invest in nursing by funding programs to train more nurse educators.)
- Build a competitive edge in cutting-edge fields like life sciences and advanced manufacturing by redirecting \$3 million for Keystone Innovation Starter Kits to recruit top faculty researchers to the state's colleges and universities. These funds will be matched dollar-for-dollar by the state's higher education institutions and will help build labs, buy equipment and hire top-notch researchers.
- Assist adult workers who are trying to upgrade their credentials while holding down a full time job. Currently, adults who are taking only one or two college courses at a time are not eligible for state higher education grants. The PHEAA Foundation will create a new \$10 million program that allows 10,000 less-than-half-time students to receive grants to continue in higher education in high-priority fields.
- Increase investment in student grants. In addition to new funds from the PHEAA Foundation, the commonwealth will increase its Grants to Students Program by \$9 million.
- Increase by \$22.8 million funding for community colleges as a vital part of the commonwealth's education and workforce development systems. The increase is the

JOB READY PENNSYLVANIA UNPRECEDENTED INVESTMENT IN WORKFORCE - *Continued from page 2*

largest in 15 years, and the resources will be targeted to align with the state's workforce needs.

- Help school districts establish a meaningful curriculum, improve college advising, create stronger learning environments, and give students more opportunities to gain college credit and workforce training through Project 720 – named for the number of days a student spends in high school from the beginning of 9th grade through the end of 12th grade. Job Ready Pennsylvania includes \$4.7 million

to double the number of districts participating in Project 720 from 41 to 80.

- Invest \$5 million to help thousands of students make the connection between high school and post-secondary education through dual enrollment programs. These programs allow students to earn high school and college credit at the same time by taking courses either at their school or on a college campus. Especially for at-risk students, dual enrollment presents a unique opportunity to get started on earning a college degree.

BUSINESS PAPERLESS PLAN PHASE II – EMPLOYER WITHHOLDING

Based on the tremendous success of electronic filing for Sales and Use Tax returns, the PA Department of Revenue is now making preparations to eliminate the coupon system for filing **Employer Withholding Tax** returns in 2006.

The Department will be contacting employers later this year with more information. However, there is no reason to wait until 2006. All employers are currently able to file and pay Employer Withholding Taxes by using the Internet based e-TIDES system at www.etides.state.pa.us, or by calling the Department's Business Tax TeleFile system at 1-800-748-8299. Third-party computer software will be available in 2006. A list of vendors will be posted on the Department's Web site at www.revenue.state.pa.us once they are approved.

Some of the advantages to filing electronically include:

- Elimination of preparation and processing errors.
- Immediate acknowledgement of receipt of returns and payments.
- Access to an online account history.
- Increased security.
- Ability to file early and set up a payment for the due date.

More than 78,200 businesses, or about 23 percent of the total required to file Employer Withholding Tax returns, are already registered with the e-TIDES Internet filing system.

While ACH debit, an available method of Electronic Funds Transfer (EFT), ACH credit and credit cards are accepted; taxpayers will continue to have the option of making their payments by check. EFT is mandatory for payments over \$20,000 and voluntary for payments under \$20,000.

The following is what you will need to use TeleFile for Employer Withholding:

- Your 8-digit Employer Account Identification Number.
- Your 9-digit Entity Identification Number, which is either, your Federal Employer Identification Number, your Social Security Number or a temporary number assigned by the Department. To verify your Entity Identification Number, contact the e-Business Center at (717) 783-6277.
- The ending date of the period for which you are reporting.
- The amount of Personal Income Tax withheld for each period, whether quarterly, monthly or semimonthly. (You should report the amount actually withheld, not the amount remitted.)
- The total amount of compensation subject to PA withholding tax for the reporting quarter.
- The total amount of PA withholding tax required to be withheld (or actually withheld, if higher) for the reporting quarter.
- The amount of withholding tax paid to the PA Department of Revenue for the reporting quarter.
- To make a payment using ACH Debit, you will need your banking information: bank routing number, account number and account type (checking or savings).

If you have any questions about electronic filing, visit the Online Customer Service Center at www.revenue.state.pa.us or call the Department's e-Business Services unit at (717) 783-6277 between the hours of 8 a.m. and 5 p.m., Monday through Friday.

FISCAL YEAR 2004-05 REVENUE COLLECTIONS

\$439.8 Million Revenue Surplus

Fiscal year 2004-05 General Fund collections for the Commonwealth of Pennsylvania totaled \$24.3 billion, which was \$439.8 million or 1.8 percent above estimate.

Sales Tax collections for the fiscal year totaled \$8 billion, \$48.7 million above estimate or 0.6 percent more than anticipated.

Fiscal year Personal Income Tax (PIT) collections were \$8.7 billion, \$225.3 million or 2.6 percent above estimate.

