

Tax Update

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FEBRUARY/MARCH 2005



THE TAX UPDATE IS A
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PENNSYLVANIA
DEPARTMENT
OF REVENUE
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FAST FACT:

Governor Rendell proposes to reduce the Corporate Net Income Tax rate by 20 percent to 7.99 percent, the lowest rate in 36 years.

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

GOVERNOR RENDELL DELIVERS 2005-06 BUDGET THAT PROPOSES LARGEST BUSINESS TAX RATE CUT IN DECADES



*Governor Rendell delivers 05-06 Budget
(Photo Credit: CMS Photo-Terry Way)*

On February 9, Governor Edward G. Rendell proposed a Fiscal Year 2005-06 budget that contains no new taxes and represents a net increase in spending of only 1 percent over the 2004-05 budget. The \$23.8 billion budget holds true to his long standing commitments to continue to modernize the Commonwealth's business tax structure, protect Pennsylvania's most vulnerable citizens, continue to cut waste by further reducing the cost of government and grow Pennsylvania's economy through creative programs that will help to create a Job Ready PA.

"While Pennsylvania faces many challenges this year, this budget is constructed to meet those challenges," said Governor Rendell. "We have already begun to effect enormous changes in Pennsylvania's economy through the economic stimulus program. Without raising any taxes on the citizens of Pennsylvania, I am proposing to reduce the corporate income tax rate and create a fairer business tax reporting system for all companies in the Commonwealth."

Governor Rendell proposed a revenue neutral reduction in Pennsylvania business taxes based on recommendations from the Business Tax Reform Commission, created last year to study Pennsylvania's business tax structure. This budget, along with continuing the phase out of the Capital Stock and Franchise Tax from its current rate of 5.99 percent to 4.99 percent

beginning January 2006, reflected many of the Commission's recommendations. The Governor proposed reducing the Corporate Net Income (CNI) tax rate to 7.99 percent. This is a 20 percent reduction in the rate of corporate taxation.

*"Our CNI rate is
the third highest
in the nation,
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Governor Rendell

"Our CNI rate is the third highest in the nation, and it is a significant roadblock to business growth," said Governor Rendell. "This reduction will help our businesses compete, and if we implement this reduction, Pennsylvania's tax rates will be lower than Ohio, West Virginia, New Jersey and Delaware."

Building on the Rendell Administration's achievements in delivering the Plan for a New Pennsylvania priorities of economic stimulus, property tax relief and investing in educational achievement, Governor Rendell unveiled a new initiative – Job Ready Pennsylvania.

Job Ready Pennsylvania will ensure that Pennsylvania businesses have access to a highly skilled labor force, and that residents have the education and training they need to be successful in the 21st century. By investing \$101 million in workforce development and education systems, the Commonwealth can impact how \$2 billion in existing resources are spent.

To view the Budget-in Brief or the entire FY 05-06 Governor's Executive Budget, please visit www.governor.state.pa.us.

MESSAGE FROM SECRETARY FAJT ABOUT 2005-06 BUDGET

Taxpayers of Pennsylvania:

As we look ahead to the 2005-06 fiscal year, I would like to take this opportunity to highlight some of the Department of Revenue's goals and reflect on the progress we have made during the past year.

A primary goal of the Department, and Governor Ed Rendell, is reforming Pennsylvania's business tax system. Pennsylvania's Corporate Net Income (CNI) Tax is the third highest in the nation. The state's 9.99 percent CNI Tax rate discourages economic development and is uncompetitive with other states. Lowering the rate will attract new businesses to Pennsylvania and encourage existing businesses to expand.

Last year, Governor Rendell created a **Business Tax Reform Commission** to recommend changes to Pennsylvania's business tax structure that would broaden the tax base, thereby allowing lower tax rates and making Pennsylvania more competitive. I was honored to chair the 12-member Commission, whose members represented a broad cross-section of the state's business community.

The **business tax reform proposal** outlined in Governor Rendell's 2005-06 budget is based on the Commission's recommendations. The Governor has proposed:

- lowering the CNI Tax rate by 20 percent;
- 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 and start-up companies and cyclical manufacturing companies;
- maintaining the current Capital Stock and Foreign Franchise Tax phase-out schedule;
- reforming the tax appeal process to provide for review by an independent panel before going to court; and,
- moving from a separate company reporting state to a mandatory combined reporting state to substantially broaden the CNI Tax base and therefore eliminate

aggressive tax planning opportunities such as "Delaware holding companies."

