PENNSYLVANIA STATE TAX DEVELOPMENTS

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I. INCOME/FRANCHISE TAXES

A. Judicial Developments

1. Pennsylvania's Supreme Court Agrees that NOL Cap Unconstitutional, Disagrees with Commonwealth Court on Remedy. On October 18, 2017, the Pennsylvania Supreme Court issued a decision in *Nextel Communications of the Mid-Atlantic, Inc. v. Commonwealth*, 171 A.3d 682 (Pa. 2017), holding that Pennsylvania's cap on the NOL deduction for 2007 violated the Uniformity Clause of the Pennsylvania Constitution. In its decision, however, the Pennsylvania Supreme Court overturned the Commonwealth Court with respect to the remedy and instead determined that striking the flat-dollar NOL cap only (leaving the percentage-based cap) was the appropriate remedy rather than striking the NOL cap in full. The result in this case was that Nextel received no relief because it had already applied the percentage limitation on its return.

   On June 11, 2018, the Supreme Court of the United States denied Nextel's petition for writ of certiorari. Nonetheless, the Pennsylvania Supreme Court's decision in *Nextel* kicked off a number of additional lawsuits seeking to resolve questions the Court left unanswered.

2. Pre-2007 NOL Cap Litigation. For tax years prior to 2007, Pennsylvania's statutory NOL cap was $2 million. During this period, there was no percentage cap. Therefore, the question is, whether applying *Nextel* and striking the flat-dollar cap in these years results in an uncapped NOL deduction.

There is litigation pending involving the flat-dollar cap for the 2006 tax year in *RB Alden Corp. v. Commonwealth*. In that case, the Commonwealth Court ruled in favor of the taxpayer striking the unconstitutional flat-dollar cap and, since that was the only cap, allowing taxpayer an uncapped NOL deduction. However, on September 21, 2018, the Pennsylvania Supreme Court vacated the Commonwealth Court's decision and remanded the case back to the Commonwealth Court for reconsideration in light of the Pennsylvania Supreme Court's decision in *Nextel*.

Simultaneously, there is also litigation pending involving the flat-dollar cap for the 2001 tax year.

The taxpayers in these cases are arguing they are entitled to an uncapped NOL deduction as a matter of statutory construction and under federal and state constitutional principles. On November 21, 2019, the Commonwealth Court agreed, finding that *Nextel* applies retroactively to the 2001 tax year and the taxpayers in both cases are entitled to an uncapped NOL. The Commonwealth appealed both decisions to the Supreme Court of Pennsylvania in February 2020. In December 2020, *RB Alden* was held pending the lead litigation. Oral argument in the lead case was held in March 2021 and the parties are awaiting the Court's decision.

3. Post-2007 NOL Cap Litigation. During tax years after 2007 but before the statutory elimination of the flat cap in 2017, Pennsylvania continued to have both a flat- and percentage-based NOL cap.

- 2007-2013.

When *Nextel* was decided, the 2007-2013 tax years were closed for assessment. So, the Department could not apply *Nextel* to those years by assessing additional tax against the taxpayers favored by the unconstitutional flat-dollar cap (i.e., those taxpayers who were allowed to use NOLs to reduce taxable income to zero because their income was below the flat-dollar cap amount). Therefore, the only way to equalize the treatment of taxpayers and remedy the discrimination resulting from application of the flat-dollar cap is to allow the disfavored taxpayers (i.e., those who could not reduce taxable income to zero because their income was above the flat cap so the percentage cap applied) to ignore the cap and use available NOLs to reduce taxable income to zero. Numerous cases are currently pending in Commonwealth Court in which the disfavored taxpayers are arguing they are entitled to relief as a matter of federal and state constitutional law.

- 2014-2016.

At the time of the *Nextel* decision, the tax years 2014-2016 were still open for audit and assessment. Therefore, the Department *could have* remedied the discrimination caused by the flat-dollar cap by denying taxpayers favored by the flat cap the benefit of the flat cap and assessing additional tax against such taxpayers based on applying the percentage cap.

However, the Department chose to do nothing. In fact, as described below in **Administrative Developments**, the Department publicly announced that it would not apply *Nextel* to years before 2017, even those years were open under the statute of limitations. A Department Bulletin and Board of Finance and Revenue decisions issued in 2018 indicated that taxpayers favored by the flat cap would neither be assessed in this manner nor would such an assessment be upheld on appeal.

There are cases pending in Commonwealth Court in which taxpayers are arguing that this unequal enforcement of the law violates the Pennsylvania Constitution's Uniformity Clause. In September 2020, oral argument was held in the lead case involving the 2014 tax year. On September 13, 2021, the Commonwealth Court issued its 3-judge panel initial decision, ruling in favor of the Commonwealth.

The Commonwealth Court held that the Pennsylvania Supreme Court's decision in *Nextel* does not apply retroactively to the 2014 tax year. According to the court, this meant that the Department of Revenue did not violate the Uniformity Clause by allowing small taxpayers to claim an uncapped net loss deduction for the 2014 tax year. The court found that although *Nextel* did not constitute a change in law, it would have been unfair to apply *Nextel* to the 2014 tax year because it would have increased the tax on small taxpayers that had computed their taxes in reliance on the unconstitutional flat cap on the net loss deduction. Exceptions are due by October 13 to have the full court review the decision of the 3-judge panel.

