MIKE TURZAI MEMBER

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HOUSE OF REPRESENTATIVES COMMONWEALTH OF PENNSYLVANIA HARRISBURG

Original: 2209

November 5, 2003

VIA FAX AND REGULAR MAIL

The Honorable Robert J. Flick Chairman, State House Finance Committee House Box 202020 Room 315 Main Capitol Harrisburg, PA 17120

Dear Chairman Flick:

An employer in my district has made me aware of proposed PIT Regulation 113.3 (c)(1) and of a final public hearing of the Independent Regulatory Review Commission on November 6, 2003 with respect to the proposed regulation. It is my understanding that there are significant policy concerns with this proposed regulation.

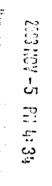
1. Inconsistency of Employee and Employer Treatments.

The proposed withholding regulation would require employers currently to withhold tax on amounts (i.e., "lawful deductions") that are not currently taxable to employees because (1) they aren't paid in "cash or property" as required under the Tax Reform Code (see 72 P.S. §7303(a)(1) (Purdon's 2000)) and (2) the amounts deducted are not actually or constructively received under either the PIT regulation applicable to employees (61 Pa. Code §101.7(c), last sentence ("mere crediting on the books of the corporation does not constitute receipt")) or federal law (see Treas. Reg. §1.451-2(a); Rev. Rul. 60-31, 1960-1 C.B. 174). It is unfair and incongruous to require employer withholding of amounts for which employees are not subject to tax.

2. Pennsylvania and Federal withholding law would impose Conflicting Requirements on Employers.

The proposed withholding regulation would substantially complicate both tax compliance and tax administration. As indicated above, for federal income tax purposes plan participants do not recognize amounts deferred under an unfunded deferred compensation plan until such amounts are actually paid out to the participant in cash after the deferral period. Furthermore, employers may claim a federal income tax deduction for compensation deferred under such plans only at such time as the employee recognizes

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the taxable income for federal income tax purposes, that is, incident to the post-deferral payment. I.R.C. §404 (a)(5). The proposed withholding regulation would yield different timing. The proposed withholding regulation would require the employer to pay via employer's general funds, amounts not actually due from the employee under Pennsylvania or federal law. Such differences violate the salutary prescription of the Department's Chief Counsel (Op. Chief Counsel, Dept. of Revenue, Jan. 27, 1982 [1975-82 Transfer Binder] Pa. St. Tax Rep. (CCH) ¶ 201-419) that when possible there be consistency between federal and Pennsylvania law in order to relieve employees, employers and even the Commonwealth from the burden and complexity of working different calculations on the same issue for federal and State purposes.

3. <u>Inequity in Timing of Withholding Payments and Corporate Net Income Tax</u> <u>Deductions.</u>

The proposed withholding regulation would also create an inequity under Pennsylvania law in the time of employer payment of withholding and the time of recognition of compensation deductions by the employer. Despite an employer's payment of withholding in the year of deferral, the employer would not receive a current deduction for the compensation for Pennsylvania Corporate Net Income Tax purposes (despite laying out funds associated with its State tax withholding obligations). The employer's deductions for CNIT purposes are limited to those items taken into account in determining federal taxable income, e.g., the items included in arriving at line 28 of page 1 of the employer's federal return, subject to certain statutorily specified modifications, which do not include taking account of the employer's payment of PIT withholding. Because under I.R.C. §404(a)(5) the employer would not be entitled to a current federal deduction for the actual amount of compensation deferred, there would be no current reduction of the employer's federal taxable income for the unpaid deferred amount, or consequently of the employer's income for CNIT purposes. Accordingly, for Pennsylvania tax purposes, current payment of withholding by the employer would not be matched by current deductibility of the relevant compensation amount by the employer. That mismatch is an inconsistent and harsh result.

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The proposed regulation could be amended as follows to address the policy concerns raised above:

§113.3. Computing withholding of Pennsylvania Personal Income Tax.

(c) Except as provided in subsection (f):

- (1) Any amount lawfully deducted by an employer from the remuneration of an employe shall be deemed to be a part of the employe's remuneration and to have been paid to the employe as compensation at the time the deduction is made, but only if the following apply:
 - (A) the amount deducted is actually or constructively received by the employe in the year of deduction, and
 - (B) the amount deducted is promotly paid by the employer in money or property (i) to the employe, (ii) to purchase an annuity or other retirement investment for the employe or (iii) to a taxing authority, other governmental body or a trustee, in each case, for credit to a tax, investment or other account or fund identified with the employe.

Thank you very much for taking this issue into consideration.

Very truly yours.

Mike Turzai

State Representative 28th Legislative District

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cc:

Mark Ryan

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