



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:

*With the expansion of the Property Tax/Rent Rebate program, 420,000 more older and disabled Pennsylvanians will be eligible to receive a rebate next year.*

# Pennsylvania Tax Update

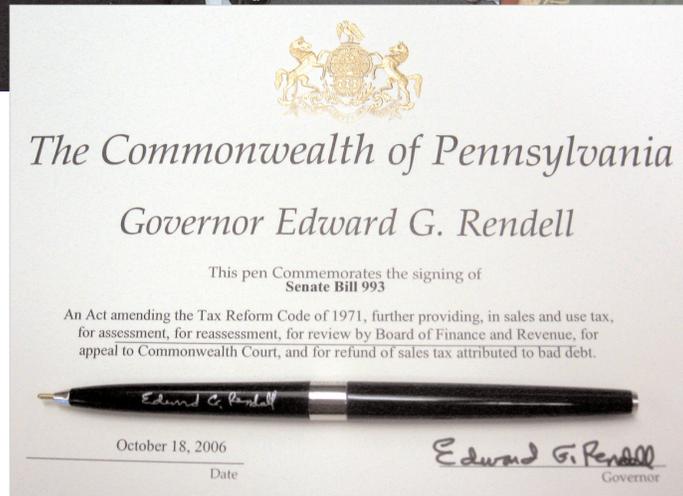
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## GOVERNOR RENDELL SIGNS BILL TO CHANGE CORPORATION TAX SETTLEMENT PROCESS



\*1.



\*2.

On Oct. 27, Governor Edward G. Rendell signed into law **Senate Bill 993**. The new law implements recommendations made by the bipartisan Business Tax Reform Commission appointed by Governor Rendell in 2004. The bill replaces the current corporation tax settlement process with an assessment and reassessment process beginning Jan. 1, 2008. The change means that corporate tax returns will be treated similarly to other tax returns and similarly to the process used in other states. **Returns will be considered accepted as filed unless the Department of Revenue or the Auditor General selects them for review or audit.**

SB 993 also standardizes assessment terminology throughout the Tax Code; requires all assessments to be sent via certified mail; standardizes all administrative appeal periods to 90 days while maintaining the appeal period to Commonwealth Court at 30 days; and requires the Revenue Department to provide taxpayers with a written explanation of the basis for any assessment.

*Continued on page 2*

\*1. Secretary Fajt holding the pen commemorating the signing of SB993. (L-R) Chris Zettlemoyer, Chief Counsel; Eileen McNulty, Exec. Dep. Secretary; Lauren Zaccarelli, Legislative Liaison; Dan Hassell, Dep. Sec. for Fiscal Policy & Planning

\*2. Pen and certificate presented commemorating the signing of SB993 by Governor Rendell on Oct. 18.

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[www.revenue.state.pa.us](http://www.revenue.state.pa.us)

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This act becomes effective immediately and shall be applicable to all determinations and assessments of tax liability by the Revenue Department after Dec. 31, 2007.

With the enactment of SB 993, most of the Business Tax Reform Commission's recommendations – including substantial business tax cuts - have been implemented in whole or in part.

### OTHER RECOMMENDATIONS FROM THE BUSINESS TAX REFORM COMMISSION:

**Recommendation:** Reduce the Capital Stock and Franchise Tax (CS/FT) by 1 mill annually until it is eliminated (Dec. 31, 2010).

**Enacted:** . . . . . Accelerated CS/FT phase-out schedule. Reduces 2006 tax rate from 4.99 to 4.89 mills and 3.89 mills for 2007.

**Recommendation:** Eliminate the annual cap on Net Operating Loss deductions.

**Enacted:** . . . . . Increased Net Operating Loss deduction from \$2 million to the greater of \$3 million or 12.5 percent of net income.

**Recommendation:** Change the weighting of the sales factor of the Corporate Net Income (CNI) Tax apportionment to 100 percent.

**Enacted:** . . . . . Changed CNI Tax apportionment formula from 60 percent sales factor to 70 percent sales factor.

Two of the Commission's major recommendations still under consideration by the General Assembly would:

- Cut Pennsylvania's Corporate Net Income (CNI) tax and close business tax loopholes that let 73 percent of corporations subject to the CNI tax report zero tax liability; and
- Give decision-making authority to independent hearing officers as recommended in the American Bar Association draft model State Administrative Tax Tribunal Act.