Fiscal year Corporation Tax collections totaled \$4.8 billion, \$58.4 million or 1.2 percent above estimate.

Inheritance Tax collections for the fiscal year totaled \$716.1 million, \$48.2 million below estimate.

Realty Transfer Tax was \$472.5 million for the fiscal year, which was \$81.6 million more than anticipated.

Other General Fund revenue including the Cigarette, Malt Beverage and Liquor Tax totaled \$1.6 billion for the fiscal year, which was \$73.9 million above estimate.

Fiscal year collections for the Motor License Fund totaled \$2.2 billion, \$54.8 million or 2.6 percent above estimate.



REVENUE DEPARTMENT ACCEPTS NATIONAL AWARD FOR COMBINED REPORTING ESTIMATE

On behalf of the Pennsylvania Department of Revenue, Secretary Gregory C. Fajt accepted the Federation of Tax Administrators (FTA) Award for Outstanding Research and Analysis in State Tax Administration.

The Department of Revenue's Bureau of Research was recognized for its work in analyzing the effects of combined reporting on state tax revenues. The analysis was done to support the Pennsylvania Business Tax Reform Commission, which examined business taxation and sought ways to improve the business climate and fairness. As a result of the Department's analysis, the Commis-



Secretary Fajt receives award from FTA President, Mary Jane Egr-Edson.

sion recommended that the state adopt mandatory unitary combined reporting as a means of broadening the corporate tax base and lowering the tax rate.

An independent panel judged all entries. Judges noted that the analysis would be very useful to other states that may be looking to move to combined reporting.

The Federation of Tax Administrators is a nonprofit organization composed of the tax and revenue departments of the 50 states, the District of Columbia and New York City. Its mission is to improve the standards and methods of tax administration.

USE TAX COMPLIANCE PROGRAM

A rapidly changing global economy presents new challenges to the Department of Revenue in its responsibility to administer and collect state taxes. In addition to ensuring the equitable treatment of taxpayers, the Department must expand its traditional collection methods and employ different approaches to improve voluntary tax compliance.

The Department of Revenue will begin a focused, proactive campaign to increase business taxpayers' awareness of reporting and paying **PA Use Tax**. The goal of the Department's Use Tax campaign is to stimulate voluntary compliance.

Use Tax is the companion tax to Sales Tax, and is owed when Sales Tax has not been charged on a taxable purchase or service. Many business owners are not aware that Use Tax may be due when purchases are made from an out-of-state business

not registered to collect and remit Pennsylvania Sales Tax. As Pennsylvania customers increasingly purchase items from out-of-state businesses, either over the Internet or through other mail order operations, the Department must ensure that the appropriate taxes are collected.

Without Use Tax compliance, Pennsylvania-based businesses face a competitive disadvantage to out of-state businesses. If businesses that do not charge Sales Tax can cheaply deliver goods, they will be selected by Pennsylvania businesses that mistakenly believe they have saved on the bottom-line price of their purchase. In the following example, a Pennsylvania customer may view his/her purchase from Baltimore-based ABC Office Direct as having saved his/her company \$500.

Example: Price Quotes for New Office Furniture

QTY	Description	Unit Price	ABC Office Direct	XYZ Office Products
			Baltimore, MD	Allentown, PA
1	Executive Desk Set	\$ 1,800	\$ 1,800	\$ 1,800
6	L-Shaped Desk Sets	\$ 850	\$ 5,100	\$ 5,100
1	Leather Chair	\$ 650	\$ 650	\$ 650
2	Hideaway Chairs	\$ 200	\$ 400	\$ 400
6	Desk Chairs	\$ 300	\$ 1,800	\$ 1,800
	Freight		\$ 350	\$ 250
	Sales and Use Tax		\$ 0	\$ 600
	Total		\$10,100	\$10,600

If Use Tax were added to the purchases made in Baltimore, the Pennsylvania vendor would have had the less expensive price – and made the sale.

The Department's Use Tax Compliance Program will have two phases, an education and outreach phase and an enforcement phase. The Department plans to educate taxpayers to encourage voluntary compliance. As part of the initial education phase, the Department will invite various professional and business associations to meet and discuss the Use Tax compliance program plans. The Department will solicit input from these associations on how to best communicate the voluntary compliance message to their business members. During this phase,

the Department will also send information packets to businesses, explaining the Use Tax and steps to be taken by taxpayers to assure their compliance.

At the conclusion of the education and outreach programs, the Department will move to an enforcement phase. The Department will mail self-audit Use Tax returns to taxpayers, permitting them to self-report and pay their Use Tax obligations. Finally, the Department will conduct a series of limited, focused examinations and field audits.

Additional information on Pennsylvania **Use Tax** can be found on the Department's Web site at www.revenue.state.pa.us.