4. <u>Sales Factor Sourcing – COP v. Market.</u> Pennsylvania's statutory rule for sourcing receipts from services changed from a cost of performance method to market sourcing, effective beginning with the 2014 tax year. Despite the statutory change, the Department continues to enforce its position that even under the pre-2014 cost of performance sourcing method, sales of services are sourced to the location of the customer. The Department supports its position by relying upon the "income producing activity" prong of the statute—and the statutory requirement that you only look to the location of a taxpayer's costs of performance if the "income producing activity" occurs in more than one state. The

Department then goes on to equate "income producing activity" with the location where the "benefit is received" by the customer. Under this analysis, receipts from services are effectively sourced on a market basis, even for tax years before the statutory change.

This issue has been raised by taxpayers for several years and is frequently resolved through settlement. However, the issue is now squarely before the Pennsylvania Supreme Court to decide in the *Synthes* case. In that case, the Commonwealth Court concluded that: 1) the pre-2014 cost-of-performance statute is ambiguous; 2) the Department's interpretation of the pre-2014 cost-of-performance statute as effectively requiring market-based-sourcing was reasonable; 3) the Department's interpretation was entitled to deference; and 4) the statutory change to market sourcing in 2014 was merely a clarification of existing law and not an indication of the General Assembly's intent to change the law. The parties have appealed to the Pennsylvania Supreme Court where the case is fully briefed before that court, and the parties are awaiting the court to schedule oral argument. *Synthes USA HQ, Inc. v. Commonwealth*, 108 F.R. 2016.

B. Administrative Developments

1. Economic Nexus Bulletin. On September 30, 2019, the Department issued Corporation Tax Bulletin 2019-04, announcing that "*Wayfair* has confirmed that out of state corporations are considered to be doing business 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." According to the Bulletin, although all corporations with economic nexus under that standard should file corporate tax returns in Pennsylvania, there will be a rebuttable presumption of corporate net income tax nexus for any corporation with at least $500,000 of sales "sourced to Pennsylvania per year pursuant to the sales factor rules contained in 72 P.S. § 7401."

On August 6, 2020, a revised version of the Bulletin was issued to provide additional guidance for pass-through entities and to explicitly include gross receipts from "interest and other intangibles" not otherwise listed in the Bulletin in determining whether the $500,000 threshold is met.

The updated Bulletin also advises taxpayers with Pennsylvania receipts of at least $500,000 "who claim to not have nexus" to file a corporate net income tax return. That return, according to the Bulletin, should include information supporting the no-nexus position as well as data that would allow the Department to calculate a tax liability if they disagree with the nexus position. We recommend that taxpayers who

are unsure about whether they have nexus in Pennsylvania to consult counsel before filing returns or providing information to the state.

2. "Pay to play" for assessment appeals? Even though prepayment is not required by statute, the practice of the Board of Appeals and the Board of Finance and Revenue is to require prepayment of an assessment before they will consider arguments to reduce the assessment other than arguments involving the narrow issue(s) that the Department of Revenue chose to list as the basis for the assessment. The administrative boards routinely dismiss these "offset" arguments that are outside the basis of the assessment without addressing them at all. The policy of the Department of Revenue and the administrative appeal boards seems to be that the only way to raise offset issues to an assessment is to pay the assessment and file a refund claim.

   One of the members of the three-member Board of Finance and Revenue has acknowledged how the Board's practice results in a prepayment requirement, and the board member rebuked this in several dissenting opinions where the majority opinion dismissed the offset issues because they were outside the basis of the assessment. The dissenting board member stated:

   > I would not interpret the basis of assessment as narrowly as the Board does here … rather, I would address the merits of any issue relating to a reported item that was included in the calculation of tax that was assessed by DOR. To apply such a narrow interpretation of the basis of assessment would require this Petitioner, and similarly situated taxpayers, to pay the assessment in order to challenge the tax calculations which resulted in the assessed tax increase. I am hesitant to require a taxpayer to pay an assessment in order to challenge it, and am unwilling to narrowly construe the basis of assessment to deprive a taxpayer of due process to challenge a tax increase without having to pay an assessment.

3. Board of Finance and Revenue Declines to Retroactively Assess Taxpayers Benefitting from Flat-Dollar NOL Cap. In *Nextel*, the Pennsylvania Supreme Court found the flat-dollar NOL cap unconstitutional and severed that provision from the statute, leaving intact only the percentage-based NOL deduction cap. In doing so, the Court left open the possibility for the Department to assess taxpayers that benefitted from the flat-dollar NOL deduction cap by applying the percentage-based NOL cap.

   In response, on May 10, 2018, the Department issued Corporation Tax Bulletin 2018-02—announcing that the Department will not assess

taxpayers who benefited from the flat-dollar NOL cap for years prior to the issuance of *Nextel*.

Nonetheless, in 2019, Pennsylvania's Auditor General informally expressed an interest in assessing additional tax against taxpayers that benefitted from utilized the flat-dollar cap. However, the Board of Finance and Revenue indicated it will not force taxpayers to use the percentage-based cap, holding in recent appeals that "[t]his Board shall exercise its equitable powers and observe the limitations of Bulletin 2018-02 so as not to increase corporate net income taxes for tax years beginning between" 2007 and 2016.

4. Federal Tax Reform Guidance—GILTI and IRC § 163(j). On January 24, 2019, the Department released Corporation Tax Bulletin 2019-02, addressing the Pennsylvania tax treatment of global intangible low-taxed income ("GILTI") and foreign-derived intangible income ("FDII"). In the Bulletin, the Department concludes that GILTI is included in the corporate income tax base and treated as a dividend. Therefore, taxpayers will be able to deduct 100% of included GILTI from wholly-owned subsidiaries from Pennsylvania taxable income. The Department also concludes that taxpayers cannot claim the GILTI or FDII deductions for Pennsylvania income tax purposes.

