PERSONAL INCOME TAX

1. The Department has started sending notices for 2014 for taxpayers who earn wages outside the US. The notices claim that even though the taxpayers earn the wages, live outside the US, etc., PA is not permitting the deduction of taxes paid to the Foreign Jurisdiction even though these are permitted if the taxpayer works in another state. I recognize the elimination of the foreign tax credit for investments occurred in 2014. What is the authority to not allow the credit on wages for foreign jurisdictions?

Answer

Act 52 of 2013 changed the criteria for when a resident credit may be claimed under Article III, Section 314, Income Taxes Imposed by Other States. Although the definition of a state under Article III, Section 301(t) includes a foreign country, it also includes an exception for that definition so that the definition of a state is that which is included in Section 314(a). The definition of a state in Section 314(a) does not include a foreign country. Therefore, no credit on any income is permitted for foreign jurisdictions. Tax Reform Code, Article III, Sections 301(t) and 314(a) are as follows:

- Section 301(t). "State" means, except as provided under section 314(a), any state or commonwealth of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States and any foreign country. ((t) amended July 9, 2013, P.L.270, No.52)

- Section 314. Income Taxes Imposed by Other States.--(a) A resident taxpayer before allowance of any credit under section 312 shall be allowed a credit against the tax otherwise due under this article for the amount of any income tax, wage tax or tax on or measured by gross or net earned or unearned income imposed on him or on a Pennsylvania S corporation in which he is a shareholder, to the extent of his pro rata share thereof determined in accordance with section 307.9, by another state with respect to income which is also subject to tax under this article. For purposes of this subsection, the term "state" shall only include a state of the United States, the District of Columbia, the Commonwealth of Puerto Rico and any territory or possession of the United States. ((a) amended July 9, 2013, P.L.270, No.52)
2. Why does Department correspondence insist fiscal year estate form PA-41 should be filed on a calendar-year basis? This persists even after written response to the Department includes full documentation of fiscal year-end. –

**Answer**
The department should not be disallowing a fiscal-year estate. Please provide (an) example(s) of the situation so that we may provide additional training and instruction to the employee(s) making the adjustment(s).

3. In an IRC sec. 351 transaction in which one of the contributing shareholders receives boot, please explain for PIT purposes whether the shareholder would recognize gain to the extent of the boot received (federal rules), or if all gain would be recognized.

**Answer**
This policy is currently under review.

4. Is a grantor trust that owns an interest in an S-Corporation able to claim a resident credit on income taxes paid by the S-Corporation to states where the S-Corporation is taxed as a C-Corporation? Examples of states where this could be the case include New York and the District of Columbia.

**Answer**
If the taxes paid to New York and the District of Columbia are based upon income, the resident credit should be able to be claimed by an irrevocable trust. However, the resident credit cannot be passed through to a beneficiary of the irrevocable trust. For a revocable trust the resident credit would be claimed at the individual level on the PA-40.

5. For a PA irrevocable trust that is treated as a Federal grantor trust, the trust is disregarded by Federal and most states. For Pennsylvania, the trust is taxed unless all of the income is distributed to the beneficiary. How would the beneficiary of the trust be able to receive equitable tax treatment by being able to claim resident credits in the following two situations:

- An S Corporation shareholder is an irrevocable grantor trust. The S Corporation files a composite tax return on behalf of the trust in another state that follows Federal grantor rules. If the trust distributes all of the income to its PA resident individual beneficiary, will the individual beneficiary be permitted to claim the resident credit from the S Corporation composite filing on his/her PA personal return?

**Answer**
Yes. The tax paid to both states is paid by the beneficiary of the trust when the trust distributes its income. If the trust does not distribute its income, the resident credit would not be allowed.
• An S Corporation shareholder is an irrevocable grantor trust. The S Corporation does not file a composite tax return in a state that follows Federal grantor rules. Instead, the PA resident individual beneficiary files a nonresident personal return in that other state and recognizes tax on business income from the S Corporation. The trust distributes all of its income to the beneficiary, and therefore the beneficiary recognizes trust income in Pennsylvania. Will the individual beneficiary be permitted to claim the resident credit against this trust income on his/her PA personal return if the income taxed in the other state is classified as S Corp/business income in the other state?

