

THE TAX UPDATE IS A
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EDWARD G. RENDELL
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FAST FACT:

Governor Rendell's 2006-07 budget cuts business taxes by an additional \$221 million. When added to the business tax cuts enacted during the past three years, business tax cuts under the Rendell Administration will total nearly \$1 billion.

GOVERNOR RENDELL'S PROPOSED 2006-07 BUDGET CUTS BUSINESS TAXES FOR FOURTH STRAIGHT YEAR

FY 2006-07 Budget Would Reduce Business Taxes By More Than \$221 Million



Revenue Secretary Gregory Fajt outlines Governor Rendell's business tax cut proposals during a press conference after the budget address on Feb. 8.
(Photo Credit: Commonwealth Media Services)

Business taxes have gone down every year under the direction of Gov. Edward G. Rendell, and would be cut by an additional \$221 million under the Governor's proposed 2006-07 budget.

Revenue Secretary Gregory C. Fajt told the House Appropriations Committee on Feb. 21 that Gov. Rendell's latest business tax cuts reflect the Governor's ongoing commitment to creating jobs and making Pennsylvania's business tax structure more competitive with other states.

"I am pleased to report that – for the fourth straight year – Governor Rendell has proposed a significant business tax cut," Fajt testified. "Under the Governor's 2006-07 budget proposal, business taxes will be cut by an additional \$221.3 million.

"When added to the business tax cuts enacted during the past three years, business tax cuts under the Rendell Administration will total nearly \$1 billion."

Under Gov. Rendell's 2006-07 budget proposal, businesses will save \$185.7 million due to the continuing phase out of the Capital Stock and Franchise Tax, \$18.3 million due to an additional reduction in the Capital Stock and Franchise Tax of one tenth of a mill, \$10 million through an increase in the Research

and Development Tax Credit from \$30 million to \$40 million, and \$7.3 million due to an increase in the Net Operating Loss deduction cap from \$2 million to \$3 million.

Fajt said the Governor's business tax cuts and his other job creation initiatives have sparked a turnaround in the state's economy.

"Pennsylvania's lower business taxes, along with a \$2 billion economic stimulus program enacted with bipartisan support in the General Assembly, are jump-starting Pennsylvania's economy," Fajt said. "In 2002, we ranked 41st out of 50 states in employment growth. Today we are 15th. And, most important of all, more than 102,000 new jobs have been created in Pennsylvania since January 2003."

Fajt urged committee members to support Gov. Rendell's comprehensive business tax reform package.

"Cutting business taxes is important, but so is making Pennsylvania's business tax system fairer and more competitive," Fajt testified. "If enacted, the Governor's business tax reform proposal would lower the Corporate Net Income (CNI) tax from 9.99 percent to 7.90 percent, uncap Net Operating Loss deductions and implement a single sales factor for CNI tax apportionment. The proposal would also close business tax loopholes that allow 73 percent of all businesses subject to the CNI tax to pay no CNI taxes, and 95 percent to pay \$10,000 or less.

"Pennsylvania's corporate tax system is broken. I hope you will join us in our ongoing effort to fix it."

Learn more about Governor Rendell's 2006-07 budget:



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NATIONAL TAX GROUP LAUDS HIGHLY COMPETITIVE PA BUSINESS CLIMATE

A new, independent report by a bipartisan tax education organization shows that Pennsylvania's business climate is one of the best and most business friendly among mid-Atlantic and New England states.

"In the past three years, we have made investments that are supporting business growth and job creation all across the Commonwealth," Governor Rendell said. "This investment in our communities, our business and our people, combined with significant reductions in business taxes and a \$2.3 billion economic stimulus package, has energized our economy."

"Over those three years, I have worked to cut business taxes and maintain Pennsylvania's strong competitive position among states and in global markets," the Governor said. "My proposed budget for 2006-07 includes more than \$221 million in new business tax reductions for a cumulative total of nearly \$1 billion."

