

Pennsylvania Tax Update

NUMBER 117 • OCTOBER/NOVEMBER 2005



THE TAX UPDATE IS A
BI-MONTHLY E-NEWSLETTER
PUBLISHED BY THE
PENNSYLVANIA
DEPARTMENT
OF REVENUE
GREGORY C. FAJT
SECRETARY OF REVENUE
EDWARD G. RENDELL
GOVERNOR



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FAST FACT:

Pennsylvania received the second largest payment from the MCI WorldCom settlement out of the 16 states involved.

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

PENNSYLVANIA FED/STATE E-FILE FOR TAX YEAR 2005

Pennsylvania IRS e-File allows individual taxpayers to file federal and state income tax returns together or separately. It is available through tax preparers or computer software. The following "Codes Update" pertains to submission of PA electronic returns only.



PA ACKNOWLEDGMENT CODES UPDATE

The Department will generate a "C" code (Conditional Acceptance) to the Electronic Return Originator (ERO) upon receipt of a PA electronic return. This acknowledgment indicates that the return was received and uploaded to our master file processing system.

If the return has been assigned a Declaration Control Number (DCN) that is already associated with another electronic return, the Department will generate a "D" code to the ERO indicating the return has been rejected. If the Department is unable to upload a return to our master file processing system, the Department will generate an "R" code to the ERO indicating the return has been rejected, requiring the error to be corrected and the return retransmitted to the PA Department of Revenue. Once the return is uploaded to the master file, it will then be subject to the same edits and suspension criteria as a paper return.

Once the return has been entered into master file processing and if no other additional information is needed to process the electronic return, the Department will generate an "A" code to the ERO to indicate the return has been processed. The Department will generate an "N" code to the ERO when additional information is needed to process the electronic return.

If an "N" code has been generated and the Department received the information needed to process the return, the Department will generate an "A" code to

the ERO to indicate that the requested information was received and that the return has been processed. **The Department will no longer send an "F" code.**

ERO REGISTRATION FOR TAX YEAR 2005

EROs who previously registered with the Department will not have to register to file Pennsylvania electronic returns for the 2005 tax season. The Department does require all EROs planning to file Pennsylvania electronic returns for the **first time** to register by sending the Department a copy of the IRS approval letter showing acceptance into the IRS's e-file program. This is a one time only registration. This letter can be faxed to the Electronic Filing Help Desk at (717) 772-4193 or (717) 787-2840 or mailed to:

PA Department of Revenue
Bureau of Individual Taxes
PO Box 280507
Harrisburg, PA 17128-0507

2005 HANDBOOK FOR ELECTRONIC FILERS (PA 1345)

The 2005 Handbook for Electronic Filers of PA Individual Income Tax returns will be available in mid November. To obtain a copy, visit the Department's Web site at

www.revenue.state.pa.us

SALES TAX BULLETIN 2005-04

Electronically Delivered Canned Software

Issued: November 1, 2005

On Sept. 15, 2005, the Commonwealth Court in Graham Packaging Company v. Commonwealth, 652 FR 2002 (2005), held that the sale of canned software delivered electronically was subject to Pennsylvania Sales and Use Tax. The decision became final on Oct. 15, 2005, as no exceptions were filed to the Court's order.

As a result, for invoices dated on or after Nov. 1, 2005, the sale or use of all canned software is taxable regardless of the

method of delivery. If a vendor collected sales tax on the sale of electronically delivered canned software invoiced prior to that date, the vendor may refund the sales tax to the purchaser or remit the sales tax to the Department on the appropriate sales and use tax return.

All letter rulings and other revenue information contrary to the Court's ruling are rescinded. Statement of Policy 60.19, 61 Pa. Code § 60.19, will be revised to reflect the Court's ruling in Graham Packaging.

PENNSYLVANIA RECEIVES \$46.5 MILLION FROM MCI-WORLDCOM SETTLEMENT

On October 4, MCI-WorldCom agreed to pay Pennsylvania \$46.5 million, its share of a \$315 million settlement reached with the company for using a tax avoidance scheme to shield billions of dollars of income from state taxes in 15 states and the District of Columbia.

"This is good news for the Commonwealth," said Governor Edward G. Rendell. "The settlement is a result of our aggressive efforts to make sure Pennsylvania received its appropriate share under the agreement".

"I want to acknowledge the extensive auditing of MCI's records performed by the Department of Revenue. The Department's hard work, knowledge and dedication resulted in Pennsylvania receiving the second largest settlement out of the 16 states involved".