**Answer**
Yes, the tax paid to both states is paid by the beneficiary of the trust when the trust distributes its income. If the trust does not distribute its income, the resident credit would not be allowed.

6. In recent years, the issues of unreimbursed employee business expenses have become highly scrutinized and narrowly scoped. In January 2016, the Department issued some expanded documentation, an affidavit form, guidance in the form of FAQ, and a notice of tips (REV-489) to underline increased tightening of the allowance of these deductions.

In a great many flow-thru entities, partnerships, LLCs, LLPs, and s-corporations, provide that owners (partners, members and/or shareholders) incur ordinary and necessary business expenses outside of the entity paying, and these expenses are not reimbursed to the incurring partners, members and/or shareholders. Federal tax law provides for an unreimbursed expense claim against the schedule E K-1 income, and such adjustment has traditionally been claimed for Pennsylvania.

In light of the above-referenced increased scrutiny and limiting expense allowances, is the Department intending to target the owners of flow-thru entities for similar possible claims of disallowance unless “sufficient support documentation” is provided? And if so, has the Department developed specific guidelines and requisite forms of support documentation for these types of unreimbursed expense claims?

**Answer**
The Department has and will continue to examine unreimbursed partner/ member /shareholder (“owner”) expenses. Personal expenses and expenses claimed for the owner’s convenience are not deductible unless required by and stated in the entity’s partnership agreement, LLC operating agreement, and/or PA S Corporation’s articles of incorporation. A complete copy of such agreement or articles must be provided to the Department upon request.

In addition, the owner expenses must satisfy the requirements of any other business deduction. The owner expenses must be ordinary, necessary, reasonable, actually incurred, and directly related to the production of income/provision of service. An itemized list of expenses must be provided. Documentation including proof of payment and business purpose must be maintained and provided to the Department upon request.
CORPORATE TAX

7. Even though they are not yet finalized, has the Department had any internal discussions surrounding the proposed Section 385 regulations and how they may or may not apply to a separate filing jurisdiction such as Pennsylvania? If passed as proposed, does the Department plan to address the 385 regulations with any formal guidance?

**Answer**
The department has not taken any action at this time.

8. ABC Corp. is a startup biotech company that conducts R&D activities (property and payroll) in PA, NJ and NY. During 2015, ABC Corp. had no receipts of any type and incurred a PA taxable loss in the amount of $1 million. ABC Corp. was entitled to apportion its taxable loss to PA, NJ and NY. As ABC Corp. had no sales anywhere, please explain how the corporation would apportion its loss to PA.

**Answer**
Since the income sourced to PA is based solely on sales and there are no sales in PA none of the loss is sourced to PA.

9. DEF Corp. owns a 20% interest in GH LP. GH LP does business in PA. DEF Corp. loans money to GP LP for which it earns interest. For federal income tax purposes, the interest on the loan is treated as a guaranteed payment. In computing its sales factor, please explain whether DEF Corp. would include the interest received from the partnership in the corporation’s sales factor.

**Answer**
The sales of corporate partners, includes all receipts of the partnership as if earned by the corporation. To the extent the interest is part of the receipts earned by the partnership, the partner’s share of the sales of the partnership sales is considered directly earned by the partner and all income is included in the sales factor.

10. Please explain whether the Department of Revenue, as a matter of policy, will accept in the computation of a corporation’s sales factor the use of PJM’s ISO load factor as a means of sourcing receipts to PA from spot sales of electricity on the PJM network. The BF&R granted PSEG Energy Resources & Trade LLC (BF&R Dkt. No. 1323618) relief on the issue.