## PROPERTY TAX/RENT REBATE PROGRAM EXPANSION

With the newly expanded Property Tax Rent Rebate Program signed into law by Governor Edward Rendell, about 420,000 additional Pennsylvanians are now eligible to enroll and receive property tax or rent rebates next year.

The Property Tax/Rent Rebate program benefits eligible Pennsylvanians age 65 and older; widows and widowers age 50 and older; and people with disabilities age 18 and older. The new law, Act 1 of 2006, increases the income limit from \$15,000 to \$35,000 for homeowners and boosts the maximum rebate for both homeowners and renters from \$500 to \$650 beginning next year. Applicants can still exclude one-half of their Social Security, Supplemental Security Income and Railroad Retirement Tier 1 benefits, so homeowners who make more than \$35,000 a year and renters who make more than \$15,000 may still qualify for a rebate.

Renters with incomes between \$0 and \$8,000 will now receive a \$650 rebate and those with incomes between \$8,001 and \$15,000 will receive a \$500 rebate.

The rebates for property taxes or rent paid during 2006 will be distributed beginning July 1, 2007.

Pennsylvanians who think they may qualify for a rebate under the expanded guidelines can sign-up **now** to have a Property Tax/Rent Rebate claim form (PA-1000) mailed to them when the forms are available next year by visiting [www.papropertytaxrelief.com](http://www.papropertytaxrelief.com) or by calling toll-free 1-888-222-9190. People who qualified for a rebate this year will automatically receive a form for next year's program and therefore do not need to sign up for the mailing.

### HOMEOWNERS

The expanded household income limits and rebate amounts are:

- \$0 to \$8,000 \$650 rebate
- \$8,001 to \$15,000 \$500 rebate
- \$15,001 to \$18,000 \$300 rebate
- \$18,001 to \$35,000 \$250 rebate

### RENTERS

The expanded household income limits and rebate amounts are:

- \$0 to \$8,000 \$650 rebate
- \$8,001 to \$15,000 \$500 rebate

## UPDATE ON SLOTS GAMING IN PENNSYLVANIA

### AWARDING OF CONDITIONAL LICENSES:

On Sept. 27, the Pennsylvania Gaming Control Board unanimously approved five applications for slot-machine gaming operator licenses, the first such licenses awarded under Act 71, the Race Horse Development and Gaming Act of 2004. On Oct. 25, the Gaming Control Board unanimously approved the application of Presque Isle Downs Inc. for a sixth gaming operator license.

All six approved licenses are associated with horseracing tracks that are operating or under construction across the Commonwealth. Three of the approved entities have indicated that they expect to begin gaming operations between November 2006 and January 2007.

In separate and unanimous votes, the Gaming Control Board approved licenses for:

- Chester Downs and Marina LLC (Chester Downs, Delaware County)
- Downs Racing LP (Pocono Downs, Luzerne County)
- Greenwood Gaming and Entertainment Inc. (Philadelphia Park, Bucks County)
- Mountainview Thoroughbred Racing Association (Penn National, Dauphin County)
- Washington Trotting Association Inc. (The Meadows, Washington County)
- Presque Isle Downs Inc. (Presque Isle Downs, Erie County)

Under Act 71, the Gaming Control Board is authorized to award 14 slot-machine gaming licenses to facilities across Pennsylvania. Seven Category 1 licenses are authorized for horse-race tracks, though only six of the conditional licenses have been applied for.

The Board plans to act on all permanent licenses for Category 1 facilities before the end of the year along with five Category 2 licenses for standalone slots facilities - two in Philadelphia, one in Pittsburgh and two at tourism-enhanced locations across the state - and one Category 3 license for existing resorts. The recent withdrawal by the Seven Springs Resort has left the second Category 3 license available. The Board expects to announce a timetable for applying for that license soon.

### OPENING OF PENNSYLVANIA'S FIRST SLOTS FACILITY:

The Commonwealth of Pennsylvania became America's 12th casino state when *Mohegan Sun at Pocono Downs* opened its gaming floors on Nov. 14. It was Pennsylvania's first slots parlor, ushering in a new era in gaming.