"It is this type of bold action that has pushed Pennsylvania up the ladder to 15th nationally in employment growth, up from 41st in 2002. That's tremendous progress, a testament to our workforce and our businesses, and proof that our policies are reaping dividends for all Pennsylvanians," the Governor added.

The 69-year-old Tax Foundation in Washington, D.C., released a report on Feb. 27 lauding the Commonwealth's overall tax environment for business – ranking it 16th among the 50 states with a more business-friendly tax code, and far ahead, and more competitive, than neighbors such as Maryland, Ohio, New Jersey and New York.

While Pennsylvania continues to experience strong job growth and low unemployment, the Tax Foundation in Washington, D.C., reported that the business-tax climate in Pennsylvania is among the most competitive in the 10 northeastern states.

According to the Tax Foundation, Pennsylvania outranks all of the mid-Atlantic and New England states, except New Hampshire and Delaware, with a better business climate.

The 10 most favorable states are: Wyoming, South Dakota, Alaska, Florida, Nevada, New Hampshire, Texas, Delaware, Montana and Oregon. The 10 worst are: Arkansas, Iowa, Nebraska, Kentucky, Maine, Vermont, Ohio, Rhode Island, New Jersey and New York.

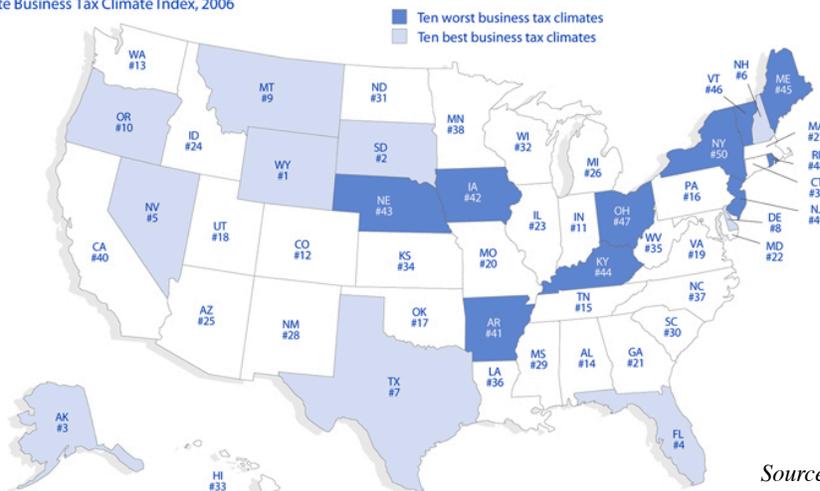
As compared to neighboring states, Pennsylvania has the second best climate, next to Delaware. Pennsylvania's neighboring states ranked: Delaware (8th); Maryland (22nd); West Virginia (35th); Ohio (47th); New Jersey (49th) and New York (50th).

The Tax Foundation's report coincides with earlier findings of the business community. The Council on State Taxation, or COST, reports that Pennsylvania ranks among the lowest states among the 50 in its business taxes – 35th and 39th, respectively – in business property taxes and business sales taxes. State and local business taxes, as a percent of Gross State Product, are calculated at 4.5 percent, below the national average of 4.7 percent.

"We have the opportunity and the obligation to attract more businesses and jobs to ensure that Pennsylvania's future is bright for our young people," Governor Rendell said. "Pennsylvania is taking aggressive steps to help create new jobs and improve the competitiveness of businesses and help them to be successful. At the same time, we are investing millions of dollars in the education and training of our current and future workforce."

To view The Tax Foundation's report, visit www.taxfoundation.org.

Figure 1
State Business Tax Climate Index, 2006



Source: 2006 State Business Tax Climate Index, The Tax Foundation

VISIT OUR WEB SITE AT:
www.revenue.state.pa.us

NEW STATE REVENUE ENFORCEMENT INITIATIVES PROPOSED IN 2006-07 BUDGET

During the Department of Revenue's House Appropriations Committee hearing on Feb. 21, Secretary Gregory C. Fajt outlined a series of new tax compliance initiatives that are expected to boost fiscal year 2006-07 revenue collections by \$40.3 million. The three enforcement initiatives are intended to stimulate voluntary compliance primarily in the areas of Cigarette and Use Taxes; abusive tax shelters and delinquent tax collections.