"The plan devised by MCI and its accountants was nothing more than a sham to avoid paying millions of dollars in state taxes. This settlement sends a strong message to corporations doing business in Pennsylvania that we will aggressively pursue companies that use abusive tax schemes to avoid paying their fair share of state taxes".

"The MCI case is further evidence that the General Assembly needs to act on the recommendations made by the Pennsylvania Business Tax Reform Commission to close corporate tax loopholes. Pennsylvania's high corporate tax rate, combined with its separate company reporting system, makes it susceptible to abusive tax schemes. I want to use the revenue gained from closing the tax loopholes to significantly reduce corporate income taxes."

GOVERNOR'S NEWSLETTER

Would you like to hear from Governor Rendell? Would you like to know, on an on-going basis, what the Governor and his Administration are doing to fulfill his vision for a new Pennsylvania?

Sign up to receive Governor Rendell's weekly E-newsletter.

The Rendell Administration is committed to reducing property taxes, creating a first-rate public education system, protecting our most vulnerable citizens and continuing economic investment to support our communities and businesses. To find out more about Governor Rendell's initiatives, [sign up to receive the Governor's weekly E-newsletter](#) and join the numerous online readers in hearing from Governor Rendell.

SHERIFF SALE NOTIFICATIONS

The Pennsylvania Department of Revenue requires only **ONE** copy of the notice for a Pennsylvania Sheriff Sale, regardless of the number of tax liens that exist. All Pennsylvania Sheriff Sale notices should be mailed to:

PA Department of Revenue
Bureau of Compliance
P.O. Box 281230
Harrisburg, PA 17128-1230

If there are any questions, please contact **Sally J. White** with the Pennsylvania Department of Revenue at (717) 783-6062 or e-mail at swhite@state.pa.us.

This notice is being issued in an attempt to reduce the number of duplicates received by the Department and to help reduce the time and expenses incurred to produce these duplicates.

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NEW TAX ENFORCEMENT WEB SITE

The Department of Revenue has added a new Tax Enforcement section to its Web site to educate the public about tax evasion. Tax evasion is a crime that hurts all Pennsylvanians and decreases the revenue available to fund essential state programs and services.

The new Tax Enforcement Web site contains:

- **ABOUT TAX EVASION**

This section of the Web site contains information about various areas of tax evasion including the: Cigarette Tax, Corporate Tax, Employer Withholding Tax, Motor Fuel Tax, Personal Income Tax and Sales Tax. For each tax type, the Department explains what tax evasion is, some examples of evasion, penalties for evasion and why tax evasion is harmful.

- **ENFORCEMENT POWERS**

The Department has the authority to issue citations, file liens, disclose tax liens and other information publicly and prosecute people and/or business owners who deliberately attempt to avoid their tax responsibilities. This section contains information on enforcement powers the Department has been recently given to help collect the taxes that are owed to the Commonwealth.

- **ASSISTANCE**

The state Department of Revenue is available to assist taxpayers who are having difficulties paying their state taxes or filing tax returns. For example, a deferred payment plan may be an option for someone who is having difficulties paying their delinquent taxes.

- **NEWS**

In some cases, taxpayers who are faced with the possibility of public disclosure comply with their tax liabilities. This section of the enforcement Web site contains press releases issued about taxpayers who were sentenced for tax evasion.

- **REPORT SUSPECTED TAX FRAUD (ONLINE FORM)**

An important new feature of the enforcement Web site is a way for taxpayers to report suspected tax fraud directly to the Department of Revenue. People can submit tips anonymously. The Department does not offer monetary rewards for reporting tax evasion crimes. Because of taxpayer confidentiality laws, the person who submits a tip will not be notified of the status of an investigation.

RESIDENT CREDIT POLICY CHANGE

Compensation of Ohio Resident Owners of PA S Corporations

Normally, an Ohio resident who earns compensation in Pennsylvania is not subject to tax on that compensation because of a reciprocal agreement between Pennsylvania and Ohio. However, as of Jan. 1, 2004, special rules apply for Ohio resident shareholder/employees with a 20 percent or greater interest in a Pennsylvania S Corporation. **Beginning in tax year 2004, any such shareholder/employee must pay tax on the compensation earned in Pennsylvania.**

If the shareholder/employee of the Pennsylvania S Corporation works or performs **100 percent** of his or her duties and responsibilities in Pennsylvania, the shareholder/employee must report all of the compensation as subject to tax in Pennsylvania. If the shareholder/employee of the Pennsylvania S Corporation works or performs **some** of his or her duties and responsibilities in Pennsylvania, the shareholder/employee must complete PA-40 Schedule NRH, Apportioning Income by Nonresident Individuals, to apportion the wages between Penn-

sylvania and Ohio. Unlike Ohio, which considers this income to be business income for Pennsylvania resident shareholders in Ohio S Corporations, this income is compensation for Pennsylvania Personal Income Tax purposes and may not be netted against any Pennsylvania business losses from the Pennsylvania S Corporation or any other Pennsylvania source losses.