**Answer**
The decision of the Board of Finance and Revenue is on appeal at Commonwealth Court.
11. ABC Corp., a Delaware corp. based outside PA, filed a RCT-101 in 2013 and 2014, but only completed the FF Tax section. The corporation claimed P.L. 86-272 protection for CNI Tax purposes. Recently, the corporation learned that it was subject to the CNI Tax in 2013 and 2014. Please advise whether ABC Corp. should report the CNI Tax on an original or amended RCT-101. How should the corporation complete the FF Tax section on the tax report?

**Answer**
As stated in prior years the RCT-101 is three tax reports on one document. In this case the RCT-101 will be filed as the original report for corporate next income tax. The CSFT of the RCT-101 should report the components of the tax which is used to calculate the current tax liability; the reports should contain a statement explaining the reason for the filing of the report. This will need to emailed to the following resource account: RA-RVCORPSPCHANDLE@pa.gov

Note: This does not open additional appeal rights for CSFT.

12. A federal bonus depreciation adjustment was partially disallowed for a prior year during an IRS audit of a corporation. The corporation had to add the partially disallowed bonus depreciation back through an IRC sec. 481 adjustment on its 2015 federal return. Please explain whether adjustments of the PA bonus modifications resulting from the IRS disallowance also should be reflected on the current year RCT-101 or a RCT-128C, and how should they be reported so as to not trigger an adjustment on desk review?

**Answer**
This is a change to federal taxable income which is result of an audit. The change would be reported on RCT-128. When filing the Report of Change, you must include an explanation of the change and a reconciliation of the changes reported to the taxable income on the RCT-128 and the income adjusted by the IRS.

13. For federal tax purposes, if a return is filed prior to the due date (or prior to the extended due date) and a mistake is discovered, a second return can be filed on or before the due date (or extended due date) which would supersede (as opposed to amend) the first return and become the original return of record. Would Pennsylvania likewise recognize the second return as the original? If not, how should the federal changes be reported? Would an REV-128C be required even though the federal return was not technically amended

**Answer**
If the IRS processes the second return as the original return the second RCT-101 is processed as the original RCT-101, not as an amended report. The reports should contain a statement explaining the reason for the filing of the report. This will need to emailed to the following resource account: RA-RVCORPSPCHANDLE@pa.gov
14. If a corporation having unrecovered bonus depreciation for CNIT purposes merges or liquidates into a bank subject to Bank Shares Tax, what happens to the corporation’s remaining unrecovered bonus balance?

**Answer**

The recovery of the unresolved Bonus Depreciation is found in Article IV while the entity in question is now subject to the tax imposed under Article VII. There is no authority in Article VII to recover this bonus depreciation.

15. Subsequent to the release of Information Notice Corporation Taxes 2014-02 providing guidance on sales of services, PICPA and other organizations provided feedback to the Department pointing out issues of concern with implementing various aspects of the guidance. These issues include the difficulty of determining the location of delivery, particularly where transactions involve a consumer/recipient who is different than the paying customer. Other states have provided a cascading approach which sequentially looks to various facts, business records and types of documentation in order to identify an approach that is reasonable, reliable and practical to apply in the taxpayer’s given business environment. The Department has previously indicated that issue and others were being considered and that it intended to move ahead with a regulatory project. Is this still the case? What is the status of the regulatory proposal? In the interim does the Department intend to put out additional supplemental guidance?

**Answer**

The Department is still working on this is. We will keep the professional organizations informed of the progress.

16. Earlier this year the Department released Information Notice Corporation Taxes 2016-1 providing guidance on the add-back provision that disallows deductions for certain transactions between affiliated members. PICPA and other organizations have commented that the proposed application of the add-back provision as set forth in the Notice appears to be overly broad based on our practitioners’ understanding of the intent and wording of the statute. Does the Department intend to provide amended or additional guidance on this issue? Is a regulatory project being considered?

**Answer**

The Department is contemplating its next action with regard to the add back. Additional guidance may be provided after the Department has time to identify and evaluate issues that arise in administering filed reports and compliance with the add-back provision.
17. As a follow-up to Corporation Tax Information Notice 2016-1, does the Department of Revenue plan to provide additional guidance related to part III? Add-Back Exceptions? Specifically, under Act 52-2013, would a taxpayer potentially be able to overcome the presumed principal business purpose of avoidance of CNIT by providing substantiation for the value of the intangible asset protection against pending or potential future suits brought against those intangible assets?