Pocono Downs is a harness racing track that is located outside of Wilkes-Barre, about 100 miles northeast of Harrisburg. It is the first of three horse tracks opening casinos. Two other racetracks, Philadelphia Park in Bucks County and Chester Downs in Delaware County plan to open by January 2007.

With the opening of Pennsylvania's first slots parlor in Nov., the ultimate goal of property tax relief for all Pennsylvania homeowners will soon follow.

### CENTRAL CONTROL COMPUTER SYSTEM FOR SLOTS GAMING:

The Revenue Department has been working for several years with GTECH Corporation to install a central control system for all slots gaming in the Commonwealth. Under Pennsylvania law, all slot machines must be connected to the system and electronically report all activity taking place on the slot machine - cash in, amount wagered, amount won, any malfunction, etc. With this information, the legal percentage of payout can be monitored and the tax due the Commonwealth is calculated. Other information is monitored and logged to maintain the integrity of slots gaming. The system is fully redundant, so gaming in Pennsylvania would not be impacted if the central system experiences technical difficulties.

Since June, the department and GTECH have been working with the licensed slots operators to connect and test their slot machines to make certain they are properly communicating with the central system.

### TAX CLEARANCES AS REQUIRED BY ACT 71:

As of Nov. 2006, the Revenue Department has completed 1,476 Gaming Board license requests for tax clearances. By category, they are:

CATEGORY	NUMBER
Facility Category 1 Slot Machine Licenses.....	5
Facility Category 2 Slot Machine Licenses.....	12
Facility Category 3 Slot Machine Licenses.....	2
Manufacturers .....	19
Suppliers .....	23
Vendors .....	30
Key Employees .....	125
Affiliates .....	134
Qualifiers .....	687
Permittees .....	439

## TAX PROFESSIONAL E-SERVICES CENTER IS HERE

Responding to the valuable insights gained from its survey of tax professionals in December 2005, the Department of Revenue is excited about the expansion of its Web site. Pennsylvania Tax Professionals, like you, can now manage your business online more efficiently with the addition of the department's "**Tax Professional e-Services Center**". The Tax Professional e-Services Center organizes most of the information and services that you need in one place and most importantly, will soon include access to your clients' Pennsylvania Personal Income Tax data.

The Center will require a one-time easy registration process to access this information. To register, you need an approved PA e-Signature on file, your federal Preparer Tax Identification Number (PTIN) and an Electronic Filing Identification Number (EFIN). If you do not have a PA e-Signature, you can obtain one on the department's **e-Services** Web site.

The enhancement to the Center will enable you to:

- Check the status of your client's PA income tax returns and refunds;
- View all notices that your client receives;
- View estimated payments and credits; and
- Evaluate a tax return summary.

You need to have filed your client's Pennsylvania Personal Income Tax returns through the Fed-State e-file program. In addition, you must indicate on those returns that a Power of Attorney (POA) has been granted.

Watch for future Tax Updates with additional information on the system, its capabilities and specific details on how to get started.

## PENNSYLVANIA FED/STATE E-FILE CHANGES FOR TAX YEAR 2006

### CHANGES TO PA ACKNOWLEDGMENT CODES

The Department of Revenue has eliminated the use of the "C" (Conditional Acceptance) and the "N" (Notification) acknowledgment codes. Upon receipt of a PA electronic return, the department will generate either an "A" (Acceptance), "R" (Rejection) or "D" (Duplicate) acknowledgment code. If the department is unable to upload a return to our master file processing system, the department will generate an "R" (Rejection) code indicating the return has been rejected. If a return has been assigned a Declaration Control Number (DCN), a Primary Social Security Number and/or a Secondary Social Security Number that is the same as a number that was previously assigned to another return, the department will generate a "D" code (Duplicate) indicating the return has been rejected. A three-digit error code will accompany the "D" code to identify which number has been duplicated.

### CHANGE TO ERO REGISTRATION FOR TAX YEAR 2006

Starting in November 2006, the Department will no longer require approved Electronic Return Originators (ERO) to register separately for electronic filing in Pennsylvania. The Department will obtain ERO information from the Internal Revenue Service.

