PICPA State Taxation Committee
Annual Meeting with the PA Department of Revenue
PA NewsMedia Association Building
Wed., October 16, 2019
1:00 p.m.

Agenda – Questions submitted by PICPA

Corporate Net Income Tax

1. Under IRC § 860E a holder of a residual interest in a Real Estate Mortgage Investment Conduit (REMIC) is required, at a minimum, to pay tax on its excess inclusion income (EII). A REMIC residual interest holder is instructed to report taxable income on federal Form 1120, line 30 for each year in an amount no less than EII and a net operating loss will be generated. This treatment is required whether the taxpayer reports a loss on federal Form 1120, line 28.

   a. For CNIT purposes, the Department has taken the position on audit that the starting point for computing PA taxable income is EII. Please explain how that position reconciles with the Department’s policies regarding the treatment of net repatriated income (Information Notice 2018-1) and GILTI/FDII (Corporation Tax Bulletin 2019-02) which are premised upon the position that the starting point for computing PA taxable income is federal taxable income before net operating losses and special deductions (Form 1120, line 28), as provided in the regulations.

   b. Assuming that the Department’s position is correct, please confirm that the holder of a residual interest in a REMIC who incurs a loss on federal Form 1120, line 28 would never get a net operating loss, as the PA net loss deduction provisions do not incorporate IRC § 860E.

   **Question 1 Answer:** Pennsylvania law provides specific rules for net loss deductions from Pennsylvania “taxable income,” 72 P.S. § 7401(3)4. However, the Pennsylvania net loss provisions do not permit a taxpayer to carryforward to future years a net loss that was never actually included in the taxpayer’s taxable income reported to Pennsylvania for the tax year in which such loss is alleged to have occurred.

2. As the Department has not issued market-based sourcing regulations there are many areas not addressed in the Information Notice, please explain the process of how the Department is determining on audit whether a corporate taxpayer’s method of sourcing service receipts is reasonable.

   **Question 2 Answer:** During the course of an audit, the auditor requests a full description of the taxpayer’s business activities, where the service is delivered, and the method used for sourcing those receipts. When the taxpayer’s business model or sourcing method does not align with the specific guidance provided in the Information Notice 2014-01, the fact pattern is reviewed and a determination is made as to a reasonable method to source using the facts presented and the sourcing rules set forth in the statute (72 P.S. § 7401(3)2.(a)(16.1)(C)). These unique fact patterns may be included in future departmental guidance.

17 FR 2016, 151—153 FR 2018), and income producing activity/cost of performance appeals that the Department may litigate.

**Question 3 Answer:** JP Morgan Securities, Inc. (Commonwealth Court Dkt. Nos. 663—666 FR 2016) were closed by stipulations for judgment satisfied August 7, 2019. New Cingular Wireless PCS, LLC (Commonwealth Court Dkt. Nos. 1001—1002 FR 2013, 16—17 FR 2016) are in the discovery phase of litigation. New Cingular Docket Nos. 151-153 FR 2018 are being reviewed by the Court separately due to jurisdiction issues.

4. Please explain the Board of Appeals’ policy of refusing to grant relief in cases that involve the application of the net loss fixed dollar limitation for tax years after 2006. The R.B. Alden and General Motors cases involve pre-2007 tax years.

**Question 4 Answer:** The PA Supreme Court held the fixed dollar net operating loss deduction (flat dollar cap) unconstitutional in the Nextel decision issued on Oct. 18, 2017. The Supreme Court, however, did not address whether this decision should be applied retroactively. The Commonwealth Court recently heard arguments regarding this issue in the RB Alden and General Motor cases. The law, therefore, in this area is not settled. As the Board of Appeals can only issue decisions “in accordance with the law,” the Board has been providing taxpayers with two options. The first option is to hold their case in pending litigation behind the RB Alden case and the second option is to issue a failure to act letter. The failure to act letter provides the taxpayer with the opportunity to appeal the issue to the Board of Finance and Revenue which can issue a decision in accordance with the law and equity. The decisions issued by the Board of Finance and Revenue regarding this issue are available on their web site.

5. Please explain whether Form REV-986 is required for taxpayers claiming PL 86-272 protection. Can the protection be claimed by attaching a statement to the return? Is there a difference in the impact on the statute of limitations if this form is filed?

