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ACTING SECRETARY OF REVENUE

EDWARD G. RENDELL
GOVERNOR



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FAST FACT:

Governor Rendell proposes to cut business taxes by another \$216 million in FY2007-08. Since 2003, he has cut business taxes by \$1.1 billion.

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GOVERNOR RENDELL'S 2007-08 BUDGET OFFERS AGENDA FOR PA PROGRESS AND TACKLES LONG-TERM CHALLENGES

On February 6, Governor Edward G. Rendell proposed a fiscal year 2007-08 budget that continues to build on progress made over the past four years by delivering property tax relief to Pennsylvania homeowners this summer – a full year ahead of schedule.

The Governor said this year's spending plan posed unique challenges as the state faces fundamental problems that need to be solved, including more than \$2 billion worth of federal funding cuts since 2002-03 for federally-mandated programs, and a \$1.7 billion transportation funding crisis that threatens to cripple the state's entire transportation network if not addressed.

Building on the success of his management and productivity program that has saved taxpayers more than \$1 billion, Governor Rendell also challenged his administration to identify additional ways to cut costs, increase efficiencies and save an additional \$500 million in the next four years. His budget reduces the jobs complement by an additional 708 positions without any layoffs, furloughs or service cutbacks.

The proposed 2007-08 General Fund Budget is \$27.3 billion, an increase of 3.6 percent, and it reduces spending by \$162 million in all areas other than the departments of Education, Public Welfare, Corrections and Probation & Parole.

ACCELERATE THE DELIVERY OF PROPERTY TAX RELIEF

Building on the strong momentum generated by the support of legislative leaders during last year's property tax debate, Governor Rendell proposed a bold new plan to accelerate the delivery of property tax relief. The Governor proposes to raise the sales tax rate by 1 percent – from 6 percent to 7 percent (from 7 percent to 8 percent in Philadelphia and Allegheny Counties) and use the revenue to begin general property tax relief for millions of Pennsylvanians *this summer*, a full year ahead of schedule.

Without any additional revenue, the property tax relief fund balance is expected to be \$450 million by this summer. Current law permits property tax relief to *all* Pennsylvania homeowners *only* when sufficient funds are available to cover the required

reserve *and* there is at least \$400 million for homeowner tax relief. So if we don't add money to the fund, all non-senior homeowners will have to wait another year for relief.

The accelerated property tax relief plan will return more than \$900 million to homeowners, which includes \$199 million already scheduled to be delivered to seniors this summer through the expansion of the Property Tax/Rent Rebate program. By combining gaming funds already being generated with a sales tax shift, millions in new revenue included in the 2007-08 budget, can be immediately returned to taxpayers.

"The tax shifting plan proposed will provide nearly \$720 million in property tax relief this summer," the Governor said in his address. "That is a full year ahead of schedule, and it finally gives all Pennsylvania homeowners real cuts in their property taxes."

This is not a one-year benefit. The Governor is asking the legislature to agree to allocate \$700 million of the increased sales tax revenues to permanently reduce the commonwealth's reliance on property taxes. This reduction would be over and above the relief that will arrive once Pennsylvania's new gaming facilities are fully operating and generating an estimated \$1 billion per year in additional property tax relief funds. "Under the plan I am proposing today, property tax relief in Pennsylvania will grow to at least \$1.7 billion a year," Governor Rendell said.

TRANSPORTATION FUNDING SOLUTION

Governor Rendell's budget includes a \$1.7 billion transportation package that successfully avoids increasing the gasoline tax, saving consumers money at the pump:

- The commonwealth would develop a plan to take advantage of the value of the Pennsylvania Turnpike. The proceeds would be used to create a new revenue stream for transportation projects. Preliminary estimates show this could produce as much as \$965 million a year for transportation.
- A new oil company gross profits tax would be levied on oil companies that do business in Pennsylvania. The 6.17-percent tax would be based on "combined reporting,"

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GOVERNOR RENDELL'S 2007-08 BUDGET - Continued from page 1

meaning the company would be taxed on the portion of total profits on a company's tax return attributable to activity in Pennsylvania. Oil companies would be exempted from the 9.99 percent Corporate Net Income (CNI) Tax. Part of the proceeds from the new tax would cover the loss of CNI Tax to the General Fund. The new tax, beginning in 2008, would generate \$760 million a year for transit.

In his budget address, Governor Rendell said that since 2004, oil companies have reported \$368 billion in profits nationwide. He said taxing these companies is the right choice for Pennsylvania consumers burdened by ever-rising gasoline prices.

