



# WELCOME

## PENNSYLVANIA CHAMBER OF BUSINESS AND INDUSTRY'S STATE TAX REFORM WEBINAR AUGUST 25, 2022



## Agenda

- Overview of tax changes and budget process
- Small business changes
- Procedural history of Act 53
- Corporate changes
- What's next?





# PRESENTERS



**ALLISON COCCIA**

Director of Political Engagement,  
PA Chamber



**MICHAEL SEMES**

Professor of Practice,  
Villanova University  
School of Law  
Graduate Tax Program  
and Of Counsel,  
BakerHostetler



**SEBASTIAN WATT**

State Tax Attorney,  
Reed Smith LLP



**DREW VANDENBRUL**

Managing Director,  
Grant Thornton LLP



# Overview of Tax Changes And Budget Process



## Background

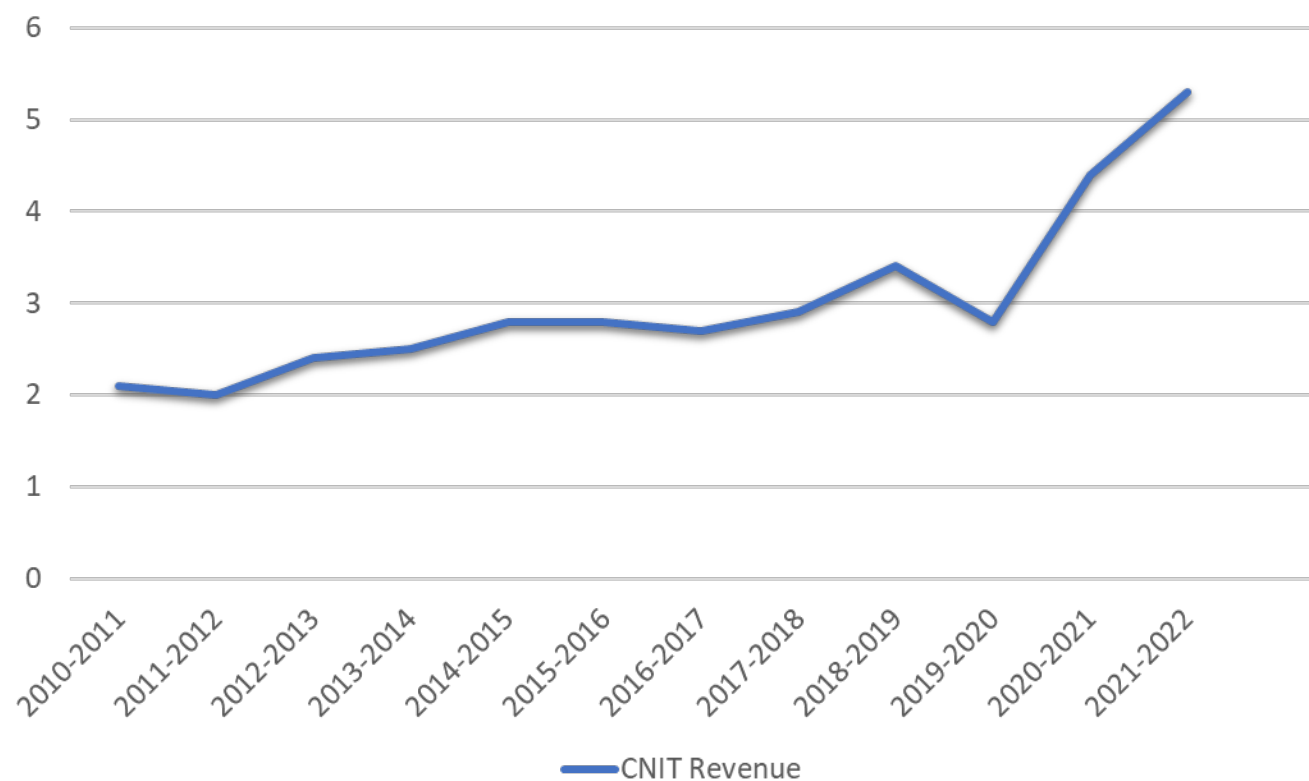
- Must balance budget every fiscal year
- CNIT collection estimates impact 'cost' of rate reduction
- Many issues – unrelated to tax - being negotiated simultaneously