Fajt stressed that paying taxes is a legal obligation for all individuals and businesses that reside in, or do business in, the commonwealth.

"Any taxpayer that avoids paying taxes increases the tax burden for the majority who meet their tax obligation," Fajt testified. "Put more simply, every dollar that we don't collect from tax avoiders is one more dollar we must collect from taxpayers."

When it comes to business taxes, the consequences of tax avoidance are even more severe. For example, a business that purchases office equipment from an Internet retailer to avoid paying sales tax gains an unfair financial advantage over its law-abiding competitors. And because the business avoided taxes by buying out-of-state, a Pennsylvania office equipment retailer loses a sale.

Use Tax

By improving compliance in Use Tax the state can help to level the playing field for many Pennsylvania-based businesses. Use Tax is a lesser known tax that is the counterpart to Sales Tax. When a person or business makes taxable purchases over the Internet or in another state and the seller does not collect Pennsylvania Sales Tax, the person or business is responsible for reporting and paying the equivalent 6 percent Use Tax, or 7 percent in Philadelphia and Allegheny Counties, to the Commonwealth.

The Department plans to first educate the public, primarily the business community, to stimulate Use Tax collections, allow a period for voluntary compliance and then conduct a series of strategic Use Tax audits. The Department estimates that with this program it can increase collections by \$18.3 million in fiscal year 2006-07.

Cigarette Tax

A Cigarette Tax compliance program will also help to level the playing field for Pennsylvania-based retailers who are responding to strong competition from Internet sites that falsely advertise that cigarettes can be purchased tax-free. Once again, Pennsylvania's brick-and-mortar businesses are at a competitive disadvantage. Under the Federal Jenkins Act of 1949, vendors that ship cigarettes into another state are required to release the names and addresses of the people who purchase the cigarettes to the taxing authorities in the purchasers' home states. A program and supporting processing system is needed to contact purchasers and collect the appropriate Cigarette Excise Tax, currently \$1.35 per pack, and accompanying Use Tax. The Department estimates that with this program it can increase collections by \$3.75 million in fiscal year 2006-07.

Abusive Tax Shelters

The Department plans to work closely with the Internal Revenue Service and other states to identify taxpayers who have benefited from abusive tax shelters and underreported income subject to tax in Pennsylvania. For Pennsylvania purposes, an abusive tax shelter will be defined as a tax avoidance scheme according to the IRS. Significant collections have been produced by other states, including New York, California, Illinois and North Carolina, which have conducted similar programs. The Department estimates that with this program it can increase collections by \$15 million in fiscal year 2006-07.

Delinquent Tax Collections

Pennsylvania licenses people and businesses in a broad range of areas. Licensees who don't pay their taxes have an unfair advantage over those who do. They have been given the privilege of doing business in Pennsylvania, without contributing their fair share TO Pennsylvania. This year the Revenue Department will begin sharing information with other state agencies in an effort to better identify license holders with unpaid state tax liabilities. The Department estimates that with license information it can increase collections by \$3.2 million in fiscal year 2006-07.

ELECTRONIC TAX FILING UPDATE

Personal Income Tax

Taxpayers have until midnight, Monday, April 17, this year to file their income tax returns since the normal April 15 deadline falls on a Saturday.

As of March 9, the PA Department of Revenue had received almost 1.5 million electronically filed state Personal Income Tax returns, a 10 percent increase over last year at this time. About 1.2 million people used the Federal/State e-file program, an option available through tax preparers and authorized computer software, to file their returns electronically. About 128,000 people have filed using the state's free Internet option, pa.direct.file, a 29 percent increase from last year. TeleFile, the free telephone filing option, has received about 167,000 returns.