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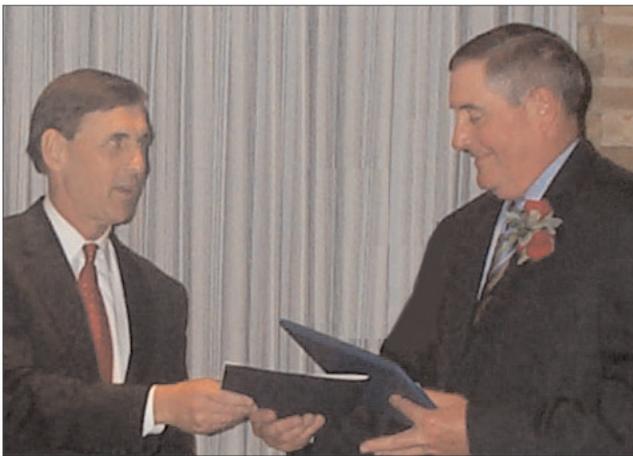
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USE TAX COMPLIANCE PROGRAM - Continued from page 5

Businesses that have a Pennsylvania Sales Tax License should report and remit Use Tax along with their Sales Tax returns. The **PA-1 Use Tax Return** may be printed and used by taxpayers who do not have a Sales Tax License.

Taxpayers who wish to voluntarily disclose and pay delinquent Use Tax may do so by contacting the Voluntary Disclosure Program Office at (717) 787-9832. Additional information can be found in the **Voluntary Disclosure Program - Guidelines and Participation Parameters brochure**.

HAPPY RETIREMENT . . . JOE BREEN



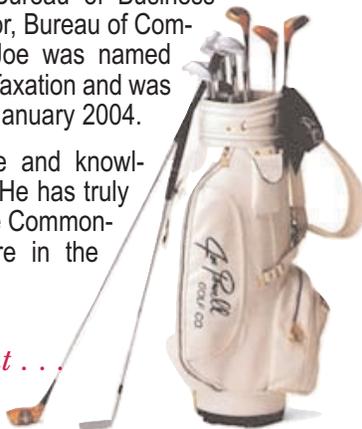
Revenue Secretary Greg Fajt presents Joe Breen with awards at his retirement dinner June 9, 2005.

Deputy Secretary for Taxation Joe Breen has retired after more than 31 years with the PA Department of Revenue. Mr. Breen began his long, distinguished career with the state in 1974 with the Department of Revenue's Bureau of County Collections. While there, he held the positions of Field Investigator, Special Investigator then Assistant Chief of Inheritance Tax.

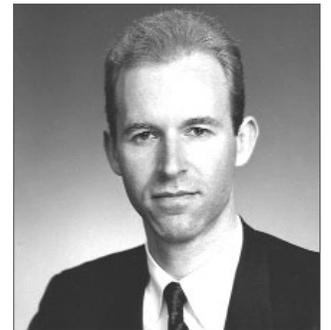
During his tenure with the Department, he held the positions of Assistant to the Director and Director, Bureau of Central Records; Director, Bureau of Accounts Settlement; Assistant to the Director and Director, Bureau of Business Trust Fund Taxes and Director, Bureau of Compliance. In October 2000, Joe was named Acting Deputy Secretary for Taxation and was named Deputy Secretary in January 2004.

Mr. Breen's vast experience and knowledge will be greatly missed. He has truly been a "worthy servant of the Commonwealth" and particularly here in the Department of Revenue.

*Best of luck Joe,
and enjoy your retirement . . .
you deserve it.*



ROBERT FREEDENBERG APPOINTED DEPUTY SECRETARY FOR TAXATION, PENNSYLVANIA DEPARTMENT OF REVENUE



Secretary of Revenue Gregory C. Fajt announced the appointment of Robert Freedenberg as Deputy Secretary for Taxation, effective Sept. 1.

Freedenberg, a resident of Camp Hill, is a partner at BarleySnyder LLC, a law firm with offices in Berwyn, Chambersburg, Hanover, Harrisburg, Lancaster, Reading and York. He will replace Joe Breen, who recently retired after working for the Revenue Department for over 31 years.

Freedenberg is chair of BarleySnyder's Tax Law Group, where he provides counsel to clients on federal, state and local tax planning and tax appeal matters. Before joining the firm, he worked for the Internal Revenue Service in both its Examination and Appeals Divisions, as well as for a Fortune 500 international manufacturer in its tax department. He has litigated tax appeals before administrative agencies and courts in Pennsylvania, North Carolina and Indiana.

Fajt said Freedenberg's appointment is part of an ongoing effort to enhance professionalism and expertise within the Revenue Department. "Rob is in every sense a tax professional," Fajt said. "He will bring a wealth of experience and knowledge to his new position."

Freedenberg earned his law degree at Temple University School of Law and an LL.M. in Taxation from Villanova University School of Law. He earned a B.B.A in Accounting from Temple University, and has passed the Certified Public Accountants' exam.