On April 29, 2019, the Department released Corporation Tax Bulletin 2019-03 to explain how the interest deduction limitation imposed by Internal Revenue Code § 163(j) impacts taxpayers' corporate net income tax calculations. In it, the Department concludes that when a federal consolidated group does not trigger the § 163(j) limitation, no limitation will apply for Pennsylvania purposes. If the federal limitation applies, however, taxpayers must separately compute their individual federal limitations (without accounting for any state-specific items), to reach the starting point for their Pennsylvania returns. The Bulletin also describes how taxpayers subject to the § 163(j) limitation should treat interest addback adjustments, nonbusiness income, and in the case where a partnership has corporate partners. The Bulletin indicates that additional guidance may be forthcoming on § 163(j) as the need arises, though nothing new has been issued as of the publication of this outline.

C. Trends and Outlook for 2021/2022

1. Addback Years Now Under Audit. For tax years beginning after December 31, 2014, 72 P.S. 7401(3)1.(t) requires taxpayers to add back related-party intangible expenses and certain interest expenses to taxable income unless one of several exceptions applies. Taxpayers have been curious to see how the Department would apply those exceptions, and we're starting to find out more now assessments for post-2014 years have been issued. As the Department ramps its auditing back up post

COVID-19 shutdowns, addback continues to be an audit interest for the Department. For example, the Department has in certain situations taken an aggressive approach to interpreting the breadth of the interest expenses that are covered by the addback statute, and the Department has also continued to rely on the "sham transaction" doctrine to disallow interest deductions. We suspect that forthcoming assessments will continue to show more trends in the Department's interpretation of the addback provisions.

2. Refund Opportunity for Entities Receiving Service Income from Out-of-State Affiliates after 2014. A recent decision from Pennsylvania's Board of Finance and Revenue indicates that companies earning revenue for the performance of services for out-of-state affiliates may be able to source those receipts to the location of the affiliate rather than to the location of the ultimate consumer of the service, even if the ultimate consumer is in Pennsylvania.

In the Board's decision, the taxpayer (based in Pennsylvania) and provided its affiliates (also based in Pennsylvania) with sales and marketing services, which are subject to market-based sourcing for periods after January 1, 2014. Those affiliates produced pharmaceuticals that were ultimately sold to the patients of the physicians targeted by the taxpayer's sales and marketing services. The taxpayer argued that its receipts from sales and marketing services should not be sourced based on the location of the affiliates, but instead should be sourced based on the location of the customer that ultimately purchased the pharmaceuticals.

In denying the taxpayer relief, the Board found that the "market for these services is the locations of the affiliated entities," not the location of the pharmaceutical's ultimate consumer. Based on the Board's decision, there may be a refund opportunity for taxpayers sourcing service receipts to Pennsylvania if the direct customer of the service is an out-of-state affiliate. *In Re: Teva Sales and Marketing Inc.*, Board of Fin. and Rev. Docket No. 1813182 (Decision Issued May 14, 2019). The taxpayer appealed the Board's decision to Commonwealth Court, where it remains pending. *Teva Sales and Marketing Inc. v. Commonwealth*, 566 F.R. 2019.

3. Department Continues to Apply Non-Statutory "Split-Apportionment" Method for Taxpayers Engaged in Distinct Activities that Each Require a Different Statutory Apportionment Formula. Pennsylvania's generally-applicable statutory formula for apportioning business income is based on a sales-factor only, but Pennsylvania has different statutory apportionment formulas that apply to business income from activities in specific industries, like pipeline companies. But what is a taxpayer to do if only a portion of its business income is from pipeline company

activities and the rest is not? In other words, how do you apply these rules when a particular taxpayer has some business income subject to the general apportionment rule and also has other business income subject to the special industry rule for pipeline companies? The case of *Buckeye Pipeline Co. v. Commonwealth*, 689 A.2d 366 (Pa. Commw. Ct. 1997) answered this question by requiring the use of a so-called "split-apportionment."

The Department's approach to split-apportionment in this context has been to divide a taxpayer's overall income between the pipeline segment and non-pipeline segment based on each segment's percentage of the taxpayer's overall gross receipts. Under the Department's method, more income would be attributed to a particular segment simply because that segment earned a higher volume of gross receipts; but that method ignores the expenses incurred to generate the receipts and it ignores whether a particular segment in fact earned income or generated a loss. In a 2017 Board of Finance and Revenue case, the taxpayer argued that the Department's method was inappropriate, and instead the income for a particular segment should be computed based on the actual revenues and expenses for the particular segment. (Of course, after the income for a particular segment is established, then the statutory apportionment formula for that segment is applied to that income amount.) The Board agreed with the taxpayer and concluded that the Department's method "did not calculate the adjusted income of each business segment according to the Tax Reform Code." The Commonwealth appealed to Commonwealth Court, and the case ultimately settled.

The Department continues to follow the approach that the Board concluded was not consistent with the statute, and the Department continues to issue assessments on this basis. There are ongoing appeals on this issue.