Taxpayers can visit the Department's e-Services Center at www.revenue.state.pa.us to file returns using pa.direct.file; make payments, including estimated payments; check the status of a return or refund; update information; pay any tax due by credit card; and access the Online Customer Service Center. Assistance is also available over the telephone by calling the automated FACT and Information Line at 1-888-PATAXES (728-2937) or the Taxpayer Service and Information Center at (717) 787-8201 Monday through Friday between the hours of 8 a.m. and 5 p.m.

Business Taxes

More and more businesses are filing Pennsylvania Sales and Use Tax and Employer Withholding Tax returns and payments electronically.

The number of Sales Tax returns filed electronically through TeleFile has increased from 24,356 returns in January/February 2005 when the system was created to 107,837 returns during the same months in 2006; this represents an increase of 442 percent. During this same period, the number of returns filed through e-TIDES has increased from 107,837 returns to 219,103 returns, a 203 percent increase.

With regard to Employer Withholding Tax during the same January/February 2005 to 2006 comparison, quarterly returns filed through e-TIDES increased from 39,571 returns to 63,807 returns, an increase of 161 percent. Payments (deposits) increased from 52,319 to 182,052; an increase of 347 percent. Because TeleFile for Employer Withholding Taxes was not implemented until April 2005, there is no comparative statistical data available at this time.

The Department's e-Business Services Unit is available to assist taxpayers Monday through Friday from 8 a.m. to 5 p.m. by calling (717) 783-6277.

IRS POSTPONES TAXPAYER DEADLINES IN AREAS HIT HARDEST BY HURRICANE KATRINA

On Feb. 26, the IRS issued the following announcement:

Individual and business taxpayers in the most severely damaged parishes and counties of Louisiana and Mississippi automatically have through Aug. 28, 2006, to file returns and make certain tax payments that had a due date or extended due date on or after Aug. 29, 2005, and on or before Aug. 28, 2006.

In light of this announcement the PA Department of Revenue will grant an extension of time to file PA Corporate Tax Reports related to these federal tax returns, up to 30 days after the extended federal due date. This will be done on a case-by-case basis. Taxpayers should indicate the parish/county

as well as Hurricane Katrina on the return. To be granted the additional time to file, the reports should be sent to:

Amy Lefchak, Director
PA Department of Revenue
Bureau of Corporation Taxes
6th Floor Strawberry Square
Harrisburg, PA 17128-0700

For additional details on the IRS announcement a copy of the full press release can be found at: <http://www.irs.gov/newsroom/article/0,,id=154615,00.html>.

PERSONAL INCOME TAX ESTIMATED PAYMENTS NOW LISTED ON DEPARTMENT LETTERS

The Department of Revenue recently completed an update to its computer-generated letters to taxpayers regarding estimated payment differences between Personal Income Tax returns filed and the Department's records. The updated notices will now include the list of payments the Department has recorded to the taxpayer's account on the reverse side of the letter.

Included in the list of payments will be all estimated payments made during a tax year, carryover credits from the prior tax year and extension payments (if

applicable). The list of payments on the letter will provide the date the payment was received by the Department, the type of payment recorded on its system (estimated payment, prior year credit or extension payment), the amount of the payment and the Social Security Number of the taxpayer to whom the payment was credited. Up to 25 payments can be recorded on the letters. If the Department recorded no payments for the return, the statement "No payments Found" will appear on the reverse side of the letter.

MILITARY FAMILY RELIEF ASSISTANCE

Pennsylvania's new Military Family Relief Assistance Program, administered by the Department of Military and Veterans Affairs, is now accepting donations to help Pennsylvania members of the Armed Forces and their families who have a direct and immediate financial need as a result of military service.

Donations can be made through a check-off on the 2005 Pennsylvania Personal Income Tax Form, or through direct contributions.

"The 2005 Pennsylvania Personal Income Tax Form includes instructions for checking a box to donate tax refunds to the program," said Maj. Gen. Jessica Wright, the state's adjutant general. "The fund is already growing due to generous contributions from the Foundation for Enhancing Communities and individuals who have made donations in memory of a Pennsylvania National Guard Soldier killed in action in Iraq."