**Question 5 Answer:** To the extent a taxpayer’s activities exceed the level where it would be permissible to file an RCT-101-D, Form REV-986 should be completed and filed as part of the taxpayer’s Form RCT-101 where protection under PL 86-272 is being asserted. Regardless of whether Form REV-986 is completed or a statement claiming protection under PL 86-272 is attached to the RCT-101, it is the longstanding position of the Department that no statute of limitations is commenced unless an RCT-101 is filed reporting all required information necessary for the calculation of CNIT, even if no CNIT is actually due based on the protections afforded under P.L. 86-272.

6. When can we expect market-based sourcing regulations?

**Question 6 Answer:** The Department hopes to issue this in early 2020 for public comment.

7. Has the Department further considered any income tax implications of the Wayfair decision? If so, can you provide guidance?

**Question 7 Answer:** The Department recently issued Corporation Tax Bulletin 2019-04, Nexus for Corporate Net Income Tax Purposes.

**Personal Income Tax**

8. Please explain why a nonresident individual cannot participate in the filing of a PA-40 NRC in the instance where he/she holds his/her interest in a pass-through entity in a single member limited liability company classified as a disregarded entity for federal income tax purposes or a revocable trust.
Question 8 Answer: Only qualifying electing nonresident individual owners may be included in the filing of the PA-40NRC. An individual is defined as a natural person and shall include the members of a partnership or association and the shareholders of a Pennsylvania S corporation [72 P.S. §7301(l)]. Trusts regardless of how they are taxed and limited liability companies regardless of the number of members do not meet this definition, and therefore, cannot be included in the filing of the PA-40 NRC. The department has the authority to request documentation to support the income allocation.

9. The alternative investment area has become more popular over the years. However, the Department's partnership forms and instructions, e.g., Schedule M, Part B, do not clearly set forth instructions on how pass-through entities should exclude income/loss from other pass-through entities. The lack of clarity creates compliance issues. Would the Department either issue (1) some type of additional guidance in this area, or (2) provide a specific section or sections in its return instructions that set forth the rules on how pass-through income from other pass-through entities should be treated for each class of income?

Question 9 Answer: For business income, if reporting a loss from a pass-through entity, please refer to the PA-20S/PA-65 Information Return Schedule M Part II Section II (h) Other income adjustments that increase PA reportable income. If reporting income from a pass-through entity, refer to Section III (d) Other Income Adjustments that decrease PA reportable income. Pass through income should be reported on the information return Part I Line 1(b) Share of Business of Income (Loss) from All Other Entities. For all other classes of income refer to the instructions for each corresponding schedule.

10. AB LP incorrectly withholds PA PIT on a corporate partner. Please explain the process for having the Department credit the erroneously withheld PA PIT to the corporate partner’s CNIT account.

Question 10 Answer: These types of scenarios would be addressed on a case by case basis. Please contact our office with specific information to address your concerns.

11. Please explain the process that the Department intends to use in auditing payors of nonemployee compensation in instances where the payee performs services within and outside of Pennsylvania.

Question 11 Answer: The department has the authority to request documentation to support the income allocation.

12. AB LP, a partnership domiciled in PA, sells an interest in a partnership and a patent. Assume for PA PIT purposes the gain from each sale is reported on Schedule D.

a. Please explain whether the gain on the sale of the interest in the partnership and patent in this instance should be sourced to PA.

b. Please explain under what circumstances gains from the sale of intangible assets reported on Schedule D would be sourced to PA for PA PIT purposes.

Question 12-A+B Answer: DOR has issued guidance on gains from the sale of intangible assets, please see Personal Income Tax Bulletin 2005-02 Gain or Loss Derived from the Disposition of a Going Concern.

13. How should PA-40 non-resident sellers (individual shareholder) of a PA S Corp present the gain from the sale of stock to the buyer when an IRC 338(h)(10) election has been made? For Example - the PA S Corp return, Page 2, Part IV, Line 10 Total Income $25,000, Line 11 Total Reportable Income $5,000, Line 12 Total non-Taxable/non-reportable Income $20,000 (the IRC 338h10 portion). How should this be presented on the PA-40 to assure proper processing and avoid additional correspondence with the Department?
**Question 13 Answer:** It would seem based on the above facts, the Information Return was prepared correctly, and therefore, the gain would not be included in the NRK1. If the non-resident shareholder seller reports the income as shown on the NRK1 there should not be an issue. If there is a specific case where there is an issue, please contact our office to discuss.

14. Taxpayer sells their stock in an S Corporation. The sales price is a base amount up front plus future payments depending on revenue for the following three years. How is this reported for sales price and basis for PIT purposes in the year of sale?

