INDEPENDENT REGULATORY REVIEW COMMISSION
COMMONWEALTH OF PENNSYLVANIA
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March 26, 1998

Honorable Robert A. Judge, Sr., Secretary
Department of Revenue
11th Floor, Strawberry Square
Harrisburg, PA 17128-1100

Re: IRRC Regulation #15-386 (#1911)
Department of Revenue
Sales and Use Tax

Dear Secretary Judge:

The Independent Regulatory Review Commission (Commission) has enclosed comments on your proposed regulation #15-386. These comments outline areas of concern raised by Commission. The comments also offer suggestions for your consideration when you prepare the final version of this regulation. These comments should not, however, be viewed as a formal approval or disapproval of the proposed version of this regulation.

If you or your staff have any questions on these comments or desire to meet to discuss them in greater detail, please contact James M. Smith at 783-5439 or John Jewett at 783-5475. They have been assigned to review this regulation.

Sincerely,

Robert E. Nyce
Executive Director

REN:kcg
cc: Anita M. Doucette
Douglas A. Berguson
Office of General Counsel
Office of Attorney General
Pete Tartline

COMMENTS OF THE INDEPENDENT REGULATORY REVIEW COMMISSION

ON

DEPARTMENT OF REVENUE REGULATION NO. 15-386

SALES AND USE TAX

March 26, 1998

We have reviewed this proposed regulation from the Department of Revenue (Department) and submit for your consideration the following objections and recommendations. Subsections 5.1(h) and 5.1(i) of the Regulatory Review Act specify the criteria the Commission must employ to determine whether a regulation is in the public interest. In applying these criteria, our Comments address issues that relate to legislative intent, paperwork requirements, clarity, need, and reasonableness. We recommend that these Comments be carefully considered as you prepare the final-form regulation.

1. Section 7.3 Petitions - Legislative intent, Economic impact, Clarity and Reasonableness

We have several concerns with Section 7.3(a) regarding the Board of Appeals (Board). Our first concern is the requirement that "Petitions *should* be filed within the time limits prescribed by statute or this title...." We question why the word "should" is used because it is less definite than the word "shall." We recommend that the Department replace the word "should" with the word "shall" in the final-form regulation.

Our second concern is with a variance from legislative intent on the timeframe for processing a petition. The Department cites 72 P.S. § 10003.6 as the basis for amendments to Section 7.3(a). This statute provides the following:

> A taxpayer shall be deemed to have timely filed a petition...if the letter transmitting the petition is received by the Department of Revenue or is postmarked by the United States Postal Service on or prior to the final day on which the petition is required to be filed.

In regard to reassessment and refund petitions, 72 P.S. Sections 7232 and 7253(c) provide identical timeframes for timely processing of petitions. Both state the following:

> It shall be the duty of the Department, within six months after receiving a filed petition..., to dispose of the issue raised by such petition and mail notice of the Department's decision to the petitioner: Provided however, that the taxpayer and the Department may, by stipulation, extend such disposal time by not more than six months.

Two sentences of Section 7.3(a) vary from 72 P.S. Sections 7232, 7253(c), and 10003.6. The two sentences state the following:

Petitions are filed on the date received by the Board.

* * *

When a petition is deemed timely filed by reason of being timely postmarked by the United States Postal Service or timely presented to the Department personnel other than personnel at the Board, the statutory period in which the Board is required to render a decision begins to run on the date that the petition is actually received by the Board.

The regulation indicates that there is a difference between the date a filing is received by the Department and the date a filing is received by the Board. However, the statute cited by the Department does not contemplate any other date than when received by the Department, or the United States Postal Service postmark. Further, the regulation states the statutory period does not begin until the petition is received by the Board. However, the statute provides that the six month time period to dispose of the issue raised by the petition starts after receipt by the Department.

The delay between the date a petition is timely filed and the beginning of the statutory period may adversely impact a taxpayer economically. The taxpayer would be held liable for interest on the unpaid disputed tax during the time period between the date filed and the date the petition is acted on. Any extension of the time period, without the taxpayers consent, would impose additional penalties on the taxpayer.

We question how the regulation is consistent with the intent of 72 P.S. Sections 7232, 7253(c), and 10003.6. We believe these statutory provisions express an intent for petitions to be processed in a timely manner after the Department receives the petition. We recommend that the Department amend Section 7.3(a) to be consistent with the legislative intent.

Finally, the proposed regulation places the burden of proof on the taxpayer to present evidence sufficient to prove the date a petition was postmarked by the United States Postal Service or date filed with the Department. We question what evidence would be considered sufficient, such as a receipt from the post office or registered mail. We recommend that the Department clarify how a taxpayer could reasonably satisfy this burden.

2. Section 31.4 Rentals or leases - Clarity

In Paragraph 31.4(a)(3), the second and third sentences are examples of the application of the substantive provision in the first sentence. We suggest that this paragraph be split into at least two parts. The examples should be placed in a second and distinct subparagraph that follows the substantive provision in the first subparagraph.