## CNI Revenue Exploded 2020-2022

CNIT Revenue 2010-2022

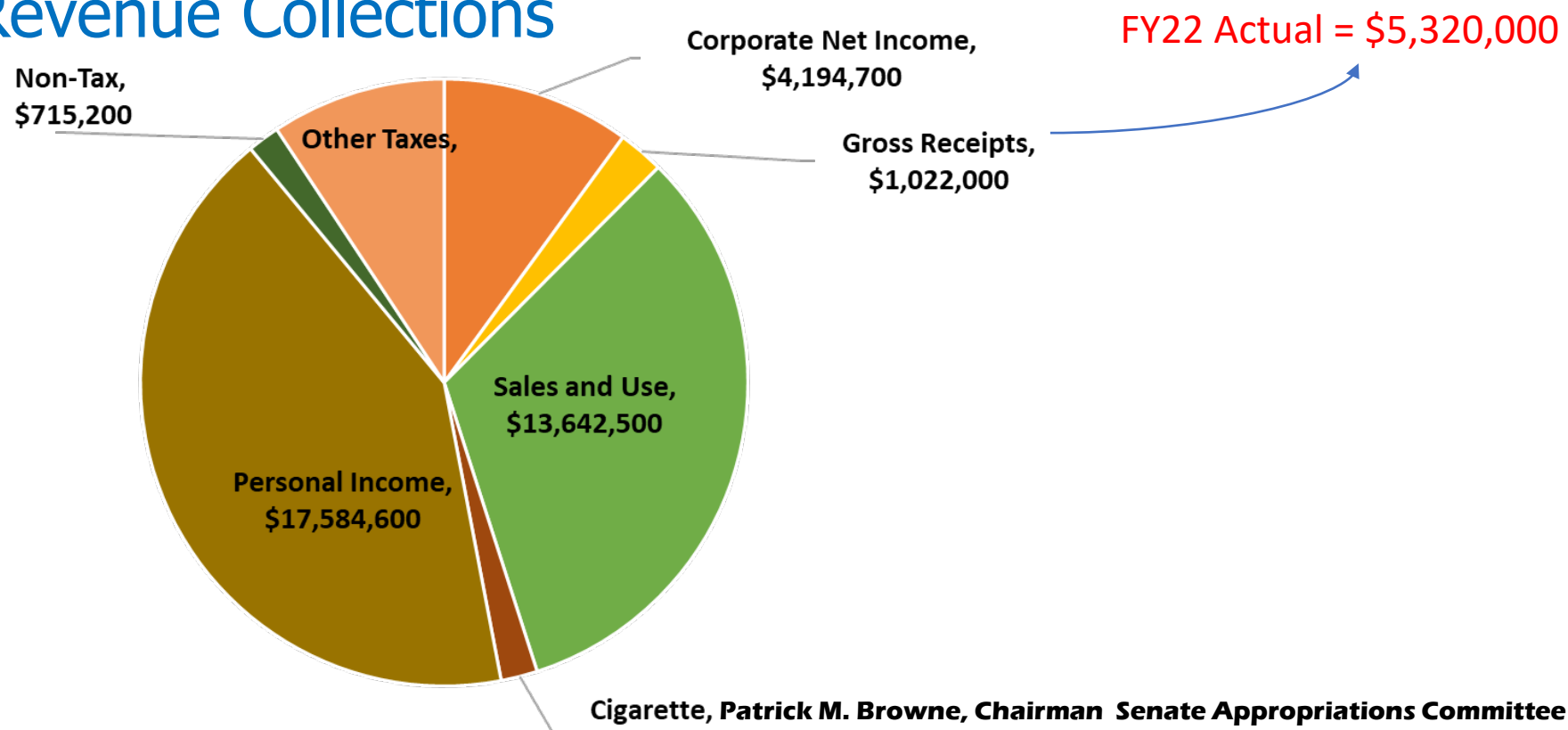


For the Fiscal Year 2021-2022, CNIT Collections were \$5.32B (**41.4% above estimate**)



# \$41.9 Billion of General Fund Revenue

## FY22 Estimated Revenue Collections



CNIT: 11% of all tax revenue



**GENERAL FUND FINANCIAL STATEMENT**  
 Produced Using Independent Fiscal Office Revenue Estimates (FY 2022-23) and Senate/House Republican Revenue Estimates (FY 2023-24 and FY 2024-25)  
*The Department of Revenue's Official Revenue Estimates are \$1.6 billion higher in FY 2022-23*  
 (amounts in thousands)  
 July 7, 2022