**Question 14 Answer:** If the sale agreement is worded such that the proceeds from the sale cannot be assigned (the agreement must state this), the taxpayer could utilize the cost recovery method for reporting the gain. For each year proceeds are received, gain would only be reported in the years whenever the proceeds received begin to exceed the adjusted basis in the stock. Sale proceeds received each year would reduce the adjusted basis amount until the full amount of the adjusted basis is received. Gain is then reported once the proceeds received exceed the adjusted basis. If the cost recovery method can’t be used, the gain should be reported in the year of the sale and a reasonable estimate of the what the future payments might be should be included. If the future payments exceed or are less than projected amounts reported for the sale, the gain reported on the original return in the year of the sale should be amended to report the actual payments received. PA does not permit an installment sale of intangibles and does not have a claim of right doctrine that would permit the future payments to be reported as additional gain or loss.

15. Does Pennsylvania follow IRC Sec. 336(e) for C Corporation, S corporations, and/or partnerships?

**Question 15 Answer:** The IRC §336(e) is an election for federal income tax purposes, therefore, for PA Personal Income Tax Purposes, the sale would be treated as a sale of stock, and PA would not follow the federal election.

### Sales and Use Tax

16. Company engages an Employment Agency vendor to search for and refer potential new employees. Company ultimately hires some of these referrals, all of whom personally reside outside of PA. These new employees do not physically work at the employer’s PA facility. Instead they are travelling sales staff who work from their homes and, on occasion, may physically visit another of the employer’s facilities outside PA. In terms of their reporting responsibilities, these employees report, on a remote basis, to the VP of Sales who does physically work at the employer’s PA facility. Is the employment agency’s fee subject to PA sales/use tax? Please explain your answer.

**Question 16 Answer:** The controlling factor is the location to which the employee is placed. If the employee’s location of employment is not readily identifiable (i.e. a traveling salesman), the location to which the employee reports is used to determine if employee placement charges are subject to PA sales tax. This would include employees that are located out of state for the convenience of the employee. If the employer requires the employee to be located out of state (per the employment contract), the placement charges are not subject to PA sales tax.

17. Please explain the procedure for an individual who is not required to hold a sales and use tax license to report use tax on a one-time purchase for which sales tax was not charged. The use tax due would be substantial and the individual does not want to wait until he/she files his/her PA PIT return.

**Question 17 Answer:** Go to https://www.etides.state.pa.us/UseTax. Login with existing eSignature User ID and Password or register a new User ID and password. Follow the steps in the attachment.
18. Please explain when charges for ownership in an interest in an airplane e.g., NetJets, would not be subject to Pennsylvania Sales and Use Tax.

**Question 18 Answer:** There are a number of business operations that offer varying levels of flight services to customers. The specific facts must be presented for Department consideration to receive a determination in which of these situations sales tax should be charged.

19. Why does the Department still use the 1980 statistics for cash sales versus credit sales for their sales tax audits? People primarily use credit or debit cards for payments today. Is the Department planning on updating the use of various forms of payment?

**Question 19 Answer:** The Department uses the most recent information available each year in computing the 1099K to total sales ratios. The most recent year for which we have 1099K information is 2017.

20. We have a client under PA sales tax audit. PA auditors note that sales tax on delivery charges of SLO wine/liquor orders from the PA fine wine and liquor stores is not charged on their invoices and should be. After an inquiry with PLCB and the Office of Chief Counsel we could not get a rational answer as to why the PLCB does not charge sales tax on delivery charges and why their policy would differ from Revenue. Does the Department have an explanation?

**Question 20 Answer:** The law makes a distinction for these sales. Shipping charges are excluded from sales tax based on the Liquor Code at Section 305 (47 P.S. §3-305 (a)), which states: “In computing the retail price of such special orders for liquor or alcohol, the board shall not include the cost of freight or shipping before applying a mark-up that is equal to ten per centum of the cost of the product and taxes but shall add the freight or shipping charges to the price after the mark-up and taxes have been applied.

21. Regarding Act 13 of 2019:

a. Will additional guidance on the definition of an “animal housing facility” be provided by Jan 1, 2020?

b. Will there be additional guidance on the definition of a “Youth Center” provided before Jan 1, 2020?

c. Can the Department please explain the sales tax absorption section?

**Question 21-A+B Answer:** The department was unaware of any specific questions, so we had not planned on issuing guidance. If specific questions need to be answered, DOR can issue guidance. When such guidance would be released depends on the nature of the questions and when we receive them.