Freedenberg serves on the Tax Committee of the Pennsylvania Chamber of Business and Industry, the Tax Subcommittee of the Harrisburg Regional Chamber of Commerce and is vice chair of the Tax Law Section of the Pennsylvania Bar Association.

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2005 FALL TAX SEMINARS SCHEDULE

SPONSOR	DAY	DATE	CONTACT	SEMINAR LOCATION
CPE Forum of Central PA 1321 11th Ave., Suite 1 P.O. Box 2210 Altoona, PA 16603	Thursday	09-22-2005	Kelly Park (814) 941-2486	The Casino 300 Lakemont Park Blvd. Altoona, PA 16602
Duquesne University School of Bus. and Admin. 701 Rockwell Hall Pittsburgh, PA 15282	Tuesday	10-04-2005	Elaine Franks (412) 396-1642	Duquesne Union Hall Duquesne University Campus Pittsburgh, PA 15282
Alvernia College 400 Saint Bernardine Street Reading, PA 19603	Tuesday	10-11-2005	Alan D. Ross, CPA (610) 372-9911	Alvernia College Student Center 400 Saint Bernardine Street Reading, PA 19603
PA Department of Revenue <i>(Limited to Government Employees)</i>	Monday	10-17-2005	Richard Santo (717) 787-8346	The State Museum of PA Auditorium Third and North Streets Harrisburg, PA 17120
Harrisburg Area Community College One HACC Drive Harrisburg, PA 17110	Thursday	11- 03-2005	Non-Credit Registration (717) 780-2414	Rose Lehrman Arts Center Harrisburg Area Community College One HACC Drive Harrisburg, PA 17110
Wilkes University Continuing Education Dept. 215 South Franklin Street Wilkes-Barre, PA 18766	Thursday	11-10-2005	Margaret Steele (570) 408-4462	The Woodlands Inn and Resort Highway 315 Wilkes-Barre, PA 18766
Neumann College Continuing Education Dept. 1 Neumann Drive Aston, PA 19014	Thursday	11-17-2005	Lois Ritacco (610) 558-5629	Neumann College Life Conference Center Aston, PA 19014
Penn State University Ogontz Campus 1600 Wood Land Road Abington, PA 19001	Thursday	12-15-2005	Theresa Bloom (215) 881-7402	Holiday Inn, Select 4700 Street Road Trevos, PA 19053

2005 FALL TAX SEMINAR AGENDA

See page 7 for Seminar Schedule Dates

TIME	TOPIC	PRESENTER
8:30 - 9:30 AM	PERSONAL INCOME TAX UPDATES <ul style="list-style-type: none"> > Schedule G Changes > PA Legislative Changes > Federal Tax Law Changes Applicability to PA > PA Forms Changes and New PA Forms 	<i>David Braden, CPA</i>
9:30 - 10:15 AM	PASS THROUGH BUSINESS <ul style="list-style-type: none"> > Trusts > Common Errors Found on Pass-Through Returns 	<i>Regis Egan</i>
<i>10:15 - 10:30 AM</i>	<i>Break</i>	
10:30 - 11:00 AM	USE TAX VOLUNTARY COMPLIANCE PROGRAM	<i>Kevin Milligan</i>
11:00 - 11:45 AM	SALES AND USE TAX – “BE A SALES TAX SURVIVOR” <ul style="list-style-type: none"> > Sales Bulletins and Letter Rulings Topics Issues in Litigation 	<i>Attorneys Marianne Rempe, Jeffery Snively, Dean Picarella</i>
11:45 - NOON	QUESTIONS AND ANSWERS	
<i>Noon - 1:00 PM</i>	<i>Lunch</i>	
1:00 - 2:00 PM	CORPORATION TAXES UPDATES <ul style="list-style-type: none"> > Limited Liability Companies > Bonus Depreciation > Qualified Sub Chapter S Subsidiaries > Legislative Updates 	<i>Jeffrey A. Creveling, Joseph Clover, Cathy Benson</i>
2:00 - 3:00 PM	INHERITANCE TAX AND ESTATE TAX UPDATE <ul style="list-style-type: none"> > Updates in the Law > Electronic Initiatives > Inheritance Tax Refresher 	<i>Shawn E. Young Holly McClintock</i>
<i>3:00- 3:15 PM</i>	<i>Break</i>	
3:15 - 4:15 PM	UNEMPLOYMENT COMPENSATION TAX UPDATES (LABOR AND INDUSTRY)	<i>Timothy McGarvey, Jim Diffendal, Paul Bowes</i>
4:15 - 4:30 PM	QUESTIONS AND ANSWERS	

In compliance with the Americans with Disabilities Act, the Department will make every effort to provide an alternative format for persons with disabilities .