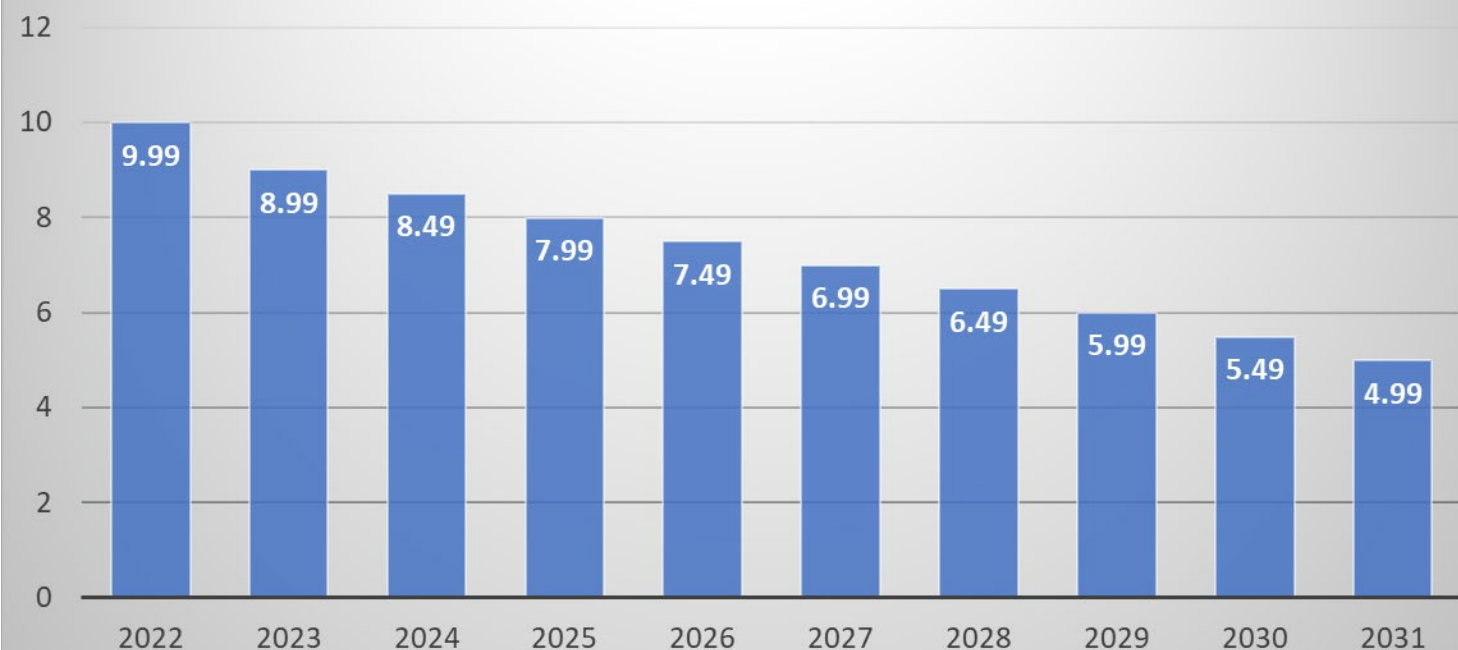
	FY 2021-22	FY 2022-23	FY 2023-24	FY 2024-25
	[A]	[B]	[C]	[D]
1 <b>Beginning Balance</b> .....	\$0	\$5,537,421	\$3,570,887	\$172,787
2 Adj. to Beginning Balance.....	4,450	-	-	-
3 <b>Adjusted Beginning Balance</b> .....	\$4,450	\$5,537,421	\$3,570,887	\$172,787
4 <b>Revenue:</b>				
5 Official Revenue Estimate.....	\$44,293,220	\$42,305,800 -4.5%	\$43,511,453 2.8%	\$44,599,239 2.5%
6 <b>ARPA Federal Stimulus - Revenue</b> .....	3,841,000	-	-	-
7 <b>Tax Code Changes</b> .....	-	(166,600)	(228,900)	(397,900)
8 <b>Cigarette Tax - Tobacco Revenue Bond Debt Service</b> .....	-	(115,300)	(115,300)	(115,300)
9 <b>EITC Expansion</b> .....	-	(115,000)	(115,000)	(115,000)
10 <b>PIT Transfer to Election Integrity Restricted Account</b> .....	-	(45,000)	(45,000)	(45,000)
11 <b>Transfer to ESF Growing Greener Debt Service</b> .....	-	(12,317)	(10,500)	(10,600)
12 <b>Sports Wagering</b> .....	-	(5,000)	(5,000)	(5,000)
13 <b>House Bill 2157 - Fireworks</b> .....	-	(14,000)	(14,600)	(15,100)
14 <b>Medical Marijuana Program Fund Transfer</b> .....	-	36,600	-	-
15 <b>Subtotal Revenue</b> .....	48,134,220	\$41,869,183 -13.0%	\$42,977,153 2.6%	\$43,895,339 2.1%
16 <b>Less: Refunds</b> .....	(\$1,420,000)	(\$1,220,100)	(\$1,250,000)	(\$1,275,000)
17 <b>Total Revenue</b> .....	\$46,714,220	\$40,649,083	\$41,727,153	\$42,620,339
18 <b>Prior Year Lapses</b> .....	270,012	150,000	150,000	150,000
19 <b>Funds Available (rows 3 + 16 + 17)</b> .....	\$46,988,682	\$46,336,504	\$45,448,040	\$42,943,126
20 <b>Expenditures:</b>				
21 Total Appropriations (GF + Enhanced FMAP + CARES + ARPA)*.....	\$43,198,698	\$45,210,581 2.9%	45,275,253 0.1%	47,220,253 4.3%
22 Less: Federal Enhanced FMAP.....	(2,327,668)	(1,272,636)	-	-
23 Less: Off-line Federal Stimulus (CARES/ARPA).....	(2,278,000)	(1,172,328)	-	-
24 Less: Supplemental Appropriations.....	758,231	-	-	-
25 <b>Total Expenditures</b> .....	39,351,261	42,765,617	45,275,253	47,220,253
26 <b>Preliminary Balance</b> .....	\$7,637,421	\$3,570,887	\$172,787	(\$4,277,127)
27 <b>Less: Transfer to Budget Stabilization Reserve Fund</b> .....	(2,100,000)	-	-	-
28 <b>Ending Balance</b> .....	\$5,537,421	\$3,570,887	\$172,787	(\$4,277,127)
29 <b>Estimated Rainy Day Fund Balance:</b>	\$2,868,521	\$4,965,078	\$4,965,078	\$4,965,078