**Question 21-C Answer:** Act 13 changed sales tax law so it is now permissible for a seller to include or “absorb” the sales tax due in the price being charged to the customer (and paid by the seller). To do so, the seller must do four things:

1. Indicate on the receipt that it is paying the tax on behalf of the purchaser.
2. State the amount of tax being paid.
3. Account for the purchase price and tax on its books separately.
4. Calculate the sales tax by multiplying the purchase price by the tax rate.

If a seller indicates to the public that it is absorbing the sales tax, the seller is solely responsible for paying the tax.
22. Why is the turn-around time to provide third-party credits in an audit so short (sometimes less than one month) even though the audit could go on for months, or years?

**Question 22 Answer:** At or shortly after the pre-audit conference the auditor will present the taxpayer with a “Requirements for the Audit Review of Third-Party Credits”. In addition to explaining documentation requirements, the form also includes a date by which the documentation should be provided to the auditor in order to be included in the findings of the audit. The date identified is the date by which the auditor expects to have the initial transactional level review completed. This is based on the industry, relative size of the taxpayer and past audit history of similarly situated taxpayers. This is the established procedure in identifying the date. However, the actual length of time it takes the auditor to complete the audit is directly related to the taxpayer’s ability to provide timely access to the requested records. If a taxpayer has concerns with the date identified by the auditor, they should at first address the issue with the auditor. If the auditor does not adequately address the issue, the taxpayer may escalate the issue to the audit supervisor.

**Administrative**

23. The Department needs to modify its PA-40 to provide on Schedule C – separate lines for Revenues from 1099-K credit cards to tie into that report. Then other Revenues from checks or cash would be reported on the primary Revenue line. There should only be an issue if the 1099-K amounts exceed the total revenues until the Department revises their form. Can this form be modified?

**Question 23 Answer:** The department will consider the changes as long as there is sufficient merit for the changes. What are the reasons for the changes and can a marked-up Schedule C be provided for the department to evaluate the changes being requested?

24. We get a number of notices requesting copies of other state returns to support out of state credit when the out of state return was already included with the original e-filed return – especially when it was auto generated (i.e., PA resident takes credit for NJ tax and software prepares both PA and NJ returns and automatically includes copy of NJ return with the PA). Is there a way to eliminate these types of notices?

**Question 24 Answer:** PTBO Comment – The department is currently working with practitioners in finding an acceptable method of transmitting the composite returns filed by those entities who may encounter software limitations. In general, the composite returns should be attached as a pdf with the electronic submission or with paper return filed. However, the department is working with software vendors and preparers on the programming logistics for e-filing.

**BIT Comment** – We do extensive training on tax return processing for all new hires and transfers into the bureau. However, in some cases it takes additional training and reviews of certain issues in order for the correct processing of a return to become clear. In that regard, please provide the DLNS for the returns where this information is being requested. Without this information we cannot identity the tax examiner(s) who need additional training so that we can stop making these requests. In the future, it would be helpful to have this information as soon as it is known so that we can stop these types of requests as quickly as possible.

25. In many cases, taxpayers and/or practitioners have gathered extensive supporting documentation, only to have the Department lose it or suggest it was never received, despite the existence of signed receipts or fax acknowledgements. How can we avoid wasting the taxpayer and the Department’s time?

**Question 25 Answer:** PTBO Response – PTBO currently has mechanisms in place whereby an analyst takes case ownership and corresponds directly with the taxpayer and/or taxpayer representative. Correspondence related to the Sales Tax Desk Review Program and any review at the entity level has a dedicated PO Box/mailing address. The taxpayer correspondence is processed, imaged, and flows to the...
analyst personal mailbox (queues). However, there may be delays depending on the mailing address of correspondence.

**CEC Response** - I would like to remind everyone that sending items via certified mail is not the best way to respond to a notice or request for information. The department continues to encourage taxpayers to respond via the instructions on the notice or form. Always make sure you or your client keeps a copy of whatever you send into the department, as it could be lost during transit via carrier. For fastest service I suggest that if your notice or instructions provides a means to email the documentation to us, that it is the quickest way to get into our systems for review. For electronically provided information: If taxpayers and/or practitioners are strictly following the procedures as outlined on the DEX-93, Personal Income Tax Correspondence Sheet, there should be no reason for documentation to go missing. However, if there is any chance the information is close to the 15MB limit, the department’s fax or email may not be recognizing its receipt due to high volume at time the information is received. It would be best in these situations to split the email or fax so that the size of each does not approach the 15 MB limit. If you know of a specific situation where this occurred, please provide additional information.