Once an ERO has been approved to file with the IRS, they are automatically approved to file with the Department as well.

### FORM AND SCHEDULE CHANGES FOR TAX YEAR 2006

#### Allowing PA Schedule O - Other Deductions

This Schedule will be used to claim deductions for Medical Savings Account contributions, Health Savings Account contributions, and/or IRS Section 529 Tuition Account Program contributions.

#### Allowing PA Schedule G-S and G-L - Resident Credit

The former PA Schedule G is now two forms for claiming a credit for taxes paid to another state or country. Up to 20 occurrences of each form can be filed with an electronic return.

#### PA Schedule D - Sale, Exchange or Disposition of Property

The amount of schedules accepted has increased from 30 to 50 occurrences per return.

#### PA Schedule A and B - Interest and Dividends

The amount of schedules accepted has increased from 10 to 40 occurrences per return.

## PENNSYLVANIA TAX TREATMENT OF IRC § 1031 LIKE-KIND EXCHANGES

### IRC § 1031 LIKE-KIND EXCHANGES

Under federal tax rules, gain or loss is recognized upon the disposition of property, including dispositions involving an exchange of property. Internal Revenue Code Section 1031 is an exception to the general rule, which states that the recognition of gain or loss can be deferred under certain circumstances when property held for productive use in a trade or business or for investment is exchanged for property of a like-kind, and is held for productive use in business or investment.

Regardless of the manner in which an IRC § 1031 like-kind exchange is structured, all exchanges contemplate the deferral of gain or loss for federal income tax purposes.

### PA PIT TREATMENT OF § 1031 EXCHANGES

One of Pennsylvania's taxable classes of income is net gains or income from the sale, exchange or other disposition of property.

The gain or income from the disposition of property is equal to the value, which is received, reduced by a taxpayer's adjusted basis in the disposed property. A taxpayer's basis in property is to be determined in accordance with generally accepted accounting principles, but usually, a taxpayer's basis is his cost.

Pennsylvania Personal Income Tax law does not contain a provision analogous to IRC § 1031. Therefore, exchanges of property that result in gain or income are generally subject to tax. However, the department has determined that gain or loss on like-kind exchanges does not have to be recognized at the time of the exchange if a taxpayer's method of accounting permits the deferral of gain from a like-kind exchange.

**Example:** APB Opinion 29 provides for non-recognition of gain or loss on certain like-kind exchanges for taxpayers who consistently use GAAP principles of accounting. A taxpayer must use the method of accounting on a consistent basis and the method of accounting must clearly reflect his income. A taxpayer may not change his method of accounting just to obtain a tax benefit for a particular transaction. Nevertheless, the deferral of gain or income associated with like-kind exchanges is the exception.

### PA RTT TREATMENT OF § 1031 EXCHANGES

Documents that effectuate or evidence the transfer of title to real estate are subject to Pennsylvania Realty Transfer Tax. Consequently, if title to Pennsylvania real estate is conveyed in an IRC § 1031 exchange, the document of conveyance is subject to tax.

In simple exchanges involving a trade of properties, Pennsylvania Realty Transfer Tax is due on the document of transfer for each property.

In multiparty exchanges involving intermediaries and multiple transfers of the same property, there can be multiple impositions of tax on the same property.

In order to have gain or loss deferred under IRC § 1031, a multiparty transaction involving an intermediary that takes title to real estate is structured so that the intermediary becomes the actual owner of the real estate it acquires. Because the intermediary becomes the actual owner of the real estate, the intermediary cannot be considered an agent or straw party. Consequently, the agent or straw party exclusion is not applicable to transfers from an intermediary.

### PA SUT TREATMENT OF § 1031 EXCHANGES

Since Pennsylvania Sales and Use Tax law defines a sale at retail as any transfer for consideration of the ownership, custody or possession of tangible personal property, Sales and Use Tax applies when a party makes a like-kind exchange of tangible personal property. If the party making a like-kind exchange obtains the replacement property from a vendor who will take the property to be exchanged in lieu of the whole or any part of the purchase price of the property, the vendor is permitted to reduce the purchase price by the amount the vendor allowed the purchaser for the trade-in. Pennsylvania Sales and Use Tax law requires that the trade-in occur at the same time as the purchase.