\* Included in year-over-year growth calculation.





## CNI Rate Cut in Half from 9.99 to 4.99



CNI Reduction Year Over Year

PA's CNI rate scheduled to drop every Jan. 1 over the next 9 years by the following percentages:

January 1, 2023 to 8.99%  
January 1, 2024 to 8.49%  
January 1, 2025 to 7.99%;  
January 1, 2026 to 7.49%;  
January 1, 2027 to 6.99%;  
January 1, 2028 to 6.49%;  
January 1, 2029 to 5.99%;  
January 1, 2030 to 5.49%;  
**January 1, 2031, and each taxable year thereafter to 4.99%**



## Historic Victory

- Bipartisan Victory
- Small business tax package
- Credits expanded
- CNIT
  - Rate reduction
  - Sourcing revisions
  - Economic nexus revision
- Still more to do so we can't take our eye off the ball





## Impact of Rate Reduction



### Current Pennsylvania Rankings:

- 2<sup>nd</sup>** - **Highest** CNI Tax Rate in the Country
- 29<sup>th</sup>** - Overall State Business Tax Climate Index
- 44<sup>th</sup>** - State Corporate Tax Burden
- 19<sup>th</sup>** – Individual Income Tax

### Pennsylvania Rankings Once Fully Implemented:

- 8<sup>th</sup>** - **Lowest** CNI Tax Rate in the Country
- 17<sup>th</sup>** - Overall State Business Tax Climate Index
- 27<sup>th</sup>** - State Corporate Tax Burden
- 18<sup>th</sup>** – Individual Income Tax

