Significant changes to Pennsylvania taxes signed into law on July 9, 2013

PUBLISHED ON
August 1, 2013

Pennsylvania enacted significant changes to a number of Pennsylvania taxes as part of the 2013-2014 budget process signed into law on July 9, 2013. The following summary highlights the most significant changes:

Real Estate Transfer Tax

The Realty Transfer Tax was amended, effective January 1, 2014, to tax transfers of holding companies, i.e., companies that own interests in real estate companies and to provide that an interest in a real estate company is considered transferred if it is subject to a binding put or call. Upon a change of 90 percent of the ownership of a real estate company in a three-year period, the real estate company owes realty transfer tax on its Pennsylvania real estate. A real estate company is an entity, 90 percent more of which is owned by 35 or fewer persons, that is primarily engaged in the business of holding, selling, or leasing real estate and derives 60 percent or more of its annual gross receipts from the ownership or disposition of real estate ("60 Percent Test"), or holds real estate, the value of which comprises 90 percent or more of its tangible assets ("90 Percent Test"). Under Act 52 to determine whether an entity is a real estate company under the 60 Percent Test or the 90 Percent Test, all real estate, wherever located, is considered. Prior to Act 52, only Pennsylvania real estate was considered.

Partnerships and S Corporations

Under Act 52, the tax treatment of partnership items and subchapter S corporation items is determined at the partnership or S corporation level. Partnerships and S corporations are liable for taxes on underreported income, when the partnership or S corporation underreports income by more than $1 million. This liability attaches to and is assessed against the partnership or S corporation, although the amended statute explicitly states that this provision shall not relieve the partner or shareholder of liability for the underreported income. Partners and shareholders will be allowed a credit for the amount paid by the partnership or S corporation. This provision applies to partnerships that have eleven or more partners who are individuals; partnerships that have at least one partner that is a corporation, limited liability company, partnership or trust; or, a partnership that elects to be subject to the provision. For S corporations, the requirements apply to S corporations that have eleven or more shareholders or that elect to be subject to this provision. This provision is effective immediately.

Inheritance Tax

Effective for estates of decedents who die on or after July 1, 2013, Act 52 excludes from inheritance tax the transfer of qualified family-owned businesses between members of the same family. Exempt transfers include:

1. The transfer of all the assets of a business operated as a sole proprietorship if, at the time of the decedent's death, the book value of the assets is less than $5 million, and the business has fewer than 50 full-time employees; and

2. The transfer of an interest in a business entity if, at the time of the decedent's death, the book value of the assets is less than $5 million and the business has fewer than 50 full-time employees, is wholly owned by the decedent or the members of the decedent's family, is engaged in a trade or business other than managing investments or income-producing assets, and has been in existence for at least five years.

To be eligible for the exemption, a family member must continue to operate the business for seven years following the decedent's death. Failure to do so results in the imposition of the inheritance tax that would have been paid, plus interest accrued from the date of the decedent's death. To enforce this provision, the transferee must annually certify that he or she is continuing to operate the business and is required to notify the Department of Revenue of any subsequent transfer. The tax becomes due on the date of a transfer that causes the transferee to fail to operate the business as required by Act 52. Note that this amendment mirrors a prior amendment to the transfer tax provisions applicable to family-owned farms.

Corporate Net Income Tax

Elimination of the "Delaware Loophole"

For years, the "Delaware Loophole" has been a device by which a corporation subject to Pennsylvania corporate net income tax has been permitted to deduct expenses for intangible assets paid to out of state affiliates.

Act 52 was enacted to close the Delaware Loophole. As a general rule, starting in 2015, a corporation may not deduct an "intangible expense or cost" or interest expense or cost directly related to an intangible expense or cost (collectively, Intangible Expenses) paid to an affiliate. Intangible Expenses are royalties, licenses, or fees paid for the acquisition, use, maintenance, management, ownership, sale, exchange, or other disposition of patents, patent applications, trade names, trademarks, service marks, copyrights, mask works or other similar expenses or costs, and interest expenses related thereto.

A corporate taxpayer that has paid or incurred an Intangible Expense to an affiliate is allowed a credit against its corporate net income tax if the affiliate is subject to tax in Pennsylvania or any other state on a tax base that includes the Intangible Expense it received from the taxpayer. The credit is equal to the taxpayer's Pennsylvania apportionment factor multiplied by the affiliate's tax liability (without reduction for any tax credit of the affiliate) with respect to the Intangible Expense it received from the taxpayer. The Act defines an "affiliate" of the taxpayer as a 50 percent or more owner or subsidiary, and ownership interests of family members and commonly-owned businesses are combined for purposes of determining the percentage of ownership. .

Annual Deduction for Net Operating Losses

The cap on the annual deduction for net operating losses are increased from the greater of $3 million or 20 percent of Pennsylvania apportioned income to:

1. The greater of $4 million or 25 percent of Pennsylvania apportioned income for tax year 2014; and

2. The greater of $5 million or 30 percent of Pennsylvania apportioned income for tax years beginning after December 31, 2014.

