Notable Tax Amendments From Pennsylvania's Budget Bill

By **Jennifer Karpchuk** (September 10, 2019, 5:08 PM EDT)

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Pennsylvania's budget bill, Act 13 of 2019, signed by Gov. Tom Wolf on June 28, made a number of significant changes to Pennsylvania's tax laws. This article will discuss the most significant changes made by Act 13 in the areas of personal income tax, sales and use tax, corporate net income tax, and changes related to trusts and estates.

Personal Income Tax

Those taxpayers taking advantage of the income tax advantages under the federal qualified opportunity zone program will be happy to hear of Act 13's change to the personal income tax. Unlike many other states, Pennsylvania's personal income tax base does not start with federal taxable income. Instead, the tax is imposed on seven specified categories of income. As such, prior to Act 13, personal income taxpayers would have been subject to tax on their gains that are deferred and excluded for federal income tax purposes under the opportunity zone program.

Act 13 alters the law to address this issue. Effective for tax years beginning after Dec. 31, 2019, Act 13 grants taxpayers opportunity zone benefits for personal income tax purposes by clarifying that "net gains," "net losses" and "dividends" do not include any amounts of gain, loss or income that are excluded from federal taxation pursuant to the opportunity zone rules. As such, taxpayers will receive all the exclusions and deferrals offered for federal income tax purposes pursuant to the opportunity zone program.

Sales and Use Tax

Marketplace Sellers

Act 13 updates sales and use tax collection rules in light of last year's monumental U.S. Supreme Court decision in South Dakota v. Wayfair Inc.,[1] which held that physical presence in a state is not required for the state to impose sales and use tax collection requirements.

Before Wayfair greatly expanded the rights of states to enforce collection by out-of-state vendors, effective March 2018, Pennsylvania enacted collection or notice and reporting requirements on remote sellers, referrers and marketplaces with $10,000 or more of sales annually into the commonwealth.

In January 2019, the Pennsylvania Department of Revenue announced its position that any person with $100,000 or more of sales in Pennsylvania was immediately required to collect sales and use tax following Wayfair.[2] Act 13 largely codifies the department's position by providing that all vendors and "marketplace facilitators" with $100,000 or more of sales into Pennsylvania during 2018 are required to collect and remit sales and use tax for the period from July 1, 2019, through March 31, 2020. Those vendors or marketplace facilitators who have $100,000 or more of sales in Pennsylvania during 2019 or any subsequent calendar year must collect and remit sales and use tax beginning April 1 of the following calendar year through March 31 of the subsequent calendar year. Further, Act 13 specifically eliminates the option to elect to report rather than collect for those meeting the $100,000 economic nexus threshold.

Another change brought about by Act 13 is that the onus of sales and use tax collection is placed upon the marketplace facilitator, not the seller. When a marketplace facilitator facilitates sales in Pennsylvania on behalf of an out-of-state marketplace seller, the tax collection responsibility falls on the marketplace facilitator, not the marketplace seller unless the marketplace seller fails to provide the marketplace facilitator with sufficient information to allow the marketplace facilitator to collect the tax. This is the case even if the marketplace seller makes sales of $100,000 or more in Pennsylvania through the marketplace facilitator.

Vendor Absorption of Tax

Prior to Act 13, there was a long-standing prohibition against vendors advertising that the sales tax imposed on certain sales would be absorbed in the vendor's stated price. Pursuant to Act 13, effective immediately, vendors can advertise that the sales tax will be absorbed by the vendor.

However, in order to advertise as such, the vendor must: (1) state on any receipt provided to the customer that the vendor will pay the tax and not imply that the transaction is exempt from sales and use tax; (2) separately state the amount of the sales and use tax on any receipt provided to the customer; and (3) keep books and records documenting the purchase price and the sales and use tax absorbed and remitted to the state.

Upon satisfying the three requirements, the law provides that the vendor "shall be solely responsible and liable for any [sales and use tax] … and shall not be entitled to a refund of such [tax]."

Notably, it is questionable whether an absolute prohibition on refunds of overpaid tax would withstand constitutional scrutiny and it is unclear how the refund prohibition will apply in practice. For instance, would a vendor be prohibited from obtaining a refund on an erroneous overpayment of tax, or tax incorrectly charged on exempt items?

Malt Beverage Tax

The sales and use tax treatment of malt beverages has traditionally differed from that of other tangible personal property because it is collected from the retailer by the manufacturer or the distributor of the beverages and not upon the retail sales to consumers. Therefore, the sales and use tax base typically is the lower wholesale price paid by the retailer rather than the full retail price.

Recent changes to the liquor laws expanded the ability of breweries to sell directly to consumers. Consequently, the department issued Bulletin 2018-02 announcing that, effective July 1, breweries would be required to collect sales and use tax on the retail price paid for beer purchased directly in their taprooms.The department's position would have resulted in brewers paying tax that was four to five times greater than the same beer sold in restaurants and grocery stores.

Act 13 supersedes Bulletin 2018-02 and provides partial relief to brew pubs by stating that the deemed retail price of sales directly to the ultimate consumer for consumption on or off premises is 25% of the retail price of the product sold. This treatment more closely aligns the tax base to the wholesale price. Further, Act 13 delays the implementation date to sales made after Sept. 30, 2019.