II. SALES AND USE TAXES

A. Legislative Developments

1. Miscellaneous Exemptions Enacted. While 2021 has not brought wholesale legislative changes to Pennsylvania's sales and use tax, a few additional exemptions were enacted:

- After December 31, 2021, items manufactured for the purpose of initiating, supporting, or sustaining breast feeding are exempt;
- After December 31, 2021, multipurpose agriculture vehicles used in farming are exempt; and

- Effective August 29, 2021 (60 days after enactment of the law), helicopter simulators, training materials, and corresponding software are exempt from Pennsylvania's sales and use tax.

2. Vendor Sales Tax Absorption - Act 13 of 2019 removes the long-standing prohibition against vendors advertising that sales and use tax is included in the vendor's stated price. Now, vendors can advertise that they will absorb sales and use tax; however, the vendor must: (i) state on any receipt provided to the customer that the vendor will pay the tax and not imply that the transaction is exempt from sales and use tax, (ii) separately state the amount of sales and use tax on any receipt provided to the customer, and (iii) keep books and records documenting the purchase price and the sales and use tax absorbed and remitted to the state.

B. Judicial Developments

1. Sales Tax Over-Collection Class Actions Pending. Multiple taxpayers, including discount warehouse clubs, furniture stores, and convenience stores, are currently subject to class action lawsuits in Pennsylvania regarding the collection of taxes. Some claims are for the over-collection of sales tax on the pre-discount cost of items purchased with coupons, while others are for the over-collection on certain exempt items. In addition to the potential taxes at issue, these class actions seek to recover attorney's fees and to impose the statutory penalties, which include, per-transaction penalties, including those imposed on a per-transaction basis.

   In one such case, BJ's Wholesale Club is accused of over-collecting sales tax on the pre-discount cost of items purchased with coupons. In May of 2020, the Commonwealth Court held that where it was obvious a coupon was used to purchase taxable items (if every item on the receipt was taxable, for example), but BJ's Wholesale collected tax on the un-discounted price, a refund was due. However, where it is unclear whether the coupon was for a taxable or nontaxable item, no refund could be granted. The implication of granting a refund in this case is that it establishes over-collection of tax by BJ's Wholesale, which may impact the class action pending against the company. On exceptions, the Commonwealth Court's decision was reaffirmed. The decision is now under appeal at the Pennsylvania Supreme Court. *John G. Myers v. Commonwealth*, 67-68 MAP 2021.

2. Manufacturing and Help Supply. Additional guidance regarding Pennsylvania's manufacturing exemption and treatment of help supply services may be forthcoming. In a case currently pending in Commonwealth Court, the taxpayer, Quality Driven Copack, is a

Pennsylvania corporation engaged in business of assembling, and selling at wholesale, pre-cooked frozen sandwiches, entrees, and bowl/bag type meals. To create its product, the taxpayer purchases the food components and packaging materials, blends the components into meals, packages, and then freezes them to complete the process. The taxpayer's main arguments are that: (1) its purchases of property for the meal assembly line are exempt property directly used in manufacturing/processing; and (2) its purchase of staffing services are not taxable help supply services.

Briefing is now complete and the parties are tentatively scheduled for oral argument on October 18, 2021. *Quality Driven Copack, Inc. v. Commonwealth*, Docket Nos. 862 & 879 F.R. 2013.

3. Fuel Blending as Manufacturing. In a rare tax appeal filed by the Commonwealth rather than a taxpayer, Pennsylvania is challenging the Board of Finance and Revenue's decision to grant Wawa a refund of tax paid on the purchase of blending equipment used at Wawa's fuel stations. To the extent the equipment was used to blend raw gasoline and biofuels into consumer-grade vehicle fuel, the Board agreed with Wawa that the equipment qualifies for Pennsylvania's manufacturing exemption. On appeal, the state will seek to convince the Commonwealth Court otherwise, arguing that the "blending of two or more fuel products does not meet the definition of 'manufacturing' or 'processing' under the Tax Reform Code." *Commonwealth v. Wawa Inc.*, 275-76 F.R. 2021.

4. Financial Institution Security Equipment Exemption Limited. On July 17, 2018, the Commonwealth Court issued its opinion in *Victory Bank v. Commonwealth*, denying the taxpayer's refund claim and holding that the taxpayer's computer hardware did not qualify as exempt financial institution security equipment.

Under the sales tax exemption for financial institution security equipment, which is set forth in a Department regulation, tax is not due on the "attachment or affixation of security equipment to real estate."

The taxpayer argued that its purchases of computer hardware were exempt because the hardware has power cords that are "attached" to buildings' electrical systems. In addition, the taxpayer argued that its purchases of software were exempt as a "component part of the hardware."

In contrast, the Commonwealth argued that the "method-of-attachment" test set forth in precedential case law requires *permanent* attachment or affixation. In those cases, the issue was whether certain items retained their character as tangible personal property upon installation. The

Commonwealth also argued that the regulation was superseded by statutory amendments that implicitly require permanent affixation.

In its July 17, 2018 Opinion, the Commonwealth Court ruled in favor of the Commonwealth and found that plugging a computer into an electric outlet did not amount to installation. While the court declined to hold that the Department's regulation was superseded in its entirety, it did find that the higher affixation standard argued by the Commonwealth applied. In response to exceptions filed by the taxpayer, the court held that, unlike a situation where the Department's litigating position conflicts with a regulation, a subsequently-enacted statute allows a court to amend or void a conflicting regulation to be consistent with the new statute, because a regulation cannot exceed the scope of its enabling statute.