"We propose a tax on gasoline, but for the first time, we propose to tax those who make gasoline rather than those who *buy* it," said Governor Rendell.

"I believe that the imposition of this tax places the burden squarely on the shoulders of those who enjoy tremendous benefits from the commonwealth's operation of state highways and bridges. America's oil companies have earned record profits in the past few years, and these profits come from one source: the pockets of the American people."

HEALTH CARE INITIATIVES

The Governor's *Prescription for Pennsylvania* health care reform plan will be funded by assessing "free-rider" businesses that do not offer health insurance and thus pass the health care costs of their employees and their families on to everyone else. The plan will also be funded by increasing the cigarette tax, establishing a tax on smokeless tobacco products, using existing funding from the adultBasic program and obtaining significant new matching funds from the federal government. The tax rate on smokeless tobacco products would be 36 cents per ounce of smokeless and loose tobacco and 36 cents per 10 cigars and cigarillos. The tax would raise about \$27.8 million to help pay for the Governor's health care initiatives. Pennsylvania is the only state in the country that does not currently tax smokeless tobacco products.

The Governor proposes to raise the cigarette tax by 10 cents from \$1.35 per pack to \$1.45 per pack. The \$49 million raised would also be used to help pay for the Governor's health care initiatives.

2007-08 BUSINESS TAX CUTS

The Governor's 2007-08 budget continues to improve Pennsylvania's business tax competitiveness by continuing the phase-out of the Capital Stock and Franchise Tax, reducing the tax rate by another mill and thereby generating an additional \$215 million in savings to Pennsylvania businesses in 2007-08.

Business taxes will be cut more than \$215 million in 2007-08 under Governor Rendell's budget proposal – bringing the total recurring tax cuts to \$1.1 billion since Governor Rendell came into office in 2003. The additional 2007-08 business tax cuts include:

- Capital Stock and Franchise Tax – continuing phase-out of the tax by one mill to lower the rate to 3.89 mills, saving businesses a total of \$215 million in 2007-08.
- Education Improvement Tax Credit – increasing the credit by \$1.4 million.

Governor Rendell has promised to continue to push for the other changes to the business tax structure, as proposed by the Business Tax Reform Commission, including:

- Reducing the Corporate Net Income (CNI) Tax rate from 9.99 percent, the third highest in the nation, to 7.9 percent.
- Closing CNI Tax loopholes that allow companies to shift money earned in Pennsylvania to other jurisdictions with lower or no taxes.
- Increasing the weight of the sales factor used to calculate the CNI Tax 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, start-up companies and cyclical manufacturing companies.

Learn more about Governor Rendell's 2007-08 budget:



CIGARETTE TAX ENFORCEMENT PROJECT

The Revenue Department is stepping-up its cigarette tax enforcement efforts this fiscal year. Along with increased retail inspections to ensure that Pennsylvania retailers are only selling cigarettes bearing the necessary Pennsylvania cigarette tax stamps, the department is going to begin utilizing federal information on cigarette shipments.

A federal law (Jenkins Act, 15 U.S.C. § 375) requires out-of-state cigarette vendors to provide purchase and shipping information to state taxing authorities, such as the PA Department of Revenue, so that appropriate state taxes can be collected. The Revenue Department has been receiving information from out-of-state cigarette vendors and has a responsibility to use this information to collect the tax money that is due to the commonwealth.

Any person who purchases cigarettes over the Internet, by telephone or from out-of-state locations, and brings the cigarettes into state, is liable for Pennsylvania cigarette and use taxes – despite what some vendors falsely advertise. This also applies to cigarettes purchased from Native American Reservations.

Pennsylvania law allows residents to possess one carton of cigarettes not bearing the Pennsylvania tax stamp; however, the purchaser is still responsible for paying the appropriate cigarette and use taxes to the commonwealth. Possessing more than one carton of out-of-state cigarettes is a violation of state law. Depending on the quantity of illegal cigarettes a person or retailer possesses, he or she could be charged with a summary, misdemeanor or felony offense and sentenced to fines and in some cases imprisonment.