**BIT Response** - For electronically provided information: If taxpayers and/or practitioners are strictly following the procedures as outlined on the DEX-93, Personal Income Tax Correspondence Sheet, there should be no reason for documentation to go missing. However, if there is any chance the information is close to the 15MB limit, the department’s fax or email may not be recognizing its receipt due to high volume at time the information is received. It would be best in these situations to split the email or fax so that the size of each does not approach the 15 MB limit. If you know of a specific situation where this occurred, please provide additional information.

26. What can be done to improve the telephone systems for calls to Harrisburg and field offices? The oft-received automated message can be completely unintelligible. What can be done to improve wait times?

**Question 26 Answer:** We are still working on issues with the new phone system. We have heard your concerns regarding the automated messages and continue to work on improving the process. The improvement of wait times is also something that we are looking at constantly. Every day we are in a constant battle between having longer wait-times or having you get a busy-signal. DOR is offering a new service starting in November - we will begin to offer tax preparers scheduled call times.

**Schedule a Call**
Make an appointment for DOR to call when it’s convenient for you. Please keep in mind that your requested call may be made within a few minutes of your scheduled time. Department representatives will work as quickly as possible to maintain the schedule, but the volume of requests may be a factor. For more information: [https://www.revenue.pa.gov/OnlineServices/TaxProfessionals/Pages/Callback.aspx](https://www.revenue.pa.gov/OnlineServices/TaxProfessionals/Pages/Callback.aspx)

27. Why does the Department require an EIN for the R & D credit electronic applications for subcontractors that taxpayers are not required to issue 1099s for?

**Question 27 Answer:** The department may request this information to help substantiate the business’s activity. It can also be used to ensure that the activity is not being claimed by both the applicant and its sub-contractor(s).

28. Does the Department have any plans to issue further guidance related to the federal TCJA changes? Is the DOR pursuing corrective legislation?
**Question 28 Answer:** The Department is planning to issue a bulletin on IRC 163(j)/interest limitation impact on IRC 382 in a revised version of the Tax Bulletin 2008-03 – Net Loss Deduction Limitations under Internal Revenue Code Section 381. This will impact tax year 2019. The Department is not pursuing any legislation relating to TCJA at this time.

29. How is EITC/OSTC treated if there are two short taxable years within a single calendar year? To which period(s) are the credits applied?

**Question 29 Answer:** The allocation of credit would be determined by the date of the contribution. Whichever short period the contribution date coincides with, is where the credit would be applied.

30. When can we expect realty transfer tax regulations?

**Question 30 Answer:** The Department hopes to issue this in early 2020 for public comment.

31. If a non-C-Corp hasn’t had any other registrations in PA in the past (sales tax, employer withholding, etc.), is it required to go through the bulk sale reporting process when it sells its assets? As an example, a real estate LLC (Federal and PA partnership) selling its real estate.

**Question 31 Answer:** Yes. A bulk sale clearance certificate would still be required in the example to permit a review and clearance, at the very least, of the LLC’s PA 20S/65 requirements.

32. Can the Department provide an update on:
   a. The Department’s Certified Service Provider arrangement?
   b. Regulations, Bulletins, and other upcoming guidance?

**Question 32-A Answer:** The Department has implemented its Certified Service Provider or CSP program as part of a comprehensive sales tax compliance strategy for online retailers with only economic presence in Pennsylvania. The Department has received and processed July and August consolidated CSP returns and payments. The Department has announced a new webinar ‘Pennsylvania Sales Tax - Economic Presence’ for October 31 at 11:30 a.m. Compliance notices will be sent in November to online retailers believed to have PA economic presence and who have not (1) directly registered for sales tax, or (2) chosen to use a CSP to report and pay PA sales taxes.

**Question 32-B Answer:** Final regulations for iLottery are being written, with final approval in 2020. Amendments to Realty Transfer Tax regulation in early 2020 for public comment. Proposed Corporate Net Income Tax regulation sales factor for services and intangibles (market-based sourcing) in early 2020 for public comment. Proposed Corporate Net Income Tax regulation for business and non-business income is being developed. The department is planning to issue a bulletin on IRC 163(j)/interest limitation impact on IRC 382 in a revised version of the Tax Bulletin 53D – Procedures for Filing Corporate Tax Reports/Returns for Mergers. This will impact tax year 2019. The department is open to PICPA’s suggestion on upcoming guidance – what are areas that PICPA would like to see more guidance?