On November 13, 2019, Victory Bank filed a Notice of Appeal in the Pennsylvania Supreme Court. Briefing was completed in May 2020 and on October 1, 2020, the Court issued a decision affirming the Commonwealth Court's decision per curiam. *Victory Bank v.* Commonwealth, 89 MAP 2019.

C. Administrative Developments

1. SUT Bulletin 2021-03: Remote Help Supply Services. The Department of Revenue issued a new sales and use tax Bulletin on September 16, 2021 to address the sourcing of help supply services given the "technological developments [that] have allowed some help supply employees to work remotely."

Historically, the Department has taken the position that help supply services are subject to Pennsylvania tax if the "delivery or use" of the service occurs in Pennsylvania. "Delivery" occurs in Pennsylvania if the temporary worker reports for work "at a location" in Pennsylvania while "use" occurs if that worker performs work "at a location" in Pennsylvania. On its face, the Department's historical policy does not contemplate a worker who provides services remotely from a location outside Pennsylvania. SUT Bulletin 2021-03 changes that. In it, the Department states that the "delivery or use" of remote help supply services occurs where the purchaser receives the benefit of the services. Specifically, the Department says that "[w]hether the help supply employee is reporting in person or remotely is not determinative." Instead, providers of help supply services should look to the location to which the work is delivered in determining the location of delivery or use under the Department's new guidance.

2. SUT Letter Ruling re: Membership Fees. On January 31, 2020, the Department of Revenue issued a sales tax letter ruling addressing sales of memberships through which members receive access to publications and other tangible personal property. The letter ruling provided that if membership fees include both services and taxable tangible personal property, those membership fees are taxable (essentially treating the fees as bundled transactions). That letter ruling, however, is no longer available on the Department's website, which creates a question as to whether this authority remains valid. Letter Ruling No. SUT-20-001.

3. SUT Bulletin 2019-03 Sales Tax Absorption. The Department of Revenue issued a sales and use tax bulletin to address the requirements relating to sales tax absorption under Act 13 of 2019 (discussed above in the Legislative Developments section). The bulletin provides an example of sales tax absorption, and how such absorption applies to the persons responsible for collecting and remitting sales tax. In particular, when absorbing sales tax, the taxpayer must (1) provide the customer with a receipt stating that the sale is subject to sales tax and that it will pay the sales tax; (2) provide the customer with a receipt separately stating the sales price of the items sold and the sales tax; (3) separately state in its books and records the sales price and the sales tax; (4) calculate the sales tax by multiplying the sales price by the applicable tax rate; and (5) remit the sales tax to the Department. The bulletin specifies that the retailer in the example is solely responsible for paying sales tax to the Department, and it cannot obtain a refund of sales tax even if it's later discovered that the customer was not subject to sales tax.

4. SUT Bulletin 2019-04 Proper Use of Direct Pay Permits. SUT Bulletin 2019-4 provides guidance on the correct use of direct pay permits. In particular, the direct pay permit must be used in conjunction with a properly completed exemption certificate. The bulletin specifies that only the holder of the direct pay permit can use the permit; it cannot be used by a vendor to justify not charging tax on sales to the holder of a permit. The taxpayer holding the direct pay permit must present its vendor with the exemption certificate in order for the vendor to not charge tax on the sale.

III. OTHER TAXES

A. Unclaimed Property

1. Judicial Developments

State Treasurer Sues to Obtain Shareholder Information. On May 10, 2019, Pennsylvania's State Treasurer filed a Commonwealth Court complaint seeking to compel PPL Corporation ("PPL") to provide shareholder information in connection with an ongoing unclaimed property audit. Pennsylvania's third-party auditor requested that PPL

provide shareholder information such as social security numbers and street addresses (irrespective of the shareholders' state of residence).

PPL declined to provide the requested information, arguing that it is not needed in order to make a preliminary determination as to the applicability of the state's unclaimed property laws. Rather, PPL argues that it should be able to provide limited owner information to isolate items that may be subject to escheat in Pennsylvania and then provide detailed information for only those items. In response, the Treasurer issued a subpoena to which PPL raised further objections, spurring the Treasurer to file a complaint.

Following briefing and argument, on July 20, 2021, the Commonwealth Court overruled PPL's objections and ordered that PPL submit an Answer to the Treasurer's Complaint. That Answer seeks dismissal of all Counts of the Complaint while also raising numerous arguments regarding the subpoena's enforceability as a new matter. If PPL prevails, the decision could serve as an important check on the ability of auditors to "fish" for owner information not directly relevant to the enforcement of Pennsylvania's own unclaimed property laws. *Torsella v. PPL Corp.*, 272 MD 2019.

U.S. Supreme Court Asked to Decide Escheat Dispute Between States. In response to litigation initiated by Pennsylvania and Wisconsin in federal district court over the priority rules for MoneyGram payments, Delaware has petitioned the Supreme Court of the United States to settle the dispute as a case of original jurisdiction. In response, the Court has appointed a Special Master to gather evidence and develop a record for their review. On July 23, 2021, the First Interim Report of the Special Master was issued. In it, the Special Master recommends that the Court find the MoneyGram payments subject to the escheat laws of the state in which they were purchased rather than to those of Delaware (as the state of incorporation for MoneyGram). As of publication, the parties have not responded. Once the record is developed, the Justices will decide whether to grant certiorari. *Treasury Dep't of the Commonwealth v. Delaware State Escheator David Gregor*, Case 1:16-cv-00351-JEJ (M.D. Pa. Feb. 26, 2016).