The Pennsylvania S Corporation employer should withhold Pennsylvania Personal Income Tax on the compensation. However, any shareholders/employees who do not have income tax withheld on their compensation must make estimated payments on that compensation if his or her total Pennsylvania taxable income for Personal Income Tax purposes is greater than \$8,000. Shareholders/employees who fail to make adequate and timely estimated tax payments will be subject to underpayment of estimated tax penalties.

DEPUTY SECRETARY FREEDENBERG SWORN IN

State Supreme Court Justice Thomas G. Saylor swore in **Robert Freedenberg** as Deputy Secretary for Taxation on Thursday, October 6. Freedenberg's son, Andrew, held the bible as he took the Oath of Office. His wife, Molly Mudd Freedenberg and son Benjamin were also in attendance for the ceremony.



*Robert Freedenberg,
Robert's son Andrew and Judge Thomas Saylor
during the swearing-in ceremony held in Harrisburg on October 6.*

RECENTLY ISSUED PERSONAL INCOME TAX (PIT) TAX BULLETINS

Deferred Compensation Plans

The Department of Revenue has issued two PIT Tax Bulletins dealing directly with Deferred Compensation Plans.

The newly released bulletins are:

- PIT Tax Bulletin 2005-03 – Deferred Compensation Under Nonqualified Plans
- PIT Tax Bulletin 2005-04 – Section 457 (b) Eligible Deferred Compensation Plans

If you have any questions regarding these Tax Bulletins, please call the Department at (717) 787-8201.

EMPLOYER WITHHOLDING NOTICE - ACT 40 OF 2005

Employers are reminded that Act 40 of 2005 did not change Pennsylvania's personal income tax rules related to employee contributions to qualified employer plans. Act 40 merely adopted Federal income tax receipt of income rules for purposes of computing when deferred compensation under a nonqualified deferred compensation plan is subject to Pennsylvania personal income tax.

Any direct employee contribution of compensation to a qualified employer plan (as defined in IRC §409A(d)(2)), such as a qualified retirement plan under IRC § 401(a) (including 401(k) plans), tax-deferred annuity plan or contract under IRC § 403(a) or (b), simplified employee pension under IRC § 408(k), SIMPLE retirement account under § 408(p), IRC § 457(b) eligible deferred compensation arrangement or IRC § 501(c)(18) trust, is subject to Pennsylvania personal income tax and

employer withholding at the time of the contribution. Likewise, amounts that an employer lawfully deducts from an employee's compensation and contributes to such a plan is considered taxable compensation at the time of the deduction and is subject to employer withholding.

Further, compensation that an employee voluntarily elects to defer under an employer's deferred compensation arrangement which compensation the employer contributes to a employee trust, pooled fund or other arrangement that is not subject to the claims of the employer's creditors is also taxable compensation and is subject to employer withholding at the time the compensation is contributed.

For further information, please see the [Tax Bulletins](#) on the Department's web site.

2005 FALL TAX SEMINARS SCHEDULE

| SPONSOR | DAY | DATE | CONTACT | SEMINAR LOCATION |
|---|-----------------|-------------------|--|--|
| 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 5 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> Bureau of Individual Taxes |
| 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> Pass Through Business Office |
| <i>10:15 - 10:30 AM Break</i> | | |
| 10:30 - 11:00 AM | USE TAX VOLUNTARY COMPLIANCE PROGRAM | <i>Kevin Milligan</i> Enforcement, Planning, Analysis, and Discovery |
| 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 Snavelly, Dean Picarella</i> Office of Chief Counsel |
| 11:45 - NOON | QUESTIONS AND ANSWERS | |
| <i>Noon - 1:00 PM 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> Bureau of Corporation Taxes |
| 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</i> Bureau of Collections and Taxpayer Services <i>Holly McClintock</i> Bureau of Individual Taxes |
| <i>3:00- 3:15 PM Break</i> | | |
| 3:15 - 4:15 PM | UNEMPLOYMENT COMPENSATION TAX UPDATES (LABOR AND INDUSTRY) | <i>Timothy McGarvey, Jim Diffendal, Paul Bowes</i> Labor and Industry |
| 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 .