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Pennsylvania Cuts Corporate Tax Rate, Makes Other Changes to Corporate Tax Law

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Pennsylvania Governor Tom Wolf has signed into law omnibus tax legislation to implement the Commonwealth's fiscal year 2022 – 2023 budget. Among other things, the enacted legislation: (1) cuts the corporate net income tax (CNIT) rate from 9.99% to 4.99% on a phased-in basis; (2) adopts market sourcing rules for intangible-related receipts; and (3) codifies the Pennsylvania Department of Revenue's (DOR's) CNIT economic nexus rules outlined in Corporation Tax Bulletin 2019?04. Notably, the enacted legislation does not include Governor Wolf's prior proposal to strengthen the Commonwealth's related party interest and intangible expense addback statute.

CNIT RATE CUT

Pennsylvania's CNIT rate is currently 9.99%—one of the highest corporate tax rates in the nation. The enacted legislation phases in a decrease of Pennsylvania's CNIT rate as follows:

- January 1, 1995, through December 31, 2022; 9.99%
- January 1, 2023, through December 31, 2023; 8.99%
- January 1, 2024, through December 31, 2024; 8.49%
- January 1, 2025, through December 31, 2025; 7.99%
- January 1, 2026, through December 31, 2026; 7.49%
- January 1, 2027, through December 31, 2027; 6.99%
- January 1, 2028, through December 31, 2028; 6.49%
- January 1, 2029, through December 31, 2029; 5.99%
- January 1, 2030, through December 31, 2030; 5.49%

- January 1, 2031, and each year thereafter; 4.99%

MODIFICATION OF INTANGIBLES SOURCING RULE

The enacted legislation shifts Pennsylvania's sourcing regime for receipts from intangibles from a cost-of-performance regime to a market-based regime. The legislation generally sources gross receipts from the sale, lease, or license of intangible property to the location the property is used. Further, the legislation generally sources receipts from a broker's sales of securities to the location of its customer and receipts from credit card interest, fees, and penalties to the billing address of the cardholder.

The legislation also contains detailed sourcing rules for interest, fees, and penalties earned by a lender, generally sourcing those receipts:

1. From loans secured by real property to the location of such real property;

2. From loans related to the sale of tangible personal property to the location the property is delivered or shipped; and

3. To the location of the borrower (if not otherwise addressed by the legislation).

These sourcing rule changes apply to tax years beginning after December 31, 2022. According to the Senate Appropriations Committee's Fiscal Note to the legislation, the purpose of the sourcing rule change is to "[a]lign[] the apportionment rules governing sales of intangible property with the sales of tangible personal property, real property and services to be consistent with market sourcing (i.e., where the purchaser paying for the sale or using the property is located)." As discussed in a prior blog post, the Pennsylvania legislature changed the sourcing regime for services from cost-of-performance to a market-based regime.

Nevertheless, the Pennsylvania DOR has insisted that current law requires the use of a market-based approach to source receipts from certain intangibles, despite the cost-of-performance statutory regime currently in effect. For tax years before 2014, the Pennsylvania DOR also employed a market-based approach to source receipts from services, despite the cost-of-performance statutory regime then in place. This is the basis of the Synthes USA HQ Inc. v. Commonwealth case, which addresses whether the market-based approach to sourcing service receipts is allowed under the cost-of-performance law then in effect. Synthes is currently pending before the Pennsylvania Supreme Court.

In Synthes, without much analysis the Pennsylvania Commonwealth Court rejected the argument that the 2014 law change evidenced that the market-based approach was not what the legislature intended in prior years. It will be interesting to see how the Pennsylvania Supreme Court handles that argument, as we expect taxpayers to make similar arguments with respect to the Pennsylvania DOR's position on the sourcing of receipts from intangibles before 2023.

ECONOMIC NEXUS STANDARDS

The enacted legislation outlines economic nexus standards for CNIT purposes, including a rebuttable presumption that a corporation with $500,000 or more of sales sourced to Pennsylvania has substantial nexus in the Commonwealth without regard to physical presence in the Commonwealth.

Although the Senate Appropriations Committee's Fiscal Note states that this change in Pennsylvania law merely "[c]odifies economic nexus rules currently in place as Pennsylvania DOR tax policy issued through Corporation Tax Bulletin 2019-04," the legislation states that the new statutory language applies to tax years beginning after December 31, 2022.

NOT IN LEGISLATION—EXPANSION OF ADDBACK PROVISION

The enacted legislation's changes to the CNIT are generally consistent with Governor Wolf's budget proposal released in February (although Governor Wolf proposed completing the phase-in of the 4.99% CNIT rate on a different time scale). However, Governor Wolf's February budget proposal also proposed "strengthening" the related party interest and intangible expense addback rules applicable under the CNIT, and the final budget legislation does not make any such amendments.

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