In addition, one commentator, James Stauffer, CPA, suggests the substitution of the word "if" for the word "because" in the third sentence of Paragraph 31.4(a)(3). We agree. This would bring the sentence into greater consistency with the overall style of the other language in this section.

3. Section 31.5 Persons rendering taxable services to tangible personal property - Clarity

Proposed Section 31.5(e) provides that agreements, such as maintenance agreements, are taxable if the persons are obligated to render a taxable service upon the property of the customer. This provision is further explained in Paragraph (2), and the example in Subparagraph (3)(ii). However, the regulation does not clearly state what distinction is made on the agreements, such as reimbursement.

We note that the three examples in Paragraph (3) all result in a payment of taxes to the Commonwealth. However, the examples are incomplete because they do not fully explain the taxability of the repairs which could result in a double payment of taxes. Subparagraph (3)(iii) is illustrative of our concern. Sherry has paid tax on the $690 warranty, which could be considered a prepayment for repairs. If the first repair totals $500, what portion of the $500 is taxable and who pays the tax? If the first repair totals $2,000, what portion of the $2,000 is taxable and who pays the tax? The regulation does not explain the full tax obligations involving the warranty.

We recommend that the Department amend Section 31.5(e) to more clearly state the distinctions between the types of agreements and more fully explain the tax obligations. We request an explanation of why the agreements described in Sections 31.5(e)(2) and (e)(3)(ii) are not taxable. We suggest that the Department simplify the examples by removing extraneous information, such as the type of business or person making the purchase. We also suggest that the Department consider using one consistent piece of equipment in all of the examples to better illustrate that it is the nature of the agreement, rather than the type of equipment purchased, that determines taxability.

4. Section 32.3 Resale exemption - Clarity

Section 32.3(a)(1) does not clearly explain what transactions qualify for the resale exemption. The complicated structure of the sentence impedes clarity. We recommend that the Department clarify this provision by breaking this sentence into two sentences.

5. Section 32.5 Multistate sales - Clarity, Paperwork, and Reasonableness

In Sections 32.5(b)(1) and (2), the language of the regulation has what appears to be an extraneous description of interstate carriers, which is not the substance of the provisions. The provisions would be clearer if the description of the interstate carriers was deleted. For example, we suggest that the Department consider the following language for Section 32.5(b)(1):

> When tangible property is sold, leased, or serviced in the Commonwealth, and the transaction requires the property to be delivered to a location outside the Commonwealth, the transaction is not subject to tax.

We also have a concern with Section 32.5(d) which requires maintenance of records to prove transactions are not subject to tax. While prudence would dictate that the business would keep these records, it is not clear why the Department would mandate maintenance of these records. This provision may be better directed by stating the burden of proof that transactions are not subject to tax is on the seller of a property or service, and what the Department would

consider sufficient evidence to prove transactions are not subject to tax. In addition, we recommend that the Department clarify how long the records would need to be maintained.

6. Section 32.21 Charitable, volunteer firemen's and religious organizations, and nonprofit educational institutions - Clarity and Need

Section 32.21(a), provides a definition of "isolated sales." Paragraph (i) limits these sales to "no more than three times nor for more than a total of seven days in a calendar year." It is not clear why two distinctions are needed. Further, the limitation to three times in a calendar year is not clear. For example, would isolated sales of the same commodity on Friday and Saturday night of the same weekend constitute two times or one time?

The examples in Paragraph (2) do not enhance the understanding. The spaghetti dinners in the Subparagraph (2)(B) example are taxed because they occur more than three times, not because they occur on more than seven days. Following this example, a Friday night fish fry or spaghetti dinner held exclusively during a religious season, such as lent, would be taxable, even though there would only be seven days of them. If an organization exceeds these limitations, it also is not clear if all of the sales are taxable, including sales below the limitation, or just the portion that exceeds the limitation. We recommend that the Department explain and clarify the intent of this provision. We also suggest that the Department consider simplifying this provision by using only one limitation.

7. Section 32.22 Sales to the United States Government or within areas subject to the jurisdiction of the Federal Government - Clarity

The two sentences in Subsection 32.22(b) appear to be contradictory regarding sale to or use of building maintenance services. The new subsection reads as follows:

> *Construction contracts.* The sale to or use of tangible personal property by construction contractors in the construction, reconstruction, remodeling, repair and maintenance of real estate, including buildings, roads, structures and bridges, for or on behalf of the United States Government, is subject to tax. However, the sale to or use of building maintenance services by the United States Government is not subject to tax.

The intent of this subsection is unclear. The term "building maintenance or cleaning services" is defined in Section 201(aa) of the TRC (72 P.S. § 7201(aa)). However, we are unsure whether the term "building maintenance services" in this subsection is intended to have the same meaning. This provision may be clearer if the second sentence was split into a separate new subsection regarding United States Government purchases. We request that the Department explain and clarify the intent of this subsection.