New Sales and Use Tax Exemptions

Act 13 provides for three new exemptions effective for sales occurring after Dec. 31. First, the existing exemption for food and beverage sales by nonprofit organizations supporting youth sports is expanded to encompass nonprofit organizations supporting youth development programs. Second, a new exemption is created for sales by volunteer fireman's organizations that raise funds for use by such organizations. Finally, a new exemption is created for the sale of building materials and supplies used for the construction or repair of an animal housing facility.

Corporate Net Income Tax

Act 13 expands the existing corporate net income tax deduction for "qualified manufacturing innovation and reinvestment" expenses by creating two tiers of investment and by increasing the allowable deduction. Previously, taxpayers who agreed to make at least $100 million of qualified investments within the initial three years could deduct 25% of the investment in each year.

Effective for tax years beginning after Dec. 31, taxpayers can now qualify for the deduction with a minimum investment of $60 million. Additionally, for the portion of investment that exceeds $60 million and is less than $100 million, the allowable deduction is increased to 37.5% of the qualifying investment. However, the 25% cap on the deduction remains in place for any investment above $100 million.

Changes Applicable to Trusts and Estates

Act 13 also made changes that are pertinent to trusts and estates. Previously, there was a discrepancy in the amount of inheritance tax assessed when a parent died and a child inherited, and vice versa. Since 2000, inheritance passing from a deceased child under age 21 to a parent, stepparent or adoptive parent has been taxed at 0%, while for the reverse scenario, for inheritance passing from a deceased parent, adoptive parent or stepparent to a child under age 21, inheritance tax was assessed at a rate of 4.5%.

To rectify this disparate treatment, Act 13 amended Section 9116 to add a new section (1.4) providing that the Pennsylvania inheritance tax rate for transfers "to or for the use of a child 21 years of age or younger from a natural parent, an adoptive parent, or a stepparent of the child shall be at a rate of [0%]." The new inheritance tax rate applies to property of a natural parent, adoptive parent or stepparent who dies after Dec. 31.

Another change in the trust and estate realm is the adoption of joint tax returns for estates and trusts. Internal Revenue Code Section 645 permits a personal representative of an estate and a trustee of a trust to elect to treat the trust and the estate as one for fiduciary income tax purposes. The effect of this allowance is to streamline the income tax return preparation for the two entities and to permit the trust return, which is filed on an annual basis, to be filed on a fiscal year basis.

In the past, Pennsylvania did not recognize the Section 645 election to treat the estate and trust as one for tax purposes. Therefore, even if the federal returns were combined, the Pennsylvania returns were required to be filed separately and the trust had to remain on a calendar year. Act 13 amends the Pennsylvania tax code at Section 7331 to recognize the Internal Revenue Code Section 645 election for tax years beginning after Dec. 31.

Analysis of Act 13's Changes

As the foregoing details, Act 13 made a number of changes applicable to many different taxpayers — individuals, companies, and trusts and estates. With some of these changes immediately effective and others effective in the near future, it is important for taxpayers to take note of these changes and understand their potential impact.

The federal opportunity program created tax incentives for certain qualified investments, but prior to Act 13, Pennsylvania was at a disadvantage to attract those investors since the investors' gains would not have been deferred for state income tax purposes as they would be federal purposes. For those taxpayers taking advantage of or considering taking advantage of the opportunity zone program, it is important to highlight the benefit of Pennsylvania's recent decision to conform to the deferral of income. Pennsylvania's conformity may help to incentivize investors to invest in blighted areas in the commonwealth.

Further, remote sellers, marketplace facilitators and vendors should take note of Pennsylvania's change in its law. Those marketplace facilitators and vendors with $100,000 or more in Pennsylvania sales who initially chose to elect to abide by reporting requirements instead of collecting the tax may no longer do so. Further, because the onus for collection is initially placed on the marketplace facilitator, those marketplace facilitators at or near the threshold should ensure they are adequately tracking sales into Pennsylvania to ensure compliance. Further, remote sellers should ensure that they are providing the marketplace facilitator with the requisite information to allow the marketplace facilitator to collect the tax so that the onus — and liability for noncompliance — does not shift to the seller. As the effective date requiring compliance has passed, it can be expected that the Department of Revenue will begin to step up enforcement efforts.

Finally, Pennsylvania brew pubs should take special note of the recent changes brought by Act 13 related to the appropriate retail price to use for sales tax purposes. With less than a month left to begin complying with the change, it is important that brew pubs have the tools in place to ensure compliance.

While Act 13 made a host of changes, a number of items again failed to make it from Gov. Wolf's proposed budget bill through to final passage. The governor's proposals have consistently called for a tax on Marcellus Shale natural gas drilling. Although Pennsylvania is now the second largest producer of natural gas in the United States behind Texas, it is the only state that does not tax gas production. However, the commonwealth does impose a per well impact fee.

The governor also called for combined reporting for corporate tax purposes and a reduction in the corporate net income tax rate, but those changes also failed to gain traction. Iowa levies the highest top statutory corporate tax rate at 12%, followed by New Jersey at 11.5% and Pennsylvania at 9.99%. Conversely, North Carolina has the lowest corporate tax rate in the country at a flat rate of 2.5%. While unsuccessful for 2019, it can be expected that the governor will again try to push these reforms in his 2020 budget.

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[1] South Dakota v. Wayfair Inc., 585 U.S. ___ (2018).

[2] See SUT Bulletin 2019-01.