B. Gaming Taxes

1. Legislative Developments

Sunset of Additional Tax on Table Games Repealed. On top of the standard 12% tax imposed on gross table game revenue, Pennsylvania's legislature enacted an additional 2% tax effective August 1, 2016. That tax was scheduled to expire on August 1, 2021, until Act 25 of 2021

repealed the expiration date, thereby making the cumulative 14% tax rate permanent.

2. Judicial Developments

Events Tickets: Services or Tangible Personal Property? As discussed below, Pennsylvania law allows a deduction from the gross terminal revenue and gross table game revenue tax bases for certain promotional items. However, five items are excluded by statute from qualifying for the deduction: travel expenses, food, refreshments, lodging, and services. The Supreme Court of Pennsylvania is now considering whether the exclusion for "services" applies to event tickets.

While the Commonwealth argues that when you consider substance over form, the tickets to baseball games, concerts, etc. are representative of services and therefore not deductible, the taxpayer argues that the tickets are intangible personal property—not services. In October 2019, the Commonwealth Court agreed with the taxpayer, finding that ambiguity as to the reach of the term "services" within the Gaming Act must be construed in the taxpayer's favor.

The Commonwealth filed its appeal with the Pennsylvania Supreme Court in March 2020. Oral argument was held on April 13, 2021 and the parties are awaiting the Court's decision. *Greenwood Gaming and Entertainment, Inc. v. Commonwealth*, 19 MAP 2020.

Gaming Tax Refund Claim Denied as Untimely. Over the course of several years, Greenwood Gaming and Entertainment, Inc. argued unsuccessfully through multiple levels of appeal that it was entitled to deduct the value of promotional giveaways from the tax bases of its gross terminal revenue and gross table game revenue liability calculations. In April 2014, the Pennsylvania Supreme Court finally ruled in favor of Greenwood Gaming and permitted the requested deductions, subject to certain qualifying criteria. *Greenwood Gaming and Entertainment, Inc. v. Commonwealth*, 90 A.3d 699 (Pa. 2014).

Upon receiving the favorable Pennsylvania Supreme Court decision, Greenwood Gaming filed a refund claim for closed periods—where tax was paid more than three years prior to filing. Both the Board of Appeals and Board of Finance and Revenue dismissed these refund clams as untimely.

On appeal to Commonwealth Court, Greenwood Gaming requested a review of the merits of its refund claim on the basis that: (i) dismissal violates its due process rights since they have been harmed and the Commonwealth was on notice of their claims by virtue of the prior

appeals; and (ii) as applied here, the statute of limitations is inequitable because Greenwood Gaming could have been liable for making a claim unsupported by the law in effect at the time as a result of the history of losses prior to the Pennsylvania Supreme Court decision.

On September 6, 2018, the Commonwealth Court unanimously granted summary relief in favor of the Commonwealth. The Court held that Greenwood Gaming failed to timely file its request for refund and equitable principles could not revive the request. Greenwood Gaming filed exceptions to the Court's decision on October 8, 2018. On September 30, 2019, the Commonwealth Court issued its opinion denying Greenwood's exceptions. *Greenwood Gaming and Entertainment v. Commonwealth*, 609 FR 2015 (Pa. Commw. Ct. 2019). Greenwood appealed to the Pennsylvania Supreme Court and on August 18, 2020, the Court issued an order affirming the Commonwealth Court's decision.

Slot Machine Tax Still Unconstitutional? In September 2016, the Pennsylvania Supreme Court held that the local share assessment had a non-uniform progressive rate structure in violation of the Uniformity Clause of Pennsylvania's Constitution. Act 42 of 2017 sought to resolve that problem by amending the tax to impose the assessment only on a percentage basis.

Although the revised assessment is collected in a uniform manner, it is then placed in a restricted account before being distributed back to the casinos based upon their relative revenue. The higher a casino's revenue, the lower the "grant" they receive from the restricted fund. Because the law required that local share assessment funds be redistributed back to only a subset of the casinos paying the assessments, the taxing scheme was challenged in the Pennsylvania Supreme Court as being in violation of the Uniformity Clause.

In April 2019, the Court ruled in favor of the taxpayer. Though the Court declined to rule on the taxpayer's Uniformity Clause argument, it found that the local share assessment violated the Fourteenth Amendment of the U.S. Constitution because the burden of the tax imposed on the taxpayer was disproportionately high compared to the benefits of the tax for this taxpayer. *Sands Bethworks Gaming, LLC v. Commonwealth*, 207 A.3d 315 (Pa. 2019).

Impact of "Stipulations" Agreed Upon at Administrative Level. In a case currently pending before Commonwealth Court, the underlying issue is whether "momentum dollars" (redeemable points) are deductible for purposes of computing the Gross Revenue Terminal Tax and the Gross Table Games Revenue Tax. The parties are currently arguing over

procedural issues surrounding the impact of agreements at the administrative appeal level. Specifically, the taxpayer and the Department of Revenue stipulated to particular facts at the Board of Finance Revenue—that momentum dollars are tangible personal property when awarded to a patron. On appeal, the Office of Attorney General is arguing that the Commonwealth is not bound by the factual stipulation made between the Department of Revenue and the taxpayer at that administrative level. On May 12, 2021, the Court heard argument on this issue as well as whether the Commonwealth waived its right to raise particular issues since it did not file a cross-appeal and whether the same methodology applies for setting the deduction amount for the Gross Revenue Terminal Tax and the Gross Table Games Revenue Tax. The parties are awaiting the Court's decision.