8. Section 34.4 Direct payment permit - Clarity

A commentator, Stauffer, suggests that the words "a copy of" be added to Section 34.4(b)(5). We agree. This revision would clarify the subsection by stating that the Department

has access to records including ***exact copies*** of electronic tapes or disks, rather than the originals. With the current language, it is unclear whether permit holders would be required to give their original tapes or disks to the Department.

9. Section 42.1 Definitions - Clarity and Consistency with other regulations

The definition of "licensed commercial or educational station" includes a list of Federal Communications Commission (FCC) licenses. This list was amended to include "cable television company" in response to a ruling by the Commonwealth Court in *Suburban Cable TV Co. v. Commonwealth*, 570 A.2d 601 (1990). Our concern is that cable television companies are not licensed by the FCC. Instead, they are registered by the FCC. To improve the clarity of this section, we recommend that the definition be revised by adding the phrase "or registrations" after the phrase "Federal Communications Commission licenses."

10. Section 46.9 Financial institution security equipment - Clarity

There are two basic concerns with this section. First, the definition of "building maintenance services" in Section 46.9(b) does not match the statutory definition of "building maintenance or cleaning services" in Section 201(aa) of the TRC (72 P.S. § 7201(aa)). In addition, the definition of "building repair services" in Section 46.9(b) is circular, unclear, and may be unnecessary. We recommend that the Department review these definitions in Section 46.9(b), explain the Department's intent, and clarify the definitions.

Second, the language in Subsection 46.9(e)(1) and (2) is unnecessarily long and the intent is unclear. There are four subparagraphs divided equally between the two subsections. Subparagraph 46.9(e)(1)(i) sets forth the specific situation in which both repair and maintenance services are not taxable. It is paired with another subparagraph describing both repair and maintenance services that are taxable. Subparagraphs 46.9(e)(2)(i) and (ii) describe maintenance services that are taxable. Whether a service is a repair or maintenance service does not appear to make it taxable. For this reason, we question the need for separate definitions for "building maintenance services" and "building repair services" in Section 46.9(b). In addition, we see no reason for the length and detail in describing services that are taxable when it appears there is only one distinct situation when these services are not subject to tax. The regulation need only set forth the specific exemption.

The problems and lack of clarity with this section are demonstrated by the comments of the Pennsylvania Bankers Association (PBA) dated February 24, 1998. PBA expressed concern with this provision stating that the issue of whether service of security equipment is maintenance or repair is "problematic." Given the section's structure and language, the distinction of a service as maintenance or repair appears to have no impact on whether its subject to tax. As Subparagraph 46.9(e)(1)(i) indicates, the services are not taxable because they are considered to be services performed under a construction contract. This status includes both repairs and maintenance. Repair and maintenance services that are not a construction contract appear to be taxable.

In contrast, the proposed revisions to this section appear to be an attempt to distinguish taxable services by whether they are repair or maintenance. Yet, the subparagraphs continue to commingle these services as both taxable and nontaxable.

Given its length and lack of clarity, we ask that the Department explain in detail its intent for this section. In its explanation, the Department needs to identify the specific regulatory and statutory basis for the exemption of services covered by construction contracts as well as the regulatory and statutory basis for taxation of repair and maintenance services to security equipment. We recommend that the Department revise and consolidate the language and Section 46.9(e) so that persons affected by the provisions will have a clear, simple, and straight-forward understanding of their tax obligations. As indicated earlier, we suggest that a clear and simple alternative to the proposed language would be simply identifying repair and maintenance services that are a construction contract as not subject to tax. If this is the only exemption, all other maintenance and repair services are taxable.

11. Section 58.13(e) Cleaning of floor covering - Clarity

The regulation adds a new Subsection (e) to Section 58.13. It reads:

> *Cleaning of floor covering.* Persons who provide the service of cleaning floor covering, whether or not the floor covering is removed from the place where it is located, are performing a taxable building cleaning service and are required to collect Sale Tax upon the purchase price, unless the purchaser qualifies for exemption under subsection (h).

The phrase "whether or not the floor covering is removed from the place where it is located" is lengthy and unnecessary. We suggest that it be deleted or shortened to "whether or not the floor covering is removed for cleaning." However, we further question whether a distinction is necessary because it appears all cleaning of floor covering is taxable unless the purchaser qualifies for an exemption.

12. Other clarity concerns

a) The last portion of Section 31.5(e)(1) states "...deductible paid under to the agreement." We recommend that the Department delete the word "to" so that the phrase will read "...deductible paid under the agreement."

b) In Section 31.5(e)(3)(iii), the second sentence contains the phrase "pays directly." We recommend amending the phrase to state "directly pays."

c) The title of Section 32.5(c) is not clear due to what appears to be an oversight or typographical error. The title states "Collection of tax by a vendor, lessor or service person shall collect tax." We recommend that the Department clarify this title.

d) Section 32.5(c)(2) lacks clarity in the description of the route which states "...by a route a portion of which is outside this Commonwealth." We suggest replacing the above phrase with the phrase "..., even if a portion of the route is outside this Commonwealth."