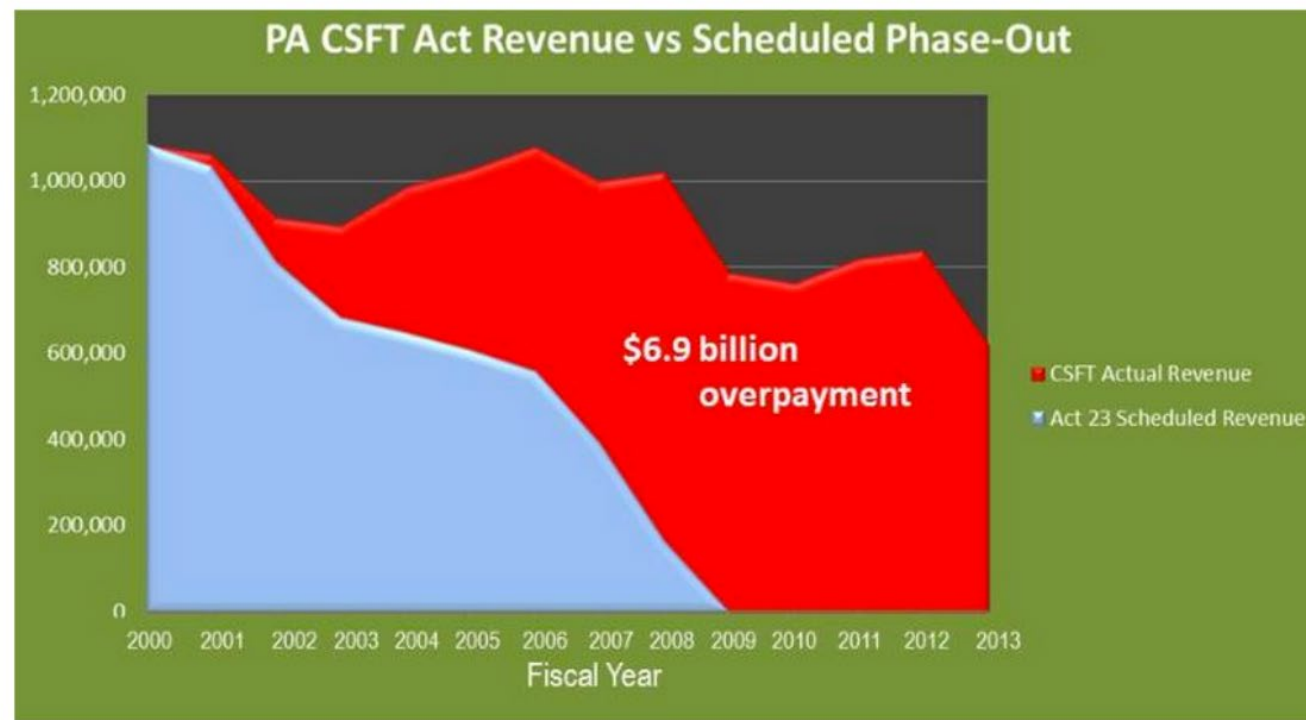




## CSFT Phase-Out: A Cautionary Tale

### CSFT Phase Out

- 4 Delays in over 13 years
- PA Businesses Taxed an Additional \$6.9 Billion through 2013 alone
- Original Phase Out as Enacted: 2000-2008
- **Actual Phase Out:** 2000-2015



Source: Pennsylvania Business Council



# Small Business Changes



## Personal Income Tax

- IRC Sec. 1031 like-kind exchanges
  - Allows deferral of tax due on gains
  - What happens if exchanged property is outside PA?
- IRC Sec. 179 expensing
  - Conforms to the IRC deductions beginning January 1, 2023





## Sales Tax

- Car sharing receipts subject to sales tax, effective January 1, 2023
- Extends the Computer Data Center Sales Tax Exemption from 15 to 25 years



## Inheritance Tax

- Original purpose of HB 1342 (PN 1440)
- House passed unanimously December 13, 2021 Section 2111(u)
- Exempts transfers of property at death by a member of the military on active duty.
  - §2111(u)
  - Effective September 6, 2022.



## Credits & KOZ

- R&D Credit increased annual credit limit from \$55M to \$60M
- EITC/OSTC – Act 55 of 2022
  - Increased EITC annual credit limit from \$225M to \$340M
  - Increased OSTC annual credit limit from \$55M to \$65M
- Film Tax Credit increased annual credit limit from \$70M to \$100M and broadened definitions
- Entertainment Economic Enhancement Program increased annual credit limit from \$8M to \$24M
- Keystone Opportunity Zone (KOZ)
  - Extended deadline to apply and approve additional zones to October 1, 2023 and December 31, 2023, respectively
  - Corrective language regarding zone extensions and affiliates
- Established Airport Land Development Zones
  - \$2,100 per incremental job
  - Applied to PIT, CNIT, bank shares tax, mutual thrift institution tax, and title insurance company shares tax





# Act 53 Timeline



# Act 53 Timeline – How did we get here?

House	May 5, 2021	HB 1342 is referred to the House Finance Committee.
	November 9, 2021	House Finance Committee reports out HB 1342 as committed; House considers HB 1342 for the <u>first time</u> .
	November 17, 2021	House considers HB 1342 for the <u>second time</u> .
	December 13, 2021	House considers HB 1342 for the <u>third time</u> and final passage (202-0).
	December 29, 2021	HB 1342 is referred to the Senate Finance Committee.
Senate	June 22, 2022	Senate Finance Committee reports out HB 1342 Senate considers HB 1342 for the <u>first time</u> .
	June 28, 2022	Senate considers HB 1342 for the <u>second time</u> . HB 1342 is re-referred to Senate Appropriations Committee.
	July 7, 2022	Senate Appropriations Committee amends the bill by adding 48 pages of significant PIT, CNIT and other changes.
	July 7, 2022	Senate considers HB 1342 for the <u>third time</u> and final passage (38-12).
	July 7, 2022	Senate refers HB 1342 to House Rules Committee, which re-reports it with amendments.
House	July 7, 2022	House concurs with Senate’s amendments to HB 1342 (184-16).
Governor	July 8, 2022	Governor signs HB 1342 into law as Act 53 of 2022.



