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TaxNewsFlash

United States

No. 2022-193
July 11, 2022

Pennsylvania: Changes to corporate net income tax laws, other tax changes

House Bill 1342 was signed into law in Pennsylvania on July 8, 2022. The bill makes significant changes to the Commonwealth's corporate net income tax laws, as discussed below.

Corporate net income tax rate reduction

The Commonwealth's current corporate net income tax rate is 9.99%, which is one of the highest in the country. House Bill 1342 reduces that rate incrementally to 4.99%. These rate reductions are scheduled to occur automatically and are not contingent on state tax revenues meeting or exceeding specific thresholds.

The rate is first reduced to 8.99% for the 2023 tax year—the tax year beginning on or after January 1, 2023 through December 31, 2023. The rate is further reduced as follows:

- 8.49% for tax year 2024
- 7.99% for tax year 2025
- 7.49% for tax year 2026
- 6.99% for tax year 2027
- 6.49% for tax year 2028
- 5.99% for tax year 2029
- 5.49% for tax year 2030
- 4.99% for tax years beginning January 1, 2031 and thereafter

KPMG observation

Previous corporate net income rate reductions were included in bills that would also have adopted unitary combined reporting. However, unitary combined reporting is not included in this legislation.

Sales factor changes

Under current law, specific sourcing rules apply to receipts from sales of services and receipts from sales of tangible personal property. All other receipts are sourced under the statutory income-producing activity test and are included in the Pennsylvania sales factor numerator if the income-producing activity is performed in Pennsylvania, or if a greater proportion of the income-producing activity is performed in Pennsylvania, based on costs of performance. House Bill 1342 adopts comprehensive customer-based sourcing rules for a number of "other" types of receipts, including:

- Gross receipts from the lease or license of intangible property
- Gross receipts from sales of intangibles
- Gross receipts from the sale, redemption, maturity or exchange of securities held by a taxpayer primarily for sale to customers
- Gross receipts related to lending activities involving real property and tangible personal property
- Gross receipts received from interest, fees, and penalties from credit card holders
- Gross receipts received from interest not otherwise addressed in the revised law

Any gross receipts associated with intangible property that are not specifically addressed will be excluded from both the numerator and denominator of the sales factor. The state tax authority is directed to promulgate rules and regulations to implement the new sourcing rules, which are effective for tax years beginning after December 31, 2022.

KPMG observation

There is ongoing litigation in Pennsylvania over the application of the income-producing activity test as applied to service receipts. The *Synthes* case, currently pending before the Pennsylvania Supreme Court, involves the interpretation of the statutory income-producing activity test in years prior to 2014 before the legislature revised the law to provide that service receipts are sourced to the location where the services are delivered. In *Synthes*, the state tax authority and the taxpayer were on the same side and argued that the tax authority's market-based interpretation of the income-producing activity test, which resulted in a refund for Pennsylvania-based taxpayer, was entitled to deference. The Attorney General, however, disagreed that the tax authority's interpretation was entitled to deference. The Commonwealth Court held in favor of the taxpayer and the tax authority, the Attorney General appealed to the Pennsylvania Supreme Court, and oral arguments were held in March 2022. Although *Synthes* involves service receipts, the outcome may be instructive as to application of the income-producing activity test to other types of receipts for years prior to 2023.

Codification of economic nexus standards

House Bill 1342 codifies Corporation Tax Bulletin 2019-04, issued post-*Wayfair*, in which the state tax authority announced that for tax years beginning on or after January 1, 2020, corporations meeting an economic nexus standard would be required to file corporate net income tax returns (unless protected under Public Law 86-272). The bulletin set forth a rebuttable presumption that a corporate taxpayer without a physical presence in Pennsylvania that had $500,000 or more of direct or indirect gross receipts sourced to Pennsylvania from any combination of (1) gross receipts from the sale, rental, lease, or licensing of tangible personal property; (2) gross receipts from the sale of services; or (3) gross receipts from the sale or licensing of intangibles, including franchise agreements, would have a filing responsibility.

Effective for tax years beginning after December 31, 2022, House Bill 1342 codifies the rebuttable presumption that a corporation with $500,000 or more of receipts sourced to Pennsylvania will have substantial nexus with the Commonwealth, despite the lack of a physical presence. However, an exception applies to affiliated entities domiciled in foreign nations that have entered into comprehensive income tax treaties with the United States. The treaties must provide "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."

KPMG observation

It is important to consider the economic nexus standard in conjunction with the revised sourcing rules that apply beginning with the 2023 tax year. A taxpayer that previously sourced receipts under the income-producing activity test may not have had the requisite level of receipts sourced to the Commonwealth. However, that may no longer be the case when those receipts are sourced using the new customer-based rules.

Sales and use tax and other tax changes

Effective January 1, 2023, House Bill 1342 requires peer-to-peer car sharing marketplace facilitators (as defined) to collect sales and use tax on facilitated shared vehicle rentals. The up-to-$2 per day fee that applies to vehicle rentals is extended to vehicles rented as part of a peer-to-peer car sharing program. However, the Commonwealth's 2% vehicle rental tax does not apply to a shared vehicle that is rented through a peer-to-peer car sharing program. The bill also extends the computer data center sales tax exemption qualification period from 15 years to 25 years for qualified purchases of equipment installed in the computer data center.

For individual (personal) income tax purposes, effective for tax years beginning after December 31, 2022, the bill conforms the Commonwealth to the section 179 expensing provisions and the section 1031 deferral provisions. A new refundable tax credit is adopted for eligible taxpayers who receive the federal child and dependent care tax credit. Finally, the bill increases the annual cap for the research and development and film production tax credits and makes certain changes to the keystone opportunity zone provisions.

For more information, contact a KPMG State and Local Tax professional:

Mark Balistrieri | mbalistrieri@kpmg.com

Mark Achord | marchord@kpmg.com