Individuals and groups can make direct contributions by sending a check to the Military Family Relief Assistance Program, c/o Department of Military and Veterans Affairs, Fort Indiantown Gap, Annville, PA 17003-5002. Donations are tax deductible to the extent authorized by federal law.

"We are moving forward with developing program guidelines and publishing new forms," said Gen. Wright. "More importantly, we need to obtain funds from the tax check-off program and private donations before we can begin to accept applications for assistance and award grants. We anticipate that we will be able to accept applications for assistance after July 2006."

Members of the Armed Forces who are residents of Pennsylvania are eligible to apply for assistance if they serve:

- 30 or more consecutive days of active duty with the Army, Navy, Air Force or Marine Corps;
- 30 or more consecutive days of active duty or state active duty in the Pennsylvania Army or Air National Guard;
- 30 or more consecutive days of active duty with Army Reserve, Air Force Reserve, Navy Reserve or Marine Corps Reserve.

The program also applies to certain family members of eligible service members as long as the relatives are residents of Pennsylvania. Additional information about this program is available on the DMVA Web site at www.dmva.state.pa.us.

PENNSYLVANIA'S TAX FORGIVENESS PROGRAM

Many Pennsylvania taxpayers qualify for the state's Tax Forgiveness program. To qualify, they must file a PA Personal Income Tax return, and include a PA Schedule SP.

The amount of Tax Forgiveness is based on marital status, eligibility income and the number of dependent children. The following are examples of taxpayers eligible to receive **100 percent** Tax Forgiveness: a single taxpayer with eligibility income of \$6,500; a married couple with an eligibility income of \$13,000; a single parent with one child and an eligibility income of \$16,000; or a couple with two children and an eligibility income of \$32,000. Eligibility income levels increase by \$9,500 for each additional dependent child. Retired persons and individuals that have low income and did not have PA tax withheld can have their PA tax liabilities forgiven as well.

Line-by-line instructions for PA Schedule SP are available on the Department's Web site at www.revenue.state.pa.us and toll-free FACT and Information Line at 1-888-PATAXES (728-2937). The easiest way to file for Tax Forgiveness is over the Internet with **pa.direct.file**, available through the Department

of Revenue's Web site. **Pa.direct.file** is free and you will receive your refund in half the time compared to filing a paper return.

For more information, visit the Department's Web site at www.revenue.state.pa.us

	Maximum Income for 100%	Income Range for Partial
Single person	\$6,500	\$6,501- \$8,750
Single person w/ one dependent	\$16,000	\$16,001-\$18,250
Single person w/ 2 dependents	\$25,500	\$25,501-\$27,750
Single person w/ 3 dependents	\$35,000	\$35,001-\$37,250
Couple w/ 2 dependents	\$32,000	\$32,001-\$34,250

Add \$9,500 for each additional dependent.

REQUESTING AN EXTENSION OF TIME TO FILE STATE INCOME TAX RETURNS

Beginning with tax year 2005 (returns due in 2006), the Internal Revenue Service (IRS) will allow individuals to use a single IRS form (Form 4868) to get an automatic six-month extension of time to file their tax return.

The PA Department of Revenue will grant a taxpayer an automatic extension of time to file a Pennsylvania tax return if the IRS granted an extension for filing the federal tax return. **The extension period granted by Pennsylvania will be equivalent to the extension period granted by the IRS.** Taxpayers should include a copy of Federal Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return, with their PA-40 state tax return and fill-in the oval for "Extension" at the top of the return.

Pennsylvania does not have an "automatic extension" form similar to the Federal Form 4868. The Pennsylvania Application for Extension of Time to File (REV-276) has a space where the taxpayer fills in the actual date to which they want the extension (i.e. Oct. 16, 2006). This form is necessary for taxpayers who owe Pennsylvania tax or for those who do not have an extension for filing their federal income tax return.

Beginning with tax year 2005, the Department will grant automatic six-month extensions when taxpayers choose to make extension payments with a credit card or with electronic funds transfer.