STATE AND LOCAL TAX
INSIGHTS

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>> SALT BRIEFS UPDATE

Pennsylvania's Proposed Budget for Fiscal Year 2010-2011

In early February 2010, Pennsylvania Governor Ed Rendell released his proposed budget for fiscal year 2010-2011. The proposed budget would include the following changes to Pennsylvania's tax structure:

- A decrease in the state sales tax rate from 6% to 4%.
- The elimination of 74 sales tax exemptions, including services such as professional (legal, accounting, engineering), consulting, computer, transportation and repairs to real property.
- The elimination of the vendor sales tax discount for sales tax returns remitted in a timely manner.
- The creation of a severance tax on natural gas drilling of 5% of value plus 4.7 cents per 1,000 cubic feet of gas produced.
- A mandatory combined reporting requirement for corporate income tax.
- A reduction of the corporate net income tax rate from 9.99% to 8.99%.
- The elimination of the cap on net operating loss carry-forwards. Currently, the cap is the greater of 20% of the taxable income or $3 million.
- A shift in the sales factor from 90% to a single sales factor of 100%.

The proposed changes are designed to generate additional tax revenues to offset future budget gaps resulting from expiring federal stimulus funds and Pennsylvania's increasing pension contribution cost.

FEATURE STORY

What to Expect in 2010

Even as the national economy begins to recover, many states are still seeing growing deficits due to shrinking tax collections, expiring federal stimulus funds and escalating pension contribution costs. In the coming year, we expect to see states trying to generate additional revenues in a multitude of ways.

Technology and Data

States are dedicating more of their budgets to technology. As a result, states are adding to and making better use of taxpayer information databases. Departments are now cross-referencing data internally among various agencies and divisions to ensure that taxpayers are properly registered for and filing all applicable taxes. In addition, states are entering into agreements with neighboring states to share information and databases in hopes of finding additional taxpayers. As such, taxpayers should expect an increase in the number of nexus questionnaires they receive in the upcoming year. It is important for taxpayers to make sure that they fully understand the nexus questions, and that they are giving thoughtful and correct answers in order to avoid unnecessary tax filings and issues.

More Auditors – More Audits

Many states are increasing the number of auditors in their employ. Ohio alone has recently hired more than 80 new auditors. Not only does this mean that many states expect to perform more audits over the coming year, it also means that many taxpayers who have not historically been audited may be targeted for an upcoming audit. For those taxpayers that have previously been audited, this could mean more questions and scrutiny during future audits, especially if a new auditor is assigned to the audit.

Stricter Audit Documentation Requirements

Taxpayers currently being audited or starting an audit in the coming months may find that the auditors are becoming much stricter on their documentation requirements. One such area is exemption certificates. In the past, auditors may have allowed additional time to obtain documentation or may have accepted certificates that were

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>> PENNSYLVANIA: TAX AMNESTY OR VOLUNTARY DISCLOSURE?

Pennsylvania's Tax Amnesty Program kicks off on April 26, 2010 and concludes on June 18, 2010 and offers individuals and businesses the opportunity to pay outstanding tax liabilities to the Department of Revenue ("Department") with no penalties and only one-half of the interest. Periods eligible for the Tax Amnesty Program include are those where a known or unknown delinquency (as defined below) exists as of June 30, 2009.

1. A known liability is a delinquency known to the Department.
2. An unknown liability is a liability for an eligible tax for which either:
   a. No return or report has been filed, no payment has been made and the taxpayer has not been contacted by the Department concerning the unfiled returns or reports or unpaid tax; or
   a. A return or report has been filed, the tax was underreported and the taxpayer has not been contacted by the Department concerning the underreported tax.

Determining the type of liability before participating in any tax amnesty is important because of the look-back period. Under the terms of Pennsylvania's tax amnesty, the taxpayer must file returns and pay all taxes back to July 1, 2004. A taxpayer with known liabilities is liable for all tax periods without limitation. Taxpayers with "unknown" liabilities as described in 2.a. (above) should consider the benefits of the shorter look-back period under Pennsylvania's Voluntary Disclosure Program prior to participating in the Tax Amnesty Program.

A Pennsylvania Voluntary Disclosure Agreement ("VDA") allows eligible taxpayers to satisfy outstanding tax liabilities without paying penalties. The look-back periods for voluntary disclosure are three years plus the current year for non-corporate taxes (sales/use, employer withholding, etc.) and five years plus the current year for corporate taxes. Taxpayers registered with the Department for a specific tax are typically not eligible to participate in the voluntary disclosure program.

WHAT TO EXPECT IN 2010 (continued)

not 100% complete. Taxpayers should not expect such leniency in the future. Especially with the increase of newer auditors, taxpayers should not assume that what was acceptable documentation in a prior audit will pass muster in the current one.

Tax Law Changes and Shifting Nexus Standards

Tax laws, especially those pertaining to state and local tax, are constantly changing. Some of the changes on the horizon for this year include the following:

- Expanding the sales tax base to services.
- Imposing sales tax on digital goods.
- More states imposing combined reporting requirements for corporate taxes.
- Continued trend towards a 100% sales factor for corporate taxes.
- Increasing sales tax rates.
- Allowing exemptions and rate decreases to sunset.
- Delaying tax phase-outs.
- Changing nexus requirements to economic presence standard for income tax.

Trend toward a Gross Receipts Tax

Many states are contemplating restructuring their transactional tax system and moving towards a tax based upon gross receipts. A gross receipts tax often means a lower tax rate applied to a larger base of transactions. They often allow the imposition of the tax to reach more out-of-state taxpayers. Consider the Ohio CAT that has impacted both in-state and out-of-state taxpayers and resulted in more revenue than expected by the Department of Taxation.

The above are only a few of the changes we expect to see in the upcoming year as the states and their respective departments and agencies look for additional revenue sources to meet budget deficits. Taxpayers who have questions regarding how pending changes might impact their business should contact their State and Local Tax professional.

For more information about any of these tax issues, contact:

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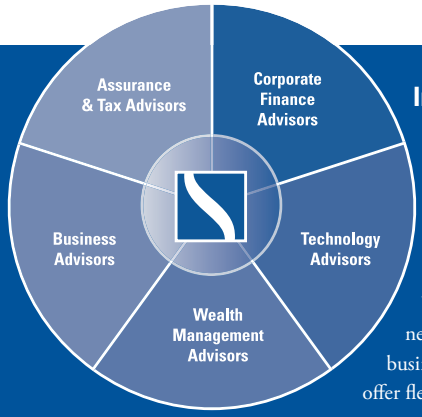

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