# Act 53 Timeline – How did we get here?

House	May 5, 2021	HB 1342 is referred to the House Finance Committee.
	November 9, 2021	House Finance Committee reports out HB 1342 as committed; House considers HB 1342 for the <u>first time</u> .
	November 17, 2021	House considers HB 1342 for the <u>second time</u> .
	December 13, 2021	House considers HB 1342 for the <u>third time</u> and final passage ( <u>202-0</u> ).
	December 29, 2021	HB 1342 is referred to the Senate Finance Committee.
Senate	June 22, 2022	Senate Finance Committee reports out HB 1342 Senate considers HB 1342 for the <u>first time</u> .
	June 28, 2022	Senate considers HB 1342 for the <u>second time</u> . HB 1342 is re-referred to Senate Appropriations Committee.
	July 7, 2022	Senate Appropriations Committee amends the bill by adding 48 pages of significant PIT, CNIT and other changes.
	July 7, 2022	Senate considers HB 1342 for the <u>third time</u> and final passage ( <u>38-12</u> ).
House	July 7, 2022	Senate refers HB 1342 to House Rules Committee, which re-reports it with amendments.
	July 7, 2022	House concurs with Senate’s amendments to HB 1342 (184-16).
Governor	July 8, 2022	Governor signs HB 1342 into law as Act 53 of 2022.





# Corporate Changes



## Overarching issues to keep in mind

- Who is impacted?
- What are the enactment and effective dates?
- Are there tax accounting/financial statement implications?
- What uncertainty exists?
- What additional guidance can be anticipated?



# Corporate Net Income Tax (CNIT) Rate Reductions

9.99% rate for tax years beginning on or after January 1, 1995 through December 31, 2022

Tax Years Beginning on or After January 1:	CNIT Rate
2023	8.99%
2024	8.49%
2025	7.99%
2026	7.49%
2027	6.99%
2028	6.49%
2029	5.99%
2030	5.49%
2031	4.99%





# Surrounding States' Corporate Tax Rates

- A comparison of corporate tax rates in Pennsylvania's bordering states
  - Highest rate, if graduated

State	Corporate Tax Rate	Year PA Rate is Lower
Delaware	8.70%	2024
Maryland	8.25%	2025
New Jersey	11.50% (9.00% after 2023)	Currently
New York	7.25%	2027
Ohio	N/A – Commercial Activity Tax (CAT)	N/A
West Virginia	6.50%	2028



# Lowest Corporate Tax Rates

- States with rates lower than Pennsylvania’s 4.99% in 2031

State	Corporate Tax Rate
Arizona	4.90%
Colorado	4.55%
Indiana	4.90%
Missouri	4.00%
North Dakota	4.31%
Oklahoma	4.00%
Texas (Margin Tax)	0.75%/0.375%

- States with no corporate net income tax:
  - North Carolina (2030), Nevada (Commerce Tax), Ohio (CAT), South Dakota, Washington (Business & Occupation Tax), and Wyoming



## CNIT Changes At A Glance

- Receipts sourcing
  - Intangibles
  - Financial transactions
- Economic nexus
  - Definitions
  - Effective date
  - Interaction with Corporation Tax Bulletin 2019-04
  - Interaction with existing addback requirements
- No retroactivity





## CNIT Sourcing Background

- Subparagraph (16) sources receipts from the sale of TPP.
- Subparagraph (16.1) sources receipts from the sale of services.
- New subparagraph (17) replaces the former “costs of performance” sourcing rule with one that is generally “market-based.”
- Applies to receipts from sales that:
  - Are neither the sales of TPP nor services; or
  - Are sales of :
    - Intangible property; and
    - Certain types of financial transactions.



## Some Current CNIT Sourcing Issues

- *Synthes*: Does subparagraph 17's 'costs of performance' language really mean 'market?'
- What is a "service" that is sourced under subparagraph 16.1?
- Where is a service "delivered?"
- Can a service be delivered to multiple locations and, if so, how is that properly taken into account?



