

# SENATE APPROPRIATIONS COMMITTEE FISCAL NOTE

**BILL NO.** House Bill 761

**PRINTER'S NO.** 3559

## **AMOUNT**

FY 2011-12: \$1.1 million Revenue Reduction  
FY 2012-13: \$4.8 million Revenue Reduction

## **FUND**

General Fund

## **DATE INTRODUCED**

February 23, 2011

## **PRIME SPONSOR**

Representative Cutler

## **HISTORY OF BILL**

Referred to FINANCE, Feb. 23, 2011  
Reported as amended, Oct. 19, 2011  
First consideration, Oct. 19, 2011  
Laid on the table, Oct. 19, 2011  
Removed from table, Dec. 6, 2011  
Second consideration, Dec. 7, 2011  
Re-committed to APPROPRIATIONS, Dec. 7, 2011  
(Remarks see House Journal Page 2460-2470), Dec. 7, 2011  
Re-reported as committed, Dec. 12, 2011  
Third consideration and final passage, Dec. 12, 2011 (191-0)  
(Remarks see House Journal Page 2517-2518), Dec. 12, 2011  
In the Senate  
Referred to FINANCE, Dec. 14, 2011  
Reported as amended, April 3, 2012  
First consideration, April 3, 2012  
Re-referred to APPROPRIATIONS, May 1, 2012  
Re-reported as amended, May 21, 2012

## **DESCRIPTION AND PURPOSE OF BILL**

House Bill 761, as amended, amends the Tax Reform Code of 1971 (Act of March 4, 1971, P.L. 6, No. 2) as follows: limits the personal income tax deductibility for contributions made to a federally qualified tuition program only to Pennsylvania's PA 529 College Savings Program; provides that a surviving spouse may file a joint return for the year in which his or her spouse died if the joint return could have been filed if both spouses were living for the entire taxable year; and provides exclusions from realty transfer tax and inheritance tax for transactions related to a "family farm business" and the "business of agriculture" between "members of the same family", respectively.

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### Personal Income Tax – PA 529

Act 67 of 2006 provided a personal income tax deduction for contributions made to any state-sponsored Internal Revenue Code section 529 qualified tuition program. In addition, rollovers, undistributed earnings, and distributions used for qualified higher education expenses are not taxable for purposes of the personal income tax.

House Bill 761, as amended, limits the personal income tax deductibility for contributions made only to Pennsylvania's PA 529 College Savings Program but not to out-of-state programs. Under existing law, contributions made to any state's 529 program are deductible from Pennsylvania's personal income tax.

The PA 529 College Savings Program is administered by the Pennsylvania Treasury Department (department). According to information provided by the department, all states (plus D.C.) sponsor at least one section 529 program, and Pennsylvania is one of only five states that provide a tax deduction for contributions made to any state program (i.e. tax parity). Furthermore, it is the only large state to have such tax parity rules in place. Arguably, tax parity puts Pennsylvania's PA 529 College Savings Program at a competitive disadvantage because Pennsylvania residents have become a target for the marketing efforts of other states' programs, without reciprocity in most instances.

The legislation, as amended, amends section 303(a.7) of the Tax Reform Code (TRC) to provide that an amount paid as a contribution into a qualified tuition program "...under Chapter 3 of the act of April 3, 1992 (P.L. 28, No. 11), known as the 'Tuition Account Programs and College Savings Bond Act'..." shall be deductible from taxable income on the annual personal income tax return. By specifically referring to the enabling legislation of the PA 529 College Savings Program in the TRC, the tax deduction will no longer be available for contributions to other states' programs.

The proposed legislation includes a provision which provides that a rollover from the PA 529 College Savings Program to another program is not exempt from the personal income tax. This additional provision guards against a potential loophole whereby tax-deductible contributions can be made to the Pennsylvania program only to be withdrawn and rolled over into another state's program, thereby skirting the intent of the proposed change. A rollover to the PA 529 program will remain tax-exempt.

The amendment of section 303(a.7) of the TRC shall not apply to contributions or rollovers made prior to January 1, 2013.

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### Personal Income Tax – Surviving Spouse

House Bill 761, as amended, provides that a surviving spouse may file a joint return for the year in which his or her spouse died if the joint return could have been filed if both spouses were living for the entire taxable year.

New subsection 331 (e.1)(2) provides that, in cases where a personal representative, executor or administrator is appointed on behalf of the deceased spouse before the tax return is filed, the surviving spouse may not file a joint return without the consent of the fiduciary. Furthermore, the surviving spouse may file a joint return with the deceased spouse without the consent of the fiduciary if the deceased spouse did not previously file a return for that taxable year and if a personal representative, executor or administrator has not been appointed by the time the joint return is made of before the due date for filing the return of the surviving spouse, including extensions. If the surviving spouse properly files a joint return, the fiduciary may disaffirm the joint return by filing a separate return for the decedent within one year after the due date, including extensions. Any joint return improperly filed by the surviving spouse or disaffirmed by the fiduciary shall be treated as a separate return of the survivor.

