

**2005 STATE TAX SUMMARY**  
**ACT NO. 40 of 2005**  
**HOUSE BILL 176, PN 2565**  
(Signed July 7, 2005)

Revenue Legislative Office

July 20, 2005

**Personal Income Tax**

➤ **Definition of Compensation**

Compensation now includes distributions from nonqualified deferred compensation plans attributable to an elective deferral of income, regardless of whether the distribution is paid during employment or retirement.

With certain exceptions, Pennsylvania's constructive receipt rules are now the same as the federal constructive receipt rules to determine when compensation is received by a cash basis taxpayer. This change applies to appeals which arise prior to or after the effective date of this act and applies to taxable years beginning after December 31, 2004.

Following the federal constructive receipt rule, deferrals to nonqualified deferred compensation plans are not includible in compensation. This change applies to appeals which arise prior to or after the effective date of this act and applies to taxable years beginning after December 31, 2002.

The exception include contributions to retirement plans like the public employee retirement system, contributions to 401(k) plans, contributions by self employed persons to retirement plans, and contributions to Roth IRAs and regular IRAs.

➤ **Interest Income**

The taxability of an exchange of life insurance annuity contracts will follow the requirements of Section 1035 of the Internal Revenue Code. Under these rules, if there is no cash involved, the exchange will be tax-free. If the exchange involves cash, the amount of cash received will be taxable as interest income. This shall apply to taxable years beginning after December 31, 2004.

➤ **Check-offs for Personal Income Tax Refunds**

Taxpayers who receive personal income tax refunds will be able to make contributions for military family relief assistance through a check-off on the personal income tax return. This shall apply to taxable years beginning after December 31, 2004.

The check-off for the US Olympics Committee has been eliminated for taxable years beginning after December 31, 2004.

Sunset dates have been established for the remaining check-offs. In general check-offs expire at the end of the fourth year after becoming effective. Existing check-offs terminate as follows:

Korea/Vietnam War Memorial:	December 31, 2005*
Breast and Cervical Cancer Research:	January 1, 2008
Wild Resource Conservation:	January 1, 2008
Organ and Tissue Donation Awareness:	January 1, 2008

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\* Since the section of the Tax Reform Code which provides for the Korea/Vietnam War Memorial expires as of December 31, 2005, this check-off is not required to be on the 2005 personal income tax return due April 15, 2006.

Juvenile Diabetes: December 31, 2008  
Military Family Relief Assistance: December 31, 2008

➤ **Estimated Payments**

Fiduciaries may follow federal rules in determining the amount of quarterly estimated payments due. This shall apply to payments made after June 30, 2006.

➤ **Information Returns**

The fine for furnishing a false or fraudulent information return (K-1) to a partner has been increased to \$250 from \$50, effectively immediately.

**Corporate Net Income Tax and Capital Stock and Franchise Tax**

➤ **Definition of Corporation**

The definition of corporation has been amended to exclude a non-profit nonstock commodity or nonprofit nonstock stock exchange. This applies retroactively to taxable years beginning after December 31, 1997.

**Realty Transfer Tax**

The Department is authorized to collect delinquent local realty transfer tax, if so requested by the local taxing authority. For these purposes, the local realty transfer tax law was amended to make it more consistent with the state realty transfer tax law. The three year period for making an assessment is extended to six years if the underpayment of the amount of tax is 25% or more. If any part of the underpayment is due to fraud or an undisclosed, intentional disregard for the rules and regulations, the full amount of the tax can be assessed at any time. This will apply to any document made, executed, delivered, accepted or presented for recording 90 days after the effective date of this act.

**Tax Credits**

➤ **Research and Development Tax Credit**

The following technical changes have been made to the Research and Development tax credit:

- The definition of pass-thru entity now includes limited liability companies and partnerships.
- The credit against Article III cannot be used against employer withholding tax.
- Procedures are established for the pass-thru of the credit to shareholders, members or partners of pass-thru entities including the written notification to the Department of the pass-thru of the credit.
- The shareholder, member or partner must use the credit in the taxable year in which the transfer is made.

These changes apply to taxable years beginning after December 31, 2005.

➤ **Film Tax Credit**

The Department of Community and Economic Development (DCED) will now administer the awarding of the credits on a “first come, first served” basis using the date on which principal photography in Pennsylvania starts. DCED will certify the amount of the credit to Revenue. Only \$10 million of credits may be awarded in any fiscal year .

Credit applications are based on budgeted expenses rather than actual expenses. Filmmakers who are awarded credits and fail to incur the agreed to amount of qualified film production

expenses upon which the credits are based must refund any unearned credit claimed. These provisions apply to any film production expenses incurred after December 31, 2004.

For the fiscal year 2005-2006, the amount of credits that can be awarded by DCED is equal to the difference between \$10 million and the amount of credits awarded by the Department on August 15, 2005.

### **Sales and Use Tax**

If a vehicle dealer makes a taxable use of a motor vehicle from its inventory, the dealer must pay use tax equal to 6% of the fair rental value of the motor vehicle during the period of use. Previously, this provision only applied for one year from the day the vehicle was acquired by the dealer. Also eliminated was a requirement that the dealer notify the Department of the election to pay tax on the fair rental value within 10 days of the commencement of use. This takes effect in 60 days.

### **Miscellaneous Provisions**

The Department is authorized to impose an additional fee of 10% of the face amount up to \$1,000 for any electronic funds transfer denied or not credited upon transmission. This is the same fee that is applied to bad checks. This takes effect immediately.

The Department is authorized to electronically file liens with county courts, when requested to do so by the county court. The filing fee may also be made electronically. This takes effect immediately.

The Department is authorized to add the cost of collection to delinquent tax liabilities. This is intended to provide the Department the ability to recoup the cost of retaining private agencies for the collection of delinquent taxes so that the Commonwealth will receive 100% of the delinquent tax liability and not the amount of the delinquent tax liability reduced by the cost of collections. This treats the Commonwealth the same manner as other creditors. This takes effect immediately.

### **Other Relevant Legislation**

#### **Act 48 of 2005, House Bill 107, PN 2567 (Health Savings Account Act)**

This act provides special tax provisions for health savings accounts. Excluded from Pennsylvania personal income tax is any income from a health savings account, as well as any amount paid out or distributed from a health savings account that is used exclusively for the qualified medical expenses of the beneficiary or for the reimbursement of those expenses. The act specifies that distributions paid out that do not go toward the qualified medical expenses of the beneficiary, as well as any excess contributions, shall be taxable. These provisions apply to tax years beginning after December 31, 2004 and the act takes effect on September 12, 2005.

#### **Act 46 of 2005, House Bill 628, PN 2564 (Public School Code)**

This act increases the total aggregate amount of Educational Improvement Tax Credits available for a fiscal year to \$44 million from \$40 million. Approximately three quarters of the aggregate credit is allocated to businesses that make contributions to scholarship organizations and the remainder to firms that contribute to educational improvement organizations. This increase takes effect immediately.