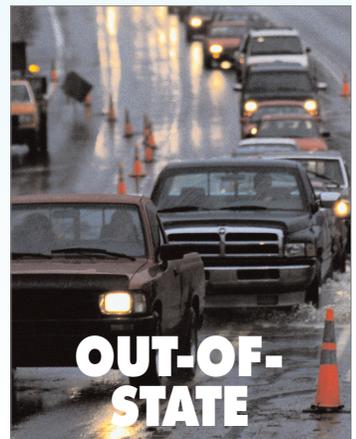
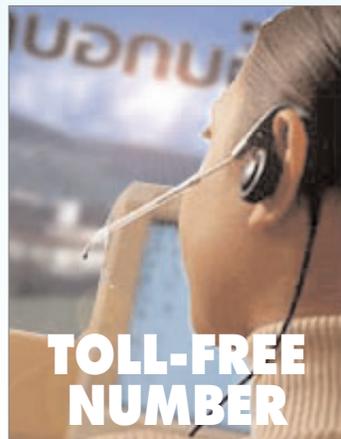
This fiscal year, the department will begin mailing letters, along with a **Consumer Cigarette Excise Tax Return (REV- 791)**, to taxpayers who were identified as purchasing cigarettes over the Internet or via mail order without paying the appropriate Pennsylvania cigarette and use taxes.

Since 2004, the PA cigarette tax rate has been \$1.35 per pack of 20 cigarettes (0.0675 per stick). The tax is imposed on the consumer, but cigarette-stamping agents apply tax stamps to the cigarette packs to indicate payment of the tax and are responsible for remitting the tax to the commonwealth. In addition to the cigarette tax, consumers pay a 6% sales and use tax on the retail purchase price of cigarettes, with an additional 1% local sales tax in Philadelphia and Allegheny Counties.

Pennsylvania-based businesses that sell cigarettes bearing the appropriate Pennsylvania cigarette tax stamp are at a competitive disadvantage against retailers that do not. By enforcing the cigarette tax laws of the commonwealth, the Department of Revenue is helping to ensure a level playing field among businesses.

The revenue generated from the state's Cigarette Tax goes to the Children's Health Insurance Program (CHIP) to provide health insurance to children of low-income families, the state's Agricultural Conservation Easement Purchase Fund used to preserve farmland and to the Health Care Provider Retention Fund for malpractice insurance.

For more information about cigarette taxes, visit the Department of Revenue's Web site at www.revenue.state.pa.us



BUSINESS LICENSE INFORMATION EXCHANGE PROGRAM IS UNDERWAY

The Commonwealth Business License Information Exchange Program, created by Governor Edward G. Rendell with Executive Order 2006-03, is to help ensure that people and businesses licensed by the state do not have unpaid state taxes.

The information exchange program will encourage economic growth by creating a level playing field for businesses. It will also help ensure that, whenever possible, the commonwealth does not issue a license, permit or registration to an entity that has failed to pay its taxes.

Under the Business License Information Exchange Program, state agencies under the Governor's jurisdiction will provide the Department of Revenue with information regarding the issuance or renewal of licenses, permits and registrations. The department will then verify that the entities seeking licenses, permits or registrations are compliant with their state tax obligations.

In addition to pursuing collection action against non-compliant taxpayers, Revenue will notify licensing agencies whenever

it determines that a prospective licensee has a state tax delinquency. To the extent permitted by law, the licensing agencies shall impose appropriate enforcement action against prospective licensees for failure to comply with state tax laws.

The executive order required the Secretary of Revenue to establish a Business License Information Exchange Committee to oversee the program. The committee consists of representatives from the departments of Revenue and Labor and Industry, as well as the Office of General Counsel.

The executive order did not eliminate the need for legislation addressing this issue, since some state agencies may lack the statutory authority to withhold licenses, permits or registrations based upon non-payment of taxes.

The Revenue Department is expected to collect \$3.2 million in previously delinquent taxes this fiscal year and \$6.3 million during fiscal year 2007-08 from the new information exchange program.

TAX PROFESSIONAL E-SERVICES CENTER

CLIENT DATA ACCESS AREA NOW AVAILABLE



The PA Department of Revenue is pleased to announce that the *Client Data Access Area* of the **Tax Professional e-Services Center** is now available.

Tax professionals who have filed their clients' Pennsylvania Personal Income Tax returns through the Fed/State e-File Program can now review their clients' Personal Income Tax data online. The client must first grant the tax professional Power of Attorney in order to access their information.

Tax professionals will need an approved PA e-Signature on file, their federal Preparer Tax Identification Number (PTIN) and an Electronic Filing Identification Number (EFIN) to access this area of the **Tax Professional e-Services Center**.

The Department mailed letters to tax professionals detailing the new capabilities of the Center and the rules for accessing the information. Direct link to the [Client Data Access Area](#).

