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Issue Brief

State Tax Issues

Issue

The Pennsylvania Institute of Certified Public Accountants (PICPA) encourages the Pennsylvania General Assembly to consider appropriate legislative action to provide taxpayers with as much certainty in the area of state tax policy as possible. With more clarity, taxpayers can better comply with state tax laws. To assist in this process, the PICPA offers The Guiding Principles of Good Tax Policy as a framework for analyzing and evaluating the current tax structure and any proposed legislative changes. While we touch on certainty and simplicity in this document, it should be noted that each of the 12 Guiding Principles are of equal importance. The PICPA presents this State Tax Issue Brief for the General Assembly’s use with tax law analysis and deliberation.

Discussion and Explanation

Businesses and their owners want accurate estimates of expenses from year to year in order to properly plan their business activities. State taxes are typically a substantial expense item. Being able to accurately plan and account for state and local tax expenses ahead of time can have a dramatic impact on a business’s decision to incorporate in a state. With all other factors being equal, states with the most certain tax regime provide the most stable option for location.

Among The Guiding Principles of Good Tax Policy, the practice of certainty establishes that tax rules should clearly specify how payment amounts are determined, when tax payments should occur, and how payment is to be made. Taxpayers should be able to determine their tax liabilities with reasonable certainty based on the nature of their transactions. If transactions subject to tax are easy to identify and value, the principle of certainty is more likely attained. On the other hand, if the tax base is dependent on subjective valuations or transactions are difficult to categorize, attaining certainty becomes difficult. Clarifying when tax payments are due and how the taxes are to be paid, including clear and understandable tax forms and instructions, is essential.

The principle of certainty also is vital with respect to estimated payments and the safe harbors that taxpayers use to prepay their tax liabilities. Unexpected and sudden changes to the calculation of the tax base or to the tax rates undermine certainty, and they should be avoided to maintain good tax policy and foster a healthy business and economic environment for taxpayers. Lack of certainty exposes taxpayers to penalties and additional assessments, having an adverse effect on business decisions.

Closely related to certainty is the principle of simplicity. When tax rules and systems become complex, the greater the likelihood that the certainty principle is compromised.

Three clear examples of where Pennsylvania tax law lacks certainty include recent proposals regarding implementation of the Wayfair decision and Department of Revenue (DOR) proposals with respect to global intangible low-taxed income (GILTI) and foreign-derived intangible income (FDII), and the lack of guidance with regard to the 2013 market-based sourcing law.

In 2018, the U.S. Supreme Court, in South Dakota v. Wayfair Inc., overturned the physical presence nexus standard for imposition of a state tax. Prior to the Wayfair decision, Pennsylvania enacted Act 43 of 2017, the Marketplace Sales Act. Act 43 requires a remote seller, marketplace facilitator, or referrer who does not maintain a place of business in Pennsylvania, but had aggregate taxable sales in Pennsylvania of at least $10,000 in the prior 12 months, on or before March 1, 2018, to file an election with the DOR to either collect and remit sales tax or to comply with the notice and reporting requirements.

Then, in January 2019, in response to the Wayfair decision, the DOR issued Sales and Use Tax Bulletin 2019-01, Maintaining a Place of Business in the Commonwealth.
The PICPA has several concerns with Sales and Use Tax Bulletin 2019-01. First, the DOR lacks the authority to make the proposed changes through the issuance of the bulletin alone. This represents a change to existing law, requiring legislative action by the General Assembly. All other states that have issued post-Wayfair guidance have gone through legislative or regulatory processes and have not resorted to executive fiat. Second, the bulletin introduces into Pennsylvania’s tax lexicon the terms “economic nexus,” “substantial economic nexus,” and “economic presence nexus,” none of which are defined in the Tax Reform Code. These new terms cannot be adopted or implemented without prospective rulemaking. Third, the bulletin appears to create uniformity issues by establishing a new and arbitrary threshold of $100,000. The current statutory threshold, enacted as part of Act 43 of 2017, is $10,000. This would appear to treat similarly situated taxpayers differently.

Similarly, the DOR issued Corporation Tax Bulletin 2019-02, Pennsylvania corporate net income tax treatment of global intangible low-taxed income (GILTI) and foreign-derived intangible income (FDII), on Jan. 24, 2019. This bulletin leads, in many instances, to a favorable outcome for many taxpayers. Pennsylvania is treating GILTI as dividend income included in the corporate net income tax (CNIT) base in the year in which it is recognized for federal income tax purposes. This dividend income should qualify for the dividends-received deduction based on ownership percentages. However, the bulletin makes clear that the federal deduction for 50 percent of the GILTI and FDII income allowed under Internal Revenue Code Section 250 is not allowed for Pennsylvania because Pennsylvania CNIT is computed without special deductions taken for federal income tax purposes. Here, too, the bulletin lacks a strong statutory foundation necessary for its conclusion. This is an area where the General Assembly should clarify statutory language on the intended treatment.

The General Assembly enacted Act 52 of 2013 requiring market-based sourcing for service revenue apportionment beginning in 2014. In December 2014, the DOR issued Information Notice 2014-01 to provide administrative guidance. However, five years later, taxpayers are still waiting for the public release of draft regulations to provide further guidance in this very complex area of corporate taxation. The timely promulgation of regulations and the completion of the full regulatory review process is essential to the clear administration of Pennsylvania’s tax laws.

Pennsylvania has taken some steps to improve its tax structure, including elimination of the capital stock/foreign franchise tax. The PICPA and our nearly 22,000 members stand ready to work with state lawmakers, the Wolf administration, and other stakeholders to improve the clarity and certainty in Pennsylvania’s tax laws.