Governor Rendell's proposal would reduce the CNI Tax rate to 7.99 percent and move Pennsylvania from the state with the third highest corporate tax rate in the nation to the 18th highest. Compared to surrounding states, Pennsylvania would move from the highest CNI Tax rate to the third lowest. Overall, the proposed changes would improve the business tax climate in Pennsylvania and make it more competitive with other states, especially its surrounding states.

The Department of Revenue continues to do its part in the administration's effort to operate more efficiently. We constantly look for ways to use tax dollars more wisely and to do more with less. Like all state agencies, the Department has reduced its overall operating expenses by 10 percent since 2002. In the upcoming fiscal year, we will eliminate 35 unfilled positions, mostly due to retirement, saving the Commonwealth about \$2.4 million. The Department will also save \$653,000 by reducing its general operating expenses. In total, the Department expects to save \$6.15 million in the 2005-06 fiscal year, as reflected in the budget.

The Revenue Department processes millions of tax returns every year. Simply stated, electronic filing is the most cost-effective way for the Department to process the returns. I would like to thank the 2.25 million taxpayers who filed their state income tax returns electronically last year and encourage more of you to do the same this year. An electronically filed tax return costs the Department approximately \$2.12 to process, compared with \$3.60 for a paper return – a savings of \$1.48 per return.

Every dollar saved is another dollar that can be used for programs that benefit Pennsylvanians, such as improving education, health care and the environment.

As part of that effort, we are asking 320,000 businesses to begin filing sales taxes electronically in 2005. We are offering businesses three easy ways to file sales tax returns: over the Internet, by calling a new toll-free telephone filing system or by using computer software.

Continued on Page 3

MESSAGE FROM SECRETARY FAJT ABOUT 2005-06 BUDGET. *Continued from page 2*

As a result of this initiative, the Department of Revenue would like to thank all of the monthly Sales Use Tax filers who made the first phase of the new electronic filing process a success.

The Department is also looking at new ways to collect delinquent tax money that is owed to the Commonwealth. The majority of taxpayers who pay their fair share should not have to shoulder a greater burden because of those who do not. As part of its expanded collections effort, the Department has developed a program that would require people who seek a business license from the state to be current on all state tax obligations. Some agencies, like the Liquor Control Board, already conduct tax clearance checks before issuing a license.

Governor Rendell initially proposed a business tax clearance program in his 2003-04 budget. Since then, the Revenue Department submitted **a report** to the General Assembly outlining the details of the program, which will add a new step to the license application process. For example, before the Department of Labor and Industry renews a taxpayer's Family Daycare Permit, it will request a tax clearance from the Department of Revenue. The Department estimates that the program will collect about \$20 million a year when fully phased in, and will encourage taxpayers to voluntarily comply with their tax obligations.

Finally, I am happy to report that the Pennsylvania Lottery is experiencing tremendous growth. Fiscal year-to-date Lottery sales, through January 31, 2005, total \$1.52 billion, which is \$160.4 million or 12 percent more than last year. By the end of fiscal year 2004-05, the Lottery expects to complete three successive years of double-digit growth.

The Lottery continues to look at new ways to fulfill its sole mission of funding programs that benefit older Pennsylvanians. Lottery's growth has helped expand the PACE and PACENET programs and give more, older adults access to low-cost prescription drug coverage.

Although we have made great progress, there is still more work to do. In the coming year, we will continue to look for ways to operate more efficiently and improve the overall competitiveness of the Commonwealth.

Sincerely,



Gregory C. Fajt
Secretary of Revenue

0400510012

PA-41 - 2004 (09-04)
PA Fiduciary Income Tax Return
PA Department of Revenue
Harrisburg, PA 17128-0413
PLEASE PRINT IN BLOCK

OFFICIAL USE ONLY

Federal Employer Identification Number Decedent's Social Security Number Daytime Telephone Number

The Department of Revenue has discovered errors in the preprinted **2004 PA-41** Fiduciary Income Tax Return and Schedules booklet. If you are using the forms and schedules in the booklet, the Department has made some changes. A corrected version, including the following changes, is available on the Department's Web site.

- On the **PA-41** Form (Front Side):
 1. Line 15 should read "Tax Due. Line 10 is more than Line 14."
- On the **PA SCHEDULE A & B**:
 2. PA SCHEDULE A & B should be shown as PA SCHEDULE A/B/J.
 3. PA SCHEDULE B Line 5 should read "Total PA Taxable Dividend Income. Add Lines 1, 2, 3, and 4. Enter on Line 2 of the PA-41."

Please access the Forms and Publications link on the Department's Web site at www.revenue.state.pa.us to obtain a revised version of PA Schedule A/B/J. The Department apologizes for any inconvenience these errors may have caused.

