



# Senate Finance Committee

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## BILL SUMMARY

**Legislation:** House Bill 440, P.N. 1716  
**Sponsor:** Representative Reed  
**Act Amended:** Tax Reform Code  
**Topic:** Tax Reform  
**Date:** June 30, 2013

### Synopsis:

Amends the Tax Reform Code relating to the Corporate Net Income Tax.

### Bill Summary:

HB 440 amends the definition of "taxable income" for the purpose of the Corporate Net Income Tax. The definition is amended to state that no deduction shall be allowed for an intangible expense or cost, or an interest expense or cost, paid accrued or incurred directly or indirectly in connection with one or more transactions with an affiliated entity. The restriction on this deduction will not apply to:

- Transactions that are directly related to a valid business purpose; or
- A transaction between a taxpayer and an affiliated entity domiciled in a foreign nation which has in force a comprehensive income tax treaty with the U.S. 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; or
- A transaction where an affiliated entity directly or indirectly paid, accrued or incurred a payment to a person who is not an affiliated entity, if the transaction is paid, accrued or incurred on the intangible expense or cost, or interest expense or cost.

When the taxpayer is engaged in one or more transactions with an affiliated entity that was subject to tax in this Commonwealth or another state or possession of the U.S. on a tax base that included the intangible expense or cost, or the interest expense or cost, paid accrued or incurred by the taxpayer, the taxpayer shall receive a credit against tax due in this Commonwealth in an amount equal to the apportionment factor of the taxpayer in this Commonwealth multiplied by the greater of the following:

- The tax liability of the affiliated entity with respect to the portion of its income representing the intangible expense or cost, or the interest expense or cost, paid accrued or incurred by the taxpayer; or
- The tax liability that would have been paid by the affiliated entity if that tax liability had not been offset by a credit.

Any credit issued shall not exceed the taxpayer's liability in this Commonwealth attributable to the net income taxed as a result of the adjustment required.

HB 440 provides a schedule to remove the cap on net operating loss deductions. The following is the schedule provided in the legislation:

- For taxable years beginning after December 31, 2013 the deduction may be the greater of 25% of taxable income or \$4 million
- For taxable years beginning after December 31, 2014 the deduction may be the greater of 30% of taxable income or \$5 million

HB 440 also provides a schedule for decreasing the corporate net income tax rate beginning in the taxable year 2014. The schedule is as follows:

- Taxable year beginning January 1, 2015 – December 31, 2015 – 9.89%
- Taxable year beginning January 1, 2016 – December 31, 2016 – 9.69%
- Taxable year beginning January 1, 2017 – December 31, 2017 – 9.49%
- Taxable year beginning January 1, 2018 – December 31, 2018 – 9.29%
- Taxable year beginning January 1, 2019 – December 31, 2019 – 8.96%
- Taxable year beginning January 1, 2020 – December 31, 2020 – 8.63%
- Taxable year beginning January 1, 2021 – December 31, 2021 – 8.30%
- Taxable year beginning January 1, 2022 – December 31, 2022 – 7.97%
- Taxable year beginning January 1, 2023 – December 31, 2023 – 7.64%
- Taxable year beginning January 1, 2024 – December 31, 2024 – 7.31%
- Taxable year beginning January 1, 2025 and each taxable year thereafter – 6.99%

HB 440 adds definitions for “intangible expense or cost,” “interest expense or cost,” “affiliated entity” and “valid business purpose.”

HB 440 includes provisions that eliminate the coal waste removal/ultra clean fuels and call center tax credits; enhances pass-through business compliance, repeals language relating to local receivers collecting use tax; eliminates the resident credit for taxes paid to foreign countries, increases the non-filer penalty for corporate net income tax returns; aligns the state tax code with Federal law relating to like-kind exchanges and start up business deductions; and closes the 89-11 realty transfer tax loophole. Finally, HB 440 contains language to require the utilization of market sourcing for the apportionment of income from service companies to the Commonwealth.

Effective date: Immediately.

### **Current Law:**

Current law does not provide any provision to limit deductions of intangible expenses or costs or interest expense or costs.

The current cap on net operating loss deductions is 20% of taxable income or \$3 million.

The corporate net income tax rate is currently 9.99%.

Additionally, current law does not provide for startup business deductions or like-kind exchanges. Section 314 of the Tax Reform Code currently allows PA residents to deduct taxes paid to another state which is defined as “any state or Commonwealth of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States and any foreign country.”

Real estate company is currently defined, for realty transfer tax purposes, as: “a corporation or association which is primarily engaged in the business of holding, selling or leasing real estate ninety percent or more of the ownership interest in which is held by 35 or fewer persons and which:

(1) Derives 60% or more of its annual gross receipts from the ownership or disposition of real estate; or

(2) Holds real estate, the value of which comprises 90% or more of the value of its entire tangible asset holdings exclusive of tangible assets which are freely transferable and actively traded on an established market.