## CNIT Sourcing Changes – Intangible Property

- (C) Gross receipts from the lease or license of intangible property, including a sale or exchange of property where the receipts from the sale or exchange derive from payments that are contingent on the productivity, use or disposition of the property, if and to the extent the property is used in this State.
- (D) Gross receipts from the sale of intangible property where the property sold is a contract right, government license or similar property that authorizes the holder to conduct a business activity in a specific geographic area, if and to the extent the property is used in or otherwise associated with this State.





## Some Intangible Property (IP) Sourcing Issues

- (C) Gross receipts from the lease or license of intangible property, including a sale or exchange of property where the receipts from the sale or exchange derive from payments that are contingent on the productivity, use or disposition of the property, if and to the extent the property is used in this State.
- (D) Gross receipts from the sale of intangible property where the property sold is a contract right, government license or similar property that authorizes the holder to conduct a business activity in a specific geographic area, if and to the extent the property is used in or otherwise associated with this State.

- What is 'intangible property?'
- How does one measure the "extent to which the IP is used in the State?"
- Need regulatory guidance to fill in the blanks.
- What happens until regulatory guidance is issued?
- Importance of pro-active advocacy.



## CNIT Sourcing Changes – Certain Types of Financial Transactions

(E) Gross receipts from the sale, redemption, maturity or exchange of securities, held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business, if the customers are in the state.

(F) Gross receipts **received by a corporation that regularly lends funds to unaffiliated entities or to individuals** from interest, fees and penalties imposed in connection with loans secured by real property [are sourced to PA if all or more than 50% of the FMV is located in PA and more than 50% is not located in any one state, then sourced to PA] if the borrower is located in this State.

(G) Gross receipts **[same as (F)]** from loans related to the sale of tangible personal property [are sourced to PA] if the property is delivered or shipped to a purchaser in this State.

(H) Gross receipts **[same as (F)]** from loans not described in (F) or (G), if the borrower is located in this State.

(I) Gross receipts received from interest, fees and penalties in the nature of interest from credit card receivables and gross receipts from fees charged to cardholders, such as annual fees, if the billing address of the cardholder is in this State.



## Some Financial Transaction Sourcing Issues

(E) Gross receipts from the sale, redemption, maturity or exchange of securities, held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business, if the customers are in the state.

(F) Gross receipts **received by a corporation that regularly lends funds to unaffiliated entities or to individuals** from interest, fees and penalties imposed in connection with loans secured by real property [are sourced to PA if all or more than 50% of the FMV is located in PA and more than 50% is not located in any one state, then sourced to PA] if the borrower is located in this State.

(G) Gross receipts **[same as (F)]** from loans related to the sale of tangible personal property [are sourced to PA] if the property is delivered or shipped to a purchaser in this State.

(H) Gross receipts **[same as (F)]** from loans not described in (F) or (G), if the borrower is located in this State.

(I) Gross receipts received from interest, fees and penalties in the nature of interest from credit card receivables and gross receipts from fees charged to cardholders, such as annual fees, if the billing address of the cardholder is in this State.

- When is a customer / borrower is "in the State?"
- Are sales of securities included at gross or net?
- Are receivables a security?





## CNIT Sourcing – Financial Transactions (cont.)

- (J) Gross receipts received from *interest*, not otherwise described in this paragraph, shall be included in the numerator of the sales factor if the lender's commercial domicile is in this State.
  
- (K) Gross receipts from *intangible property*, not otherwise described in this paragraph, shall be excluded from the numerator and denominator of the sales factor.
  
- (L) The Department shall promulgate the rules and regulations necessary to implement this paragraph.



## Some More Financial Transaction Sourcing Issues

- (J) Gross receipts received from *interest*, not otherwise described in this paragraph, shall be included in the numerator of the sales factor if the lender's commercial domicile is in this State.
- (K) Gross receipts from *intangible property*, not otherwise described in this paragraph, shall be excluded from the numerator and denominator of the sales factor.
- (L) The Department shall promulgate the rules and regulations necessary to implement this paragraph.
  - Impact of (K) throw out
    - Burden
    - Constitutional fairness
  - When will we see regulations and/or issue administrative guidance?
  - Will there be changes to the tax forms?
  - Importance of pro-active advocacy.



## CNIT – Economic Nexus

- Result of 2018 US Supreme Court decision in *Wayfair*
- \$500K receipts threshold, tied to sourcing of receipts under Section 401
- PA DOR Legislative Summary indicates “this legislation codifies the Department of Revenue-issued Corporation Tax Bulletin 2019-04”
  - See comparison of Act 53 and the Bulletin on the next slides
- Carve-out for foreign affiliated entities located in a tax treaty country (see paragraph (5))





# Corporate Net Income Tax – Economic Nexus – Section 402(A)

A corporation shall be subject to and shall pay an excise tax for exercising... any of the following privileges:

...