**Answer**
The Department is contemplating its next action with regard to the add back. Additional guidance may be provided after the Department has time to identify and evaluate issues that arise in administering filed reports and compliance with the add-back provision.

**SALES & USE TAX**

18. (a) When a personal income tax return is audited, (unreimbursed business expenses), can the Dept. of Revenue respond to the taxpayer/practitioner that they have received the information?

**Answer**
The Department does not currently have a mechanism in place to provide a response when correspondence is received; however, we are currently researching ways to provide this service to taxpayers in the future.

(b) What is the time span for the Department to complete their audit after receipt of the information?

**Answer**
The timeframe for response varies throughout the tax season. While we experienced a delay this past tax season in reviewing correspondence, we have addressed that issue and are currently providing response to correspondence received within 2 weeks from the date received. Our goal for next tax season is to have correspondence reviewed within 8 weeks of receipt.

19. A vendor provides information technology services to a client. This includes utilizing software, which is electronically transferred to the client, and support services provided by the vendor’s employees. The support services include monitoring the software’s findings on a daily basis and providing assistance to ensure the client’s operating system is operating as intended. The IT provider bills the client via a flat, lump-sum, recurring monthly charge, of which the largest portion relates to the value of the services provided by the vendor’s employees (in relation to the charge for the software provided). Under Act 84 of 2016, the transfer of digital products are subject to Pennsylvania sales and use tax. Does this transaction fall within the scope of this new law or does it maintain its identity as a professional service which simply utilizes software to provide its services?
Answer
As there is a single charge for this transaction, the sale is subject to tax as part of sale involves the taxable transfer of canned software. More detailed facts are necessary to provide a definitive answer if the charges are unbundled.

20. Under Act 39, a wine expanded permit holder must charge sales tax to its customers on sales of wines. Additionally, the permit holder must also pay sales tax at time of purchase. The permit holder/retailer can then claim a refund from the DEPARTMENT for the sales tax it paid upon its purchase of the wine which it then resold. What will be the reporting mechanism for obtaining this refund from the DEPARTMENT?

Answer
In lieu of a refund, Wine Expanded Permit licensees may recover the tax paid on the original purchase price to the PLCB when filing their Sales, Use, and Hotel Occupancy Tax return with the Department. A licensee may claim a “Tax Paid Purchase Resold” (TPPR) credit on a sales tax return within three years of a purchase that is resold. The amount of the TPPR credit may not exceed the total amount due for that return or be less than zero. Unused TPPR credits can be carried forward on subsequent returns. The licensee should keep documentation supporting the TPPR credit taken for at least three years from the date the return is filed.

INHERITANCE TAX

21. Why is filed inheritance tax return response from the Department taking so long (4 - 6 months) now? In the past written response was received in about 30 days.

Answer
Statutorily, the department has 6 months from the date an Inheritance Tax return is filed with the Register of Wills to complete the review of the tax return and issue an assessment. The current turn-around time for review is 4 ½ months from the date the return is filed. The Department makes every effort to review returns in a timely manner and we continue to identify ways to improve processing times.

ADMINISTRATIVE

22. With the due date of the federal returns changing for many corporations to 10/15, does the Department intend to change the due date of the R&D credit application to 10/15?

Answer
No, the deadline is a statutory.

§ 8703-B (a)

Credit for Research and Development Expenses.--(a) A taxpayer who incurs Pennsylvania qualified research and development expense in a taxable year may apply for a research and
development tax credit as provided in this article. By September 15, a taxpayer must submit an application to the department for Pennsylvania qualified research and development expense incurred in the taxable year that ended in the prior calendar year.