For questions concerning the Center, refer to the Department's Online Customer Service Center or call the Department at (717) 787-1392.

UPDATE ON NON-QUALIFIED DEFERRED COMPENSATION

The Department of Revenue, in a previous *PA Tax Update* article (April/May 2006, No. 120), provided guidance to employers and taxpayers with respect to deferrals and distributions from Nonqualified Deferred Compensation Plans. The employer requirements included providing plan participants with a letter stating the amount of elective deferrals previously included in PA taxable compensation on a year-by-year basis and new coding for W-2s beginning in 2006 to indicate the certain attributes with respect to the amounts of deferrals and distributions. Due to the IRS extension of their coding requirements for Box 12 of the W-2, the Department of Revenue advised employers that their requirements with respect to the new coding for Box 14 of the W-2s were suspended for tax year 2006. Employers were further advised that, even though they did not need to include the information on the W-2, they would still need to be able to provide the amounts of current year elective deferrals or current

year distributions that may have been previously included in PA taxable income.

Taxpayers who do not have the information included on their W-2 with respect to deferrals or previously taxed distributions should complete and include with their PA-40 the new PA Schedule W-2 RW, Reconciliation Worksheet to provide the Department of Revenue with the information missing from the W-2s. Taxpayers and tax preparation professionals should include this new worksheet with the return at the time of filing to avoid delays in receiving any refunds they might be due. Returns received without the new worksheet will be put in a hold status until the worksheet is requested and received from the taxpayer. **It is suggested that this new worksheet be completed and included with a PA-40 return any time the Medicare Wages on a W-2 do not match the Pennsylvania Wages on a W-2.**

1099R REPORTING REQUIREMENTS

Beginning in tax year 2006, taxpayers receiving and reporting 1099R distributions on their state income tax returns are to report and include all 1099R distributions, regardless of whether or not the distributions are taxable to Pennsylvania, on PA Schedule W-2S, Part B.

This requirement is as a result of a Departmental review of 1099Rs filed by the payers of the distributions that included Codes 1 or 2 in Box 7 of the 1099R. While reviewing the tax returns of the individuals shown to have these types of 1099Rs, it was noted that a significant number of the taxpayers with distributions Coded 1 or 2 did not indicate that they had PA taxable compensation - particularly those with distribution Code 1. After following up with taxpayers and tax preparers, the Department learned that many did not think that they had taxable compensation to Pennsylvania in these circumstances, nor did they think they needed to include the information on their returns. Therefore, the Revenue Department decided to revise PA Schedule W-2S to require all 1099R information to

be included regardless of whether or not the distributions result in any taxable compensation to Pennsylvania.

Taxpayers filing paper returns are required to include a photocopy of the 1099R with their return, regardless of whether or not there is PA tax withheld from the distribution. Taxpayers filing using the e-file method are not required to submit the 1099R form separately to the Department of Revenue. The Department of Revenue receives these documents along with the information it receives from the IRS as part of the Fed/State e-file program.

Form 1099Rs from annuities not considered to be employer sponsored retirement plans (annuities sold by insurance companies, brokers, banks, etc.) should not be listed on Part B of Schedule W-2S. The amount of income that is determined to be subject to tax for Federal Income Tax purposes for these types of annuities is to be reported as interest income for PA Personal Income Tax purposes as a result of Act 40 of 2005.

QUALIFIED TUITION PROGRAM CONTRIBUTION DEDUCTIONS

With Governor Edward G. Rendell's signing of the 2006-07 state budget, families are better able to pay for a child's college education thanks to a \$25 million tax break.

Contributions to any qualified tuition program as defined in section 529 of the Internal Revenue Code (TAP 529), including those offered by other states, will be deductible from taxable income. The amount deducted for each designated beneficiary cannot exceed the annual limitation on gifts permitted by the Internal Revenue Code for purposes of federal estate and gift tax, which is currently \$12,000. The deduction cannot result in taxable income being less than zero.

Distributions used for qualified higher education expenses, as well as undistributed earnings in the accounts, will not be taxable. Federally qualified rollovers between accounts and beneficiary changes will also not be taxable events for Pennsylvania purposes. Distributions that are not used for qualified higher education expenses are subject to tax. These changes will apply to tax years beginning after Dec. 31, 2005.

For more information about TAP contribution deductions or to submit a question, please visit the Department's [Online Customer Service Center](http://www.revenue.state.pa.us) on the Department's Web site at www.revenue.state.pa.us.