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PHASE ONE OF SALES AND USE TAX ELECTRONIC FILING ... A SUCCESS

The Department of Revenue would like to thank all of the monthly Sales and Use Tax filers who filed their returns and payments electronically. So far, 80 percent of monthly filers filed their return using one of the three electronic filing methods:

- The Internet-based **e-TIDES** system, which has undergone extensive redesign to offer more user-friendly access and provide secure, full-service functionality to business taxpayers.
- The new Sales Tax TeleFile system, which began operation in January 2005. TeleFile turns the hassle of filing into a simple five-minute toll-free telephone call. No registration is required to use the TeleFile option.
- Third-party software, which may be the best option for taxpayers who file returns in multiple states. The Department is working with a number of vendors, and will list them on its Web site as they are tested.

The Department received positive feedback from businesses for both the e-TIDES Internet-based business tax filing system and the new TeleFile telephone filing system. Of the total number of electronic sales tax returns filed in February 2005, 69 percent of taxpayers used the e-TIDES system and 31 percent used the TeleFile system. The Department appreciates all of the suggestions that were made to further improve the systems.

For Sales and Use Tax taxpayers who file quarterly, the first electronic return and payment is due on April 20, 2005. Returns

and payments can be filed online by accessing **e-TIDES** or by calling the Business Tax TeleFile number at 1-800-748-8299. While ACH debit, ACH credit and credit cards are accepted, taxpayers continue to have the option of making their payments by electronic funds withdrawal or check. *(Please see sample check below.)*

Here are some tips:

- If you have not yet registered to use **e-TIDES**, please do so as soon as possible.
- File your return early. You can still make your payment effective on the due date. Filing early makes it easier to get assistance if you need it.
- Remember, no registration is required to **TeleFile**, but you may still want to register with **e-TIDES** to take advantage of the extra benefits of viewing your filing and payment history online and receiving due date reminders via email.
- Explore third-party solutions to see if one is right for you. You can find a list of all approved third-party vendors at www.revenue.state.pa.us/stvendors.

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. The call center gets very busy as due dates approach, so the Department encourages taxpayers to file early if they can.

SAMPLE PAPER CHECK FOR SALES & USE TAX

| | | |
|---|-----------------------------------|------|
| John Smith 123 Cool Creek Lane Any City, PA 12345 | <u>50-42</u> 370 1234567890 | 1234 |
| Date _____ | | |
| Pay To The Order Of: _____ | \$ <input type="text"/> | |
| _____ Dollars | | |
| Your Bank Commonwealth Region Harrisburg, PA | | |
| Memo ST 12345678 1/31/05 | Signature _____ | |
| (717) 123-4567 | ⑆0312001021: 2501126110814 110001 | |

Tax Type
(Sales Tax)

Telephone No.

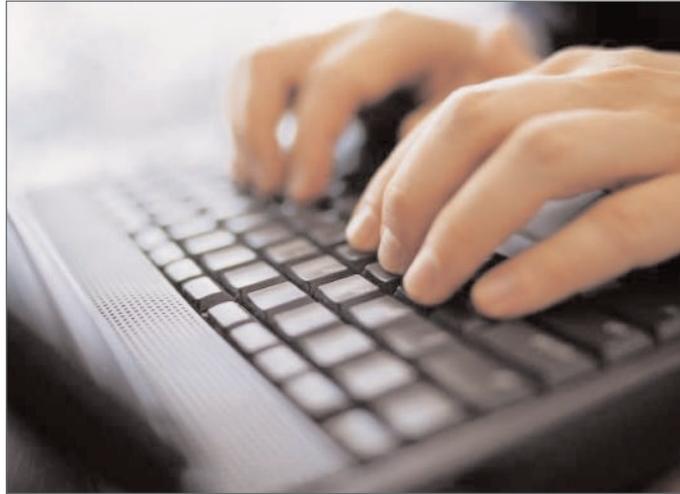
Account ID No.
(License No.)

Tax Period
End Date

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

ELECTRONICALLY FILED INCOME TAX RETURNS ON PACE TO SET RECORD

As of March 18, the Department of Revenue had received 1.5 million electronically filed Personal Income Tax returns, 10 percent more than last year at this time. Federal/State e-file, an option available through tax preparers and authorized software, has experienced the greatest growth in use over last year with 1.2 million returns filed, a 15 percent increase. Total electronically filed returns using pa.direct.file, the free Internet filing option, decreased 1 percent to 115,297 returns. TeleFile, the free telephone filing option, has received 239,625 returns, a 5 percent decrease over last year indicating that more taxpayers are using computers to file their returns.