If the statute is changed to allow for the 10/15 filing deadline via amendment – DOR would need the extra month to process the credit to 1/15 of following year. This would trigger an issue in selling the credits and credit utilizations which effectively make the credit useless for the filing period, as the award would be in another calendar year. The applicants would lose a year which more or less brings back the one year holding period, but is worse because they could not use it on the prior year return for awardees.

23. I have a Pennsylvania Limited Partnership (LP) that has sold their last piece of real estate and has decided not to continue this business entity. I am finding conflicting information on the Department’s website with regard to the procedures that we need to undertake. There is an S-Corporation which is the General Partnership (GP) and I know that entity will need a Tax Clearance Certificate and will need to file the appropriate documents with the DOS. But, what, if anything, needs to be done with the DOS for the LP? In one FAQ answer posted on the Department’s site, it states that GPs that are not required to withhold tax at the source (employer withholding and sales tax) are not required to obtain tax clearance certificates. They just file the PA-65 and check the box as final. In another FAQ it says to dissolve a LP, you need to file the REV-181 for the LP as well as for the Corporate partner. The LP has only ever owned and leased out commercial real estate. So, no sales tax, no withholding. Also if the entities still will file a 2016 tax return, can the tax clearance certificate be obtained now, or do we need to wait until after the entity has completed its final filing?

Answer
If an entity is registered at DOS and the entity wants to dissolve (regardless if it is the LP or the corporate partner), a tax clearance certificate is needed. (The key here is if the entity is registered at DOS.)

Regarding 2016 filing – if the entity only files the PA-20S/PA-65, our procedure has been not to wait until 2017 to issue a clearance. If an entity files the RCT-101, we do require the final tax return be filed before a clearance certificate will be issued.

24. How do you amend a PA-40 in the following circumstances? H & W file a joint personal income tax return, and erroneously report income of W which was earned outside the U.S. W has not set foot in the U.S. since Jan. 8, 2008 and has been a bone fide resident of Singapore since that date. H & W want to file an amended return to eliminate that income. Should the amended return be filed as a separate return for H?

Answer
Additional information should be supplied for the department to provide an accurate answer. However, if the question is trying to determine if a refund can be obtained in such a situation and how to file an amended return to obtain that refund, we offer the following as our answer: Because the issue involves multiple tax years - one of which the statute of limitations for filing an appeal may expire on before the department reviews and provides a notice to the
taxpayer on if an amended return refund were denied, the matter is better resolved by filing a Petition for Refund (REV-65) for the open tax years. If the spouse can prove that there is no intent to return to Pennsylvania, they should file a petition for refund to claim the spouse is not a resident of PA. Going forward, the taxpayer would then file his return in Pennsylvania as married filing separately.

25. What is the Department’s position regarding NJ potentially pulling out of the long–standing reciprocity agreement? Also, what is the estimated revenue impact?

**Answer**
New Jersey has now reversed their decision on pulling out of the reciprocal agreement.

ADDITIONAL QUESTIONS

26. Can insolvent insurance companies participate in amnesty, similar to bankrupt entities?

**Answer**
Yes. An insurer that is under supervision, is currently in liquidation, or is under rehabilitation may be able to participate in the Amnesty Program. For insurers under supervision, they will need the prior written approval of the Insurance Department or the appointed supervisor. For insurers in liquidation or rehabilitation, including those under a Federal or state receivership, the liquidator, rehabilitator, or receiver acts in place of the insurer and so is responsible for participating in Amnesty on behalf of the insurer.

27. Has the Department considered including a longer look back period on the e-SOA for sales and employer taxes?

**Answer**
While we appreciate the suggestion to provide more periods, we are currently concentrating on other enhancements to the current format such as adding new BTS taxes that were enacted in the 2016 budget. Furthermore, we are monitoring the new tools use, reviewing output, and fixing any problems discovered on the e-SOA. We are actively soliciting suggestions for additional communications that we should consider making available through e-TIDES.

28. Is the department considering making “What’s my Revenue ID?” a function on its website?

**Answer**
Revenue is currently exploring options to securely provide practitioners a method to obtain a client’s Revenue ID number without having to call the Department.