CLARIFICATIONS TO PA SCHEDULE G-S AND PA SCHEDULE G-L INSTRUCTIONS

Line 4a, Tax due or assessed in the other state or country of Schedules G-S and G-L provide the following instructions:

"Enter the amount of income tax reported to the other state or country as due and payable before any credits for taxes withheld, estimated tax payments, or other payments are taken into account."

To clarify, this amount is generally the tax liability as determined on the other state's return. However, any special tax credits awarded or claimed must be used to reduce this amount.

Line 4b, Tax paid in other state or country of Schedules G-S and G-L provide the following instructions:

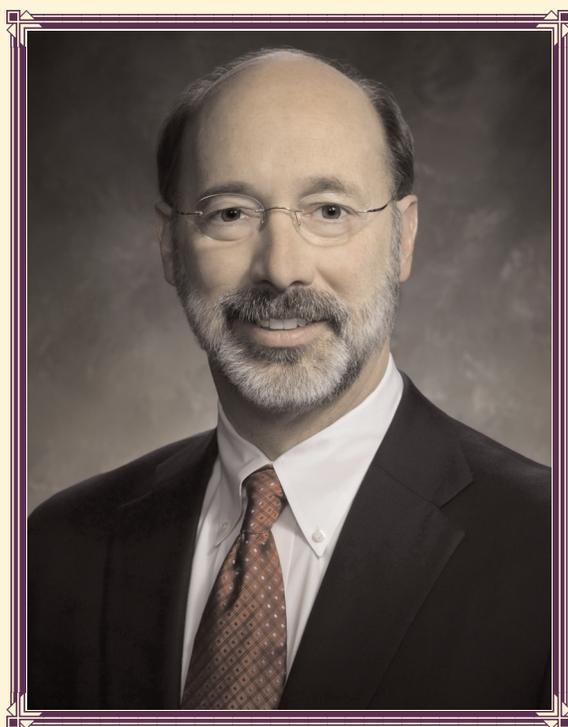
"Enter the amount of income tax actually paid to the other state or country in the form of estimated taxes, withholding taxes, extension payments, and other payments (additional assessments of taxes)."

To clarify, the other payments portion of this instruction includes payments that the taxpayer intends to make with the filing of the return if there is a balance due after application of estimated taxes, withholding taxes and extension payments. If a taxpayer does not make the payment of taxes due with their return or does not intend to make that payment, do not include the balance due on the return with this amount.

The Department of Revenue allows taxpayers to list "Various" on the Schedules G-S or G-L for interest and dividend income taxed in foreign countries.

In these cases, the Department of Revenue will also accept the Federal Form 1116 in lieu of the individual pages from Broker statements to support the taxes paid to the other countries. A spreadsheet showing the calculation of the credit on a country-by-country basis is also needed to support the credit claimed along with the Federal Form 1116. The statement showing the amounts of income, tax paid and credit calculated on a country-by-country basis may show the name of stock, type of income, or transaction taxed in lieu of the country's name.

MEET THOMAS W. WOLF ACTING SECRETARY OF REVENUE



Thomas W. Wolf was nominated as Secretary of the Pennsylvania Department of Revenue in January 2007 by Governor Edward Rendell. Upon confirmation by the Senate of Pennsylvania, Wolf will also serve as an Ex-Officio member of the PA Gaming Control Board.

Wolf was appointed by the Governor to serve on the 12-member Pennsylvania Business Tax Reform Commission, which issued a report in 2004 recommending changes to make business taxes fairer, simpler and more competitive with other states.

Wolf served as Chairman of the Board and President of the Wolf Organization, Inc., a family-owned building materials business based in York, Pa. The Wolf Organization distributes building materials through 30 branches located along the eastern seaboard. It was ranked among the top 50 Best Places to Work in PA in 2006.

Wolf earned his doctorate degree from the Massachusetts Institute of Technology in 1981 and his Master's degree in philosophy from the University of London in 1978. He graduated magna cum laude from Dartmouth College with a Bachelor of Arts degree in 1972.

Wolf has a long history as a volunteer for many community and charitable organizations. He has served as President of Better York, Inc.; Chair of the Board of Trustees for York College of Pa.; Board Member of the Keystone Research Center and the Pennsylvania Business Roundtable; Chair of the Lancaster York Heritage Region, York County Chamber of Commerce, United Way of York County, WITF, Inc., and The York County Community Foundation.

Wolf was born Nov. 17, 1948 in York, Pa.