If an exchange occurs through the use of a qualified intermediary and the property to be exchanged is eligible for the isolated sale exemption, the sale to the intermediary is not subject to tax. The replacement property "purchased" from the qualified intermediary is subject to tax if the purchaser has no valid exemption reason and the qualified intermediary is a vendor of tangible personal property. A qualified intermediary is a vendor of tangible personal property if the intermediary engages in 1031 exchanges as a business. The replacement property's "purchase price" may not be reduced by the amount the intermediary allows for the property traded-in unless the intermediary accepts the property traded-in in lieu of all or part of its "purchase price" of the replacement property and the intermediary "purchases" the property traded-in at the same time it "sells" the replacement property to the party making the trade-in.

Additional information on this topic is discussed in greater detail in [PIT Bulletin 2006-07](#), [RTT Bulletin 2006-01](#) and [SUT Bulletin 2006-01](#).

## CORPORATION TAX NEXUS AND THE REVENUE DEPARTMENT'S DISCOVERY PROGRAM

The Department of Revenue's Discovery Division plays an important role in the Department's tax enforcement program. The Discovery Division investigates out-of-state businesses that operate in Pennsylvania without formally registering to file and pay Pennsylvania business taxes. The Division is crucial to ensuring that Pennsylvania-based businesses have a level playing field for doing business and that all businesses operating in the Commonwealth pay their fair share of state taxes.

The Discovery Division uses a variety of sources to identify potential candidates for nexus investigations. These resources include U.S. Customs information; state agency licensing information; unemployment compensation and personal income tax withholding; construction contract data; and motor vehicle, watercraft and aircraft registration. Internet searches also provide a wealth of information in identifying and verifying Pennsylvania activities of out-of-state businesses.

For purposes of Pennsylvania corporate taxation, nexus is defined as a physical connection that subjects a corporation to the requirement of filing and paying tax. If the business conducts any of the following activities it has established nexus:

- Having or maintaining, either directly or through a subsidiary, an office, distribution house, sales house, warehouse, service enterprise or other place of business irrespective of whether the place of business is located permanently or temporarily or authorized to do business within this Commonwealth.
- Having or maintaining an agent of general or restrictive authority irrespective of whether the agent is located permanently or temporarily or authorized to do business within this Commonwealth.
- Maintaining a stock of goods.
- Regularly soliciting orders through a solicitor, salesman, agent or representative, whether or not the orders are accepted in this Commonwealth, or performing promotional activities in this Commonwealth.
- Regularly engaging in the delivery of property in this Commonwealth, other than by common carrier or United States mail, and soliciting business within this Commonwealth, whether by means of United States mail, radio, television, newspaper or otherwise.
- Regularly engaging in an activity in connection with the leasing or servicing of property, which is located within this Commonwealth.

Federal Public Law 86-272 exempts businesses whose activities are limited to sales solicitation from Corporate Net Income taxation. However, non-Pennsylvania corporations and limited liability companies (including those that have elected to report to the IRS as partnerships) whose in-state activities are limited to just sales must still register, file and pay Pennsylvania Capital Stock/Franchise Tax.

In addition, for those whose specific activities are limited in Pennsylvania, the Department of Revenue has adopted de minimis provisions. These provisions describe the level of business activity within Pennsylvania which requires the filing of Corporate Tax reports. The description of the de minimis standards, as well as details on what constitutes "solicitation only" activities may be found in the Department of Revenue's **Corporation Tax Bulletin 2004-01**. For those with limited Pennsylvania activities within the scope of this policy, a Declaration of De Minimis PA Activity (RCT-101D) may be filed in lieu of the Corporate Tax report.

Several examples illustrate the impact of the Discovery program on Pennsylvania business tax compliance:

**Example #1:** A Virginia consulting company is first identified through a matching program with employer withholding records. An investigation confirms Pennsylvania business activities. In addition, the unemployment compensation records evidence presence of Pennsylvania-based employees not disclosed by the company. The corporation is subjected to delinquent Capital Stock/Franchise and Corporate Net Income Taxes back to the date consulting started in the Commonwealth.