3. Administrative Developments

Gaming Tax Bulletin. The Department issued Pennsylvania Gaming Tax Bulletin 2019-01. The Department issued this bulletin to address the gaming expansion under Act 42 of 2017 and, specifically, the applicability of the Department Bulletin 2015-01 addressing the deductibility of promotional items from "gross terminal revenue". As stated in Bulletin 2019-01, the Department's policy "remains that 'cash equivalents' generally do not include amounts provided to players as part of reward programs unless the amounts meet the definition of 'cash equivalent'" for purposes of determining promotional play deductions.

C. Bank Shares Tax

1. Legislative Developments

Treatment of Reports of Condition for Merged Institutions. Act 25 of 2021 immediately amended the definition of "receipts" for Bank Shares Tax purposes to account for mergers and acquisitions. Pursuant to the new definition, the income statements included in each institutions' Reports of Condition should be "combined as if a single institution had been in existence for that year."

Edge Act Exclusion Phase-In. Act 84 of 2016 made a number of changes to the Bank Shares Tax. Among those still being phased in is the exclusion of the equity of Edge Act subsidiaries (formed pursuant to 12 U.S.C. § 611) from the bank shares tax base. This exclusion will be phased-in with a 20% exclusion for calendar years beginning on or after January 1, 2018, and a 100% exclusion for calendar years beginning on or after January 1, 2022.

D. Gross Receipts Tax

1. Legislative Developments

Sales of Electric Power to Boroughs for Resale. Act 28 of 2020, signed June 5, 2020, amends Title 8 (applying to Boroughs and Incorporated Town) of the Pennsylvania statutes, to provide that the sale of electric power to a borough for resale inside the limits of the borough, and the sale of electric power by a borough inside the limits of the borough, are exempt from the gross receipts tax imposed under 72 P.S. § 8101.

2. Judicial Developments

Resale Exemption Does Not Apply to Receipts from Sales to IDAs. In a decision recently affirmed by the Pennsylvania Supreme Court, a taxpayer was denied gross receipts tax ("GRT") relief on its sales to an Industrial Development Authority ("IDA"). The taxpayer, a wholesale seller of electricity, sought to exclude amounts from its tax base that were generated from the sale of electricity to an IDA that resold the electricity to its own customers.

In ruling against the taxpayer on its resale argument, the Commonwealth Court found in May 2017 that the IDA was not a qualifying purchaser for purposes of the resale exemption because it was not itself subject to the GRT. In March 2018, the Commonwealth Court overruled exceptions that were filed by the taxpayer and affirmed its decision. The taxpayer appealed that decision to the Pennsylvania Supreme Court. On December 28, 2018, the Pennsylvania Supreme Court affirmed the order of the Commonwealth Court. *American Electric Power Serv. Corp. v. Commonwealth*, 199 A.3d 880 (Pa. 2018).

3. Trends and Outlooks

Corporation Tax Bulletin 2020-01 – Telecommunications and Electric Gross Receipts Tax Sales for Resale. On January 23, 2020, the Department of Revenue issued a sales tax bulletin clarifying the exemption for resales to political subdivisions in light of the *American Electric Power Serv. Corp. v. Commonwealth* decision discussed above. That decision requires a taxpayer claiming a sale for resale to substantiate that the counterparty actually resold the commodity in a transaction on which gross tax is ultimately paid. Accordingly, as described in the bulletin, the Department developed a Sale for Resale Acknowledgement Form that can substantiate such transactions. The Sale for Resale Acknowledgement Form will be issued by the Department to resellers and sellers wishing to claim a sale for resale exemption must obtain this form from the reseller.

E. Personal Income Tax

1. Legislative Developments

Non-employee Income Tax Withholding Requirements. Under Act 43 of 2017, taxpayers filing Form 1099-MISC who pay at least $5,000 annually to any one nonresident individual or disregarded entity with a nonresident member, are now required to withhold income tax from such payments. With respect to payees who receive less than $5,000 annually from the taxpayer-payor, withholding is discretionary. However, payments from the United States and Pennsylvania governments are exempt from withholding regardless of their aggregate value.

Though this change became effective 60 days from Act 43's enactment, the Department received significant pushback on the difficulty of becoming compliant with the expanded withholding requirements on such short notice. In response, the Department issued guidance in February 2018 stating that it would not enforce the requirement to withhold until July 1, 2018. Since then, the Department has also issued a Withholding Exemption Certificate and made additional guidance available on its website.

The House of Representatives has introduced bills to repeal these Act 43 changes, as well as technical correction bills; however, none of these bills have been enacted.

2. Judicial Developments

Refund Statute of Limitations. A taxpayer is challenging the statute of limitations period for seeking a refund of paid assessments. In *Epifanio Torres v. Commonwealth*, the Department conducted a desk audit and used information received from the IRS to assess tax against the taxpayer. The Department issued an assessment notice to taxpayer on January 9, 2008. The taxpayer paid the assessed tax on September 3, 2014, and filed a refund claim on October 29, 2015, over three years later. The taxpayer argues that its refund claim was timely filed under section 72 P.S. § 10003.1(b), which requires the taxpayer to file a petition for refund for taxes paid with respect to the audit period within six months of the mailing date of the notice of assessment, determination or settlement, or within three years of actual payment of the tax, whichever is later. The Department filed Application for Relief to dismiss the action on April 30, 2019. On September 30, 2019 the Taxpayer filed its brief. The Commonwealth filed its brief on October 30, 2019, and the Taxpayer filed its reply brief on November 13, 2019. The court held oral argument on February 11, 2020 before a panel. On February 28, 2020, the court filed its Memorandum Opinion affirming the Board of Finance and Revenue decision. The Taxpayer filed

exceptions on March 20, 2020 and filed its brief on July 2, 2020. The Commonwealth filed its brief in opposition to the Taxpayer's exceptions on September 2, 2020, and the Taxpayer filed its brief on the exceptions on September 11, 2020. On December 29, 2020, the Court ordered the case to be submitted on briefs. A decision on exceptions is expected in October 2021.