Capital Stock and Franchise Tax

Despite statements that they were set to expire, the Capital Stock and Franchise Tax have been extended for two more years at declining rates. In 2014, the rate is .67 mills, and in 2015, the rate is .45 mills. The amended statute provides for the Capital Stock and Franchise Tax to expire in 2016. In 2013, the rate remains at .89 mills.

The Capital Stock and Franchise Tax is an annual tax imposed on certain state law entities, including business trusts, limited liability companies, and corporations that do business in Pennsylvania. Limited liability companies treated as partnerships or disregarded entities for federal income tax purposes are subject to the Capital Stock Franchise Tax. If an entity subject to the Capital Stock and Franchise Tax is a partner, directly or through another state law partnership, in a state law partnership that does business in Pennsylvania, the partner is subject to Capital Stock and Franchise Tax. This means that if a limited liability company or corporation owns an interest in a partnership that does business in Pennsylvania, a limited liability company or corporation is subject to Capital Stock and Franchise Tax. The tax base is a formula stock value determined from book net income and book net worth that is allocated and apportioned to Pennsylvania.

Pennsylvania Personal Income Tax Changes

Some of the most notable changes include:

1. Taxpayers may deduct start-up expenses in accordance with Section 195 of the Internal Revenue Code.

2. A taxpayer must capitalize intangible drilling and development costs and recover them over a 10 year period unless the taxpayer elects to currently expense such costs under Section 2163(c) of the Internal Revenue Code. Alternatively, because Pennsylvania does not allow individuals to use net operating losses, a taxpayer may elect to expense one-third of intangible drilling and development costs and recover the remainder over a 10 year period beginning in the year in which the costs are incurred.

3. Every partnership, S corporation, estate, and trust must maintain a list of its owners or beneficiaries. Failure to maintain such list will cause the partnership, S corporation, trust, or estate and the general partner, tax matters partner, corporate officer, or trustee to be liable for tax, interest, and penalty with respect to the entity.

Sales and Use Tax Changes

1. Exemption for Aircraft Parts and Services. Act 52 added an exemption from sales and use tax for the sale at retail or use of aircraft parts and services to aircraft and aircraft components effective October 7, 2013. Aircraft eligible for this exemption include fixed-wing aircraft, powered aircraft, tilt-rotor or tilt-wing aircraft, and glider or unmanned aircraft.

2. Obtaining Sales Tax License. To obtain and maintain a sales tax license, a taxpayer must be current on all

Pennsylvania taxes. If the Department declines to issue a sales tax license or sends a taxpayer a notice of revocation, the taxpayer must appeal within 30 days of the notice to maintain a timely appeal.

Pennsylvania Tax Credits

Tax credits impacted by Act 52 include the following:

1. Film Tax Credit: Effective for tax years beginning after December 31, 2013, film production companies entitled to the Pennsylvania Film Tax Credit must, as a condition of the credit, withhold personal income tax from payments to pass-through entities that represent individual talent. Taxpayers may begin to earn credits before the first actual day of photography if approved by the Pennsylvania Film Office. The Pennsylvania Film Office also is authorized to consider more flexible criteria to determine whether a project is entitled to the film tax credit. Film tax credits purchased or assigned in 2013 may be carried forward to 2014 and film tax credits purchased or assigned in 2014 may be carried forward to 2015.

2. City Revitalization and Improvement Zones: Act 52 establishes the City Revitalization and Improvement Zone program designed to promote economic development in cities of the third class. Between July 9, 2013, and December 31, 2016, the Department of Community and Economic Development may establish two zones in cities of the third class, allowing for abatement of several Pennsylvania and local taxes within the zone. After 2016, the Department of Community and Economic Development may approve two additional zones per year.

3. Innovate in PA Tax Credit: The Innovate in PA Tax Credit Program is designed to provide funding for the Ben Franklin Technology Partners, the PA Venture Capital Investment Program, and Life Sciences Greenhouses. Beginning on October 1, 2013, insurance companies can purchase up to $100 million of credits to offset insurance premiums taxes to be used for tax years beginning on or after January 1, 2016. The funds from the purchases of these credits will be used by the Department of Community and Economic Development to support the three venture capital programs.

4. Mobile Telecommunications Broadband Investment Tax Credit: Act 52 creates a new tax credit for tax years beginning after December 31, 2013, and before January 1, 2024, (capped at $5 million per year) equal to 5 percent of the cost of investment in qualified broadband equipment located in Pennsylvania.

If you have questions about any of these items, please call John Hibschman or Alex Snyder at 717-846-888. In particular, clients with Pennsylvania real estate should be considering restructuring ownership structures to allow realty transfer tax to be minimized in the future.

Any advice expressed above as to tax matters was neither written nor intended by the sender or Barley Snyder to be used and cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. If this document is delivered to any person or party other than to our client to whom the advice is directed, the recipient may not and should not rely upon any advice expressed above for any purpose and should seek advice based on the recipient's particular circumstances from an independent tax advisor.