**Example #2:** U.S. Customs data is received for repeated transactions involving a Canadian importer to Pennsylvania businesses. An investigation confirms the ongoing sales, delivery and service of machinery to Pennsylvania manufacturers. The Canadian corporation is subjected to Capital Stock/Franchise and Corporate Net Income Taxes beginning with the date that sales and service of its products began in Pennsylvania.

**Example #3:** Federal Aviation Administration data is received on newly purchased aircraft registered from Pennsylvania addresses. The review of one transaction confirmed the exempt use of the aircraft for Sales and Use Tax purposes, but a simultaneous review of the Corporate Tax registry showed that the Maryland corporation, which was the aircraft owner, was not registered. Capital Stock/Franchise and Corporate Net Income Taxes were imposed back to the date of the initial purchase and use of the aircraft within Pennsylvania.

## 2006 FALL TAX SEMINARS SCHEDULE

SPONSOR	DAY	DATE	CONTACT	SEMINAR LOCATION
<b>Penn State University</b> Ogontz Campus 1600 Wood Land Road Abington, PA 19001	<b>Wednesday</b>	<b>12-06-2006</b>	<b>Theresa Bloom</b> (215) 881-7402	<b>Holiday Inn, Select</b> 4700 Street Road Trevose, PA 19053

## 2006 FALL TAX SEMINAR AGENDA

*See page 7 for Seminar Schedule Dates*

TIME	TOPIC	PRESENTER
8:15 - 9:30 AM	<b>INTRODUCTION &amp; PERSONAL INCOME TAX UPDATES</b> <ul style="list-style-type: none"> <li>&gt; Update on Nonqualified Deferred Compensation and PA-40 W-2 Reconciliation Worksheet</li> <li>&gt; PA Booklet and forms changes. New PA forms</li> <li>&gt; Common Errors</li> <li>&gt; Tax Law Changes</li> </ul>	<i>David Braden, CPA</i> Bureau of Individual Taxes
9:30 - 10:15 AM	<b>PASS THROUGH BUSINESS UPDATE</b> <ul style="list-style-type: none"> <li>&gt; Abusive Tax Shelters</li> <li>&gt; Calculation of Partnership/Shareholder Basis</li> </ul>	<i>Mary Hubler</i> Pass Through Business Office
<i>10:15 - 10:30 AM Break</i>		
10:30 - 11:00 AM	<b>USE TAX VOLUNTARY COMPLIANCE PROGRAM AND OTHER VOLUNTARY COMPLIANCE INITIATIVES</b>	<i>Kevin Milligan</i> Enforcement, Planning Analysis, and Discovery
11:00 - 11:45 AM	<b>SALES AND USE TAX</b>	<i>Jeffery S. Snively and Lora A. Kulick</i> Office of Chief Counsel
11:45 - NOON	<b>QUESTIONS AND ANSWERS</b>	
<i>Noon - 1:00 PM Lunch</i>		
1:00 - 2:00 PM	<b>CORPORATION TAXES UPDATES</b> <ul style="list-style-type: none"> <li>&gt; Amended Reports, Corrected Reports, and Reports of Change</li> <li>&gt; New Schedules for 2006</li> <li>&gt; What is required with RCT 101</li> <li>&gt; Federal/State E-file Program</li> </ul>	<i>Greg Skotnicki, John Naccarato, Jeffrey A. Creveling or Joseph Clover</i> Bureau of Corporation Taxes
2:00 - 3:00 PM	<b>INHERITANCE TAX AND ESTATE TAX UPDATE</b> <ul style="list-style-type: none"> <li>&gt; Updates in the Law</li> <li>&gt; Electronic Initiatives</li> <li>&gt; Inheritance Tax Refresher</li> </ul>	<i>Holly McClintock</i> Bureau of Individual Taxes
<i>3:00- 3:15 PM Break</i>		
3:15 - 4:15 PM	<b>UNEMPLOYMENT COMPENSATION TAX UPDATES (LABOR AND INDUSTRY)</b>	<i>Timothy McGarvey, Jim Diffendal, Paul Bowes</i> Labor and Industry
4:15 - 4:30 PM	<b>QUESTIONS AND ANSWERS</b>	

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