Foreign Tax Credits. In *Neubauer v. Commonwealth,* a taxpayer is challenging the disallowance of credits for tax paid to foreign countries, and specifically whether the disallowance is unconstitutional under *Comptroller v. Wynne*, 135 S. Ct. 1787 (2015). *Neubauer* was originally held pending the petition for cert. to the U.S. Supreme Court in *Steiner v. Utah*, which was denied by the Supreme Court on February 24, 2020. Thus, the stay of the matters was lifted by the Commonwealth Court, and the next court deadline in *Neubauer* is January 14, 2022.

F. Local Taxes

1. Legislative Developments

Philadelphia NOL Carryforward Period. On Jan. 24, 2019, Philadelphia enacted an ordinance that extended the NOL carryforward period for the business income and receipts tax ("BIRT"). The ordinance only becomes effective when the Pennsylvania General assembly passes authorizing legislation. If enacted, NOLs may be carried forward for 20 tax years (instead of only 3 tax years) following the year in which they were incurred. The ordinance applies only to those losses incurred on or after the ordinance's effective date. NOLs incurred prior to the ordinance's effective date retain the three-year carryforward period. The earliest net loss may be carried over to the earliest taxable year possible.

The General Assembly has introduced bills to authorize this, but nothing has been enacted.

Proposal for Destination-Based Local Sales and Use Tax. On July 17, 2020, Pennsylvania Representatives Innamorato and Kenyatta issued a memorandum to all House members seeking to close the "Amazon Local Sales Tax Loophole". Under current law, local taxes imposed by Philadelphia and Allegheny counties source sales using an origin approach. Amazon, which does not have physical presence in Philadelphia County or Allegheny County, is not subject to the local sales tax under the current origin-based approach. The draft language proposed by the representatives would source sales using a destination approach for local sales tax purposes, which is consistent with sourcing for state sales tax purposes. The proposed legislation would require online sales in Pennsylvania to be finalized at the address of the purchaser, thereby subjecting sales to Philadelphia and Allegheny

county addresses to local sales tax, thereby closing the "Amazon Loophole". The draft legislation has not yet been introduced as bill by the representatives.

2. Judicial Developments

Uniformity Challenge to Local Property Tax Assessments. On January 16, 2020, the Commonwealth Court ruled that a school district's practice of targeting commercial properties to raise tax revenue did not violate the uniformity clause of the Pennsylvania Constitution. In particular, the court determined that Bethlehem Area School District's assessments that were filed exclusively against commercial properties were based on efforts to identify properties, regardless of their classification, that would generate at least $10,000 in new tax revenue. The Pennsylvania Supreme Court declined to hear the appeal without comment. *Bethlehem Area Sch. Dist. v. Northampton County*, 66 – 67 MAL 2020.

In contrast, on July 29, 2021, the Commonwealth Court upheld the Trial Court's decision that the City's reassessment solely of commercial properties in order to raise revenue was not uniform. *Duffield House Assocs. LP v. City of Philadelphia*, No. 1501 C.D 2019 (Pa. Commw. Ct. Jul. 29, 2021). Here, a group of commercial property owners and lessees appealed their 2018 Philadelphia real estate tax assessments on the grounds that they were selectively assessed. The Philadelphia Court of Common Pleas struck the assessments and in reinstating the 2017 assessments, ordered the City of Philadelphia to refund approximately $118 million to taxpayers. The City and School District appealed and argued that their methodology for issuing the 2018 assessments did not violate Pennsylvania's Uniformity Clause. Ultimately, the Court rejected their arguments and upheld the trial court's decision striking the 2018 assessments.

IV. ADDITIONAL NOTES OF INTEREST

A. Extended Tax Return Deadlines. In response to COVID-19, the Department of Revenue extended the due date for various 2019 tax returns, thereby also pushing back deadlines for returns filed with an extension. For example, the extended due date for calendar year C-corporation taxpayers to file their 2019 RCT-101 was delayed to February 16, 2021. In addition to granting some reprieve from the original filing deadlines, taxpayers should also keep in mind that by extending the original due date for tax returns, the Department of Revenue indirectly extended the refund claim deadline that would otherwise fall on April 15, 2023 for corporate taxpayers. Taxpayers with fiscal-year reporting periods will be similarly impacted.

V. BIOGRAPHIES

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Lee is a partner in Reed Smith's State Tax Group. He works closely with clients to determine the best course of action--from strategy development through litigation--to resolve the taxpayer's issues. In addition to representing clients in state tax appeals, Lee also provides multi-state advice to corporations on various state income, franchise and sales tax issues--and works with these corporations to implement any resulting tax-saving strategies.

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Kenny is a partner in Reed Smith's State Tax Group. His practice focuses primarily on multi-state corporate tax and sales and use tax issues. Kenny represents clients in a wide range of industries in connection with state tax return positions, audits, administrative appeals, and litigation in various jurisdictions.

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