(5) (I) Having substantial nexus in this Commonwealth. Substantial nexus in this Commonwealth means a direct or indirect business activity that is sufficient to grant the Commonwealth authority under the Constitution of the United States to impose tax under this article and for which a basis exists under Section 401 to apportion or allocate the corporation's income to this Commonwealth.

(II) For purposes of this section, business activity includes, but is not limited to:

- (A) The leasing or licensing of intangible property that is utilized in this Commonwealth;
- (B) Regularly engaging in transactions with customers in this Commonwealth involving intangible property, including loans made by a corporation that regularly lends funds to unaffiliated entities or to individuals; or
- (C) Sales of intangible property that was utilized by the corporation within this Commonwealth.

(III) There shall be a rebuttable presumption that a corporation with \$500,000 or more of sales sourced in the current tax year to this Commonwealth under section 401 has substantial nexus in this Commonwealth without regard to physical present in this Commonwealth.

(6) Paragraph (5) shall not apply to an affiliated entity<sup>1</sup> domiciled in a foreign nation which has in force a comprehensive income tax treaty with the United States providing for the allocation of all categories of income subject to taxation, or the withholding of tax, on royalties, licenses, fees and interest for the prevention of double taxation of the respective nations' residents and the sharing of information.

<sup>1</sup> Defined in Section 401 (10).



## Corporate Net Income Tax – Economic Nexus – Bulletin 2019-04

For Pennsylvania Corporate Net Income Tax purposes the decision in *Wayfair* has confirmed that out of state corporations are considered to be doing business in this Commonwealth and/or carrying on activities in this Commonwealth to the extent they are taking advantage of the economic marketplace of the Commonwealth regardless of whether they are physically present in Pennsylvania. As a result, the Department will require such taxpayers to begin filing Corporate Tax Reports so long as they meet the minimum thresholds for nexus under the Constitution of the United States. While the Court in *Wayfair* did not express a bright line threshold of economic activity which would satisfy the nexus requirements existing under the Due Process and Commerce Clauses, it did approve the approach of South Dakota whereby an out of state taxpayer was subjected to a sales tax collection requirement where it had in excess of either 200 sales or \$100,000 worth of sales of goods or services to South Dakota customers during the course of a tax year. While all taxpayers with nexus under the Constitution of the United States should file a Corporate Tax Report with Pennsylvania, the Department will deem there to be a rebuttable presumption that corporations without physical presence in the state, but having \$500,000 or more of gross receipts sourced to Pennsylvania per year pursuant to the sales factor rules contained in 72 P.S. § 7401, have a filing requirement with the Commonwealth for purposes of the Corporate Net Income Tax. Examples include gross receipts from:

- (1) the sale, rental, lease, or licensing of tangible personal property;
- (2) the sale of services;
- (3) the sale or licensing of intangibles, including franchise agreements;
- (4) interest and other intangibles not included above.



## Some Economic Nexus Issues

- Impact on current structure / financial statements
- Potential new filing requirements
- Effective date January 1, 2023
- Signed July 8, 2022 (Q3)
- Interaction with existing intangible expense or interest expense disallowance under Section 401(3)(1)(t)(1)
  - Credit calculated by multiplying the taxpayer's apportionment factor by the greater of:
    - the tax liability of the affiliated entity related to intangible or interest income; or
    - the tax liability that would have been paid by the affiliated entity.
  - Query whether this will fully offset any tax of the affiliated entity now calculated under the new economic nexus and receipts sourcing rules





# What's Next?



## What didn't make it onto the table?

- Elective pass-through entity (PTE) tax – HB 1709
  - PA Chamber supported legislation
  - Actively opposed by Department of Revenue
  - Allow tax at the PTE level to facilitate federal deductions
  - Revenue-neutral to Pennsylvania (federal deduction)
  - **Amended Sec. 314 to allow resident partners a credit for similar taxes in other states**
  - PA remains the largest outlier
- Phila. NOL extension – HB 324
  - Philadelphia legislation passed [date] to extend BIRT NOL carryover from 3 years to 20 years
  - No Pennsylvania revenue impact
  - Does not bode well for enabling legislation needed for market-based sourcing
- Bank Shares Tax
- HB 1059 – Estimated payments
- HB 2277 – Elimination of Accelerated Sales Tax Pre-payment Requirement
- HB 1960 – NOLs



# Questions





***Thank You***