Refunds from electronically filed returns are processed in about half the time of those from paper returns. Also, a refund can be directly deposited into a checking or savings account. This option is not available with a paper return. The electronic filing systems perform the math calculations, thus eliminating errors that can delay the processing of a return and/or refund. Plus, taxpayers receive instant confirmation that the return has been filed and received by the Department.

“Electronic filing is the most cost-effective method for the Department to process tax returns,” Secretary of Revenue Gregory C. Fajt said. “Last tax season, 2.25 million taxpayers, or 40 percent of all taxpayers, filed their state tax return electronically. We are well on our way to surpassing that record this year.”

“All electronic filing options are secure,” Fajt said. “Filing a tax return electronically also gives taxpayers more options and advantages.”

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.

TAX PREPARATION SOFTWARE MUST BE TESTED AND APPROVED BY STATE REVENUE DEPARTMENT

The Department of Revenue's imaging systems can only accurately read computer-generated tax returns produced on software from Department approved vendors. Tax returns and refunds could be delayed or rejected if they are submitted on computer-generated forms that have not been tested and approved by the Department.

Before using computer-generated forms to prepare PA Personal Income Tax returns, please check to see if the company's software has been approved by the PA Department of Revenue.

See the Department's Web site for a list of [Approved Personal Income Tax Form Vendors](#) that offer software to file 2004 PA Personal Income Tax forms.

For more information, contact:

Ed Davis
PA Department of Revenue
Forms Approval Coordinator
(717) 705-0595
edavis@state.pa.us

APPLYING PA SALES TAX ON PURCHASES USING DISCOUNT COUPONS

Recently, there have been questions about the Department's regulations as they pertain to Sales Tax on items purchased with a coupon or other discounting methods.

The regulations of the Department of Revenue specify that amounts representing "on-the-spot" cash discounts, employee discounts, volume discounts, store discounts, such as "buy one, get one free," wholesalers or trade discounts, rebates and store or a manufacturer's coupon *shall establish a new purchase price, if both the item and the coupon are described on the invoice or cash register tape.*

The regulations require a retailer to deduct the coupon amount from the taxable portion of the purchase price, *if the cash register receipt describes both the item purchased and the coupon that applies to it.* The description requirement ensures that a coupon relating to a nontaxable item will not reduce the taxable purchase price. It also protects the retailer by showing why the taxable price was reduced.

The Department interprets the requirement of a description to mean that the cash register receipt makes a clear reference to the item and the coupon related to it or a clear reference that there is an amount deducted on any purchase or a percentage discount on all items listed whether taxable or not.

The regulations also state that an amount representing a discount that is allowed for prompt payment of bills, which is dependent on an event occurring after the completion of the sale, may not be deducted in computing the tax.

Examples:

1. A customer buys two hamburgers from a restaurant with a "buy one, get one free" coupon. The price of one hamburger is \$1. The restaurant rings up \$2 on the cash register. They then enter a credit in the cash register for the amount of \$1, resulting in an adjusted price of \$1. The acceptance of the coupon by the restaurant established a new purchase price of \$1, which is subject to 6¢ tax.
2. A buyer purchases 15 grocery items from the grocery store. All of the items are exempt from tax except a bottle of soda. The price of the soda is \$1. The buyer gives the clerk a manufacturer's coupon having a face value of 50¢ for the soda. The clerk totals the 15 items on the cash register, including \$1 for the soda. None of the items are described or identified on the cash register tape. The clerk then reduces the total sale by \$1, double the amount of the coupon. The coupon is not described or identified on the register tape. Therefore, the acceptance of the coupon by the clerk does not establish a new purchase price. The \$1 purchase price of the soda is subject to 6¢ tax. The redemption of the coupon represents a refund, which does not affect the purchase price of the soda.
3. A customer buys a coffee pot from a department store. The price of the coffee pot is \$30. The customer pays \$1.80 sales tax on the purchase of the coffee pot. The sale includes a \$10 manufacturer's mail-in-rebate form. The customer completes the form, mails it to the manufacturer and receives a \$10 check from the manufacturer. The receipt of the rebate check by the customer does not establish a new purchase price of the coffee pot. The department store properly collected sales tax in the amount of \$1.80.
4. Someone buys and accepts delivery of a load of lumber from a lumber company. The lumber company sends this person a billing invoice, which states, "Lumber - \$1000, Sales Tax - \$60." The invoice also states, "if invoice is paid within 30 days, customer is entitled to a 1 percent discount." The invoice is paid within five days. While this person is entitled to a discount of 1 percent of \$1000, they are still required to pay the sales tax in the amount of \$60, as a new purchase price has not been established.

TAX FORGIVENESS

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.