New subsection 331 (e.2) provides that if both taxpayers die during the same tax year, a joint final return may be filed if a joint return could have been filed had both spouses lived for the entire taxable year and with the consent of the personal representatives, executors or administrators of both deceased spouses under subsection (e.1) by the due date, including extensions, of the joint tax return.

Under current law, joint returns between a surviving spouse and a deceased spouse are not permitted. If the deceased was married at the time of death, the surviving spouse must file a separate return as "single" unless he or she remarries before the end of the taxable year. Jointly owned income, such as interest, must be apportioned between the decedent and the survivor from the beginning of the tax year to date of death. After the date of death, all taxable income derived from jointly held property is attributed to the surviving owner.

The amendment of section 331(e) of the TRC shall apply to taxable years beginning after December 31, 2011.

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### Realty Transfer Tax

With regard to the realty transfer tax, the legislation amends the definition of "association" to include a general partnership and limited liability partnership. The existing definitions of "family farm corporation" and "family farm partnership" are eliminated and replaced with a newly added definition of "family farm business", which is a corporation or association of which at least 75% of its assets are devoted to the business of agriculture and at least 75% of each class of stock of the corporation or interests in the association is continuously owned by members of the same family.

Under the legislation, the following transactions are excluded from realty transfer tax:

- A transfer of real estate devoted to the business of agriculture to a family farm business
- A transfer between members of the same family of an ownership interest in a family farm business that owns real estate

Existing law provides for certain exemptions from realty transfer tax for family farm corporations and family farm partnerships. The legislation intends to ensure that a family farm business which is reorganized to provide limited liability will not be subject to realty transfer tax.

House Bill 761 also provides that a family farm business is an acquired company when, because of voluntary or involuntary dissolution, it ceases to be a family farm business or when, because of the issuance or transfer of stock in the corporation or transfer of interests in the association or because of acquisition or transfer of assets that are devoted to the business of agriculture, it fails to meet the minimum requirements of a family farm business.

The legislation specifies that the conveyance of assets held by one family farm business to another family farm business shall not be considered a transfer of assets under the realty transfer tax if the same individuals hold at least 50% of the ownership interest in each family farm business.

The provisions of 61 Pa. Code § 91.222 (relating to acquired family farm partnership) are abrogated.

The amendment to the realty transfer tax shall be retroactive and apply to any document made, executed, delivered, accepted or presented for recording on or after July 1, 2010.

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### Inheritance Tax

With regard to the inheritance tax, the legislation provides that a transfer of real estate devoted to the business of agriculture between members of the same family shall not be subject to the state inheritance tax, provided that after the transfer the real estate continues to be devoted to the business of agriculture for a period of seven years beyond the transferor's date of death and the real estate derives a yearly gross income of at least \$2,000.

House Bill 761 specifies that any tract of land which is no longer devoted to the business of agriculture within seven years shall be subject to the inheritance tax in the amount that would have been paid for nonexempt transfers of property, plus interest.

Owners of real estate exempt under this provision shall certify annually to the Department of Revenue that the land qualifies for the exemption and shall notify the department within 30 days if it fails to qualify.

The legislation provides definitions of the terms "business of agriculture" and "members of the same family" with respect to the inheritance tax exemption.

The amendments to the inheritance tax shall apply to the estates of decedents dying after December 31, 2011.

The Act shall take effect immediately.

### **FISCAL IMPACT:**

#### Personal Income Tax – PA 529 Plan

There are no estimated administrative impact/costs to the Department of Revenue because of the effective date of January 1, 2013. The system and form changes have not been created yet and would be updated through the regular tax season change process.

The Department of Revenue estimates a gain to the General Fund of \$300,000 per year because of the rollover provisions in the Bill. Furthermore, limiting the PIT deduction to only the PA 529 Plan will cause a reduction in refunds, which will result in a savings to the Commonwealth beginning in fiscal year 2013-14. The savings are estimated at \$4.7 million in FY 2013-14; \$5.2 million in FY 2014-15; and \$5.9 million in FY 2015-16.

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### Personal Income Tax – Surviving Spouse

The amendment of section 331 of the TRC affects the procedures involved in filing a final tax return where one or both spouses die during the tax year. However, the legislation will have little effect on the aggregate amount of personal income tax owed by taxpayers in these situations.

### Realty Transfer Tax and Inheritance Tax

The Department of Revenue, through the Governor's Budget Office, indicates that there will be a limited number of realty transfer tax transactions in a given year, resulting in nominal costs.

The Department indicates that there will be unspecified administrative costs associated with amending the inheritance tax return and instructions. With respect to the inheritance tax exemption, the Department of Revenue projects the following negative fiscal impact to the General Fund:

- Fiscal Year 2011-12 - \$1.1 million
- Fiscal Year 2012-13 - \$4.8 million
- Fiscal Year 2013-14 - \$5.5 million
- Fiscal Year 2014-15 - \$5.9 million
- Fiscal Year 2015-16 - \$6.2 million

Because the amendments to the inheritance tax apply to the estates of decedents dying after December 31, 2011, there is a reduced cost in the current fiscal year (i.e. FY 2011-12).