

**Testimony before the House Finance Committee**  
**John Kaschak, Deputy Secretary for Taxation**  
**Sue Leighton, Deputy Secretary for Compliance & Collections**  
**Department of Revenue**  
**Tuesday, December 12, 2017**

Chairman O'Neill, Chairman Wheatley and members of the committee, my name is John Kaschak, and I serve as the Deputy Secretary for Taxation for the Pennsylvania Department of Revenue. Also with me today is Sue Leighton, Deputy Secretary for Compliance and Collections. We appreciate the opportunity to meet with you today and provide an overview of the Department's ongoing review of personal income tax returns that include Schedules C and UE.

To provide a general synopsis, Schedule C is used to report income or losses from a business that a taxpayer operates, or from a profession the taxpayer operates as a sole proprietor. Schedule UE is used to report unreimbursed employee business expenses incurred in the performance of the duties of the taxpayer's job or profession. Those may include union dues or agency fees, work clothes, professional license fees and mileage, among other expenses.

In recent years, the Department acquired the analytical tools to be able to determine which tax schedules merit further examination. We are increasingly analyzing data and trends in the returns that are filed with the Department to identify areas where potential tax loss and non-compliance are occurring. Pennsylvania's Tax Reform Code, Act 2 of 1971, at Section 338 requires the Department to make inquiries, determinations and assessments of all the taxes imposed under Article III (Personal Income Tax). The review of Schedules C and UE are part of the Department's ongoing efforts to fulfill this mandate and ensure compliance with Pennsylvania reporting requirements.

A pilot review of Schedule C was preformed for the 2015 tax year on refund-only returns. Information was published in the January 2016 Tax Update regarding the upcoming Schedule C Reviews and information was also discussed at our 2016 Fall Tax Seminars.

Our data analytics tools identify average expenses claimed in a particular industry. The returns that are suspended for examination are the ones that are identified as outliers. Put simply, if you are a business owner and your Schedule C return lists expense that is well outside the expected range for the industry that you work in, your return will be suspended for review. The Department has not limited its reviews to a particular industry or level of income. The same rationale holds true for the department's review of Schedule UE.

The Department saw these reviews as a preferable alternative to field audits. The information that we are requesting would have been necessary in order for the taxpayer or practitioner to prepare the return. Of the roughly 6 million personal income tax returns filed with the Department in tax year 2016, 540,000 returns were filed with Schedule C. Of those returns,

approximately 46,000 were suspended for review. Similarly, 1,032,165 returns were filed with Schedule UE. Of those returns, 58,280 were suspended for review.

All reviews are being conducted by seasoned tax examiners working for the Department of Revenue. Once the Department receives the applicable information from the taxpayer, the average response time is about three months.

Individuals and tax practitioners have voiced their frustrations. The data analytics used for the 2016 tax year resulted in more reviews than anticipated. We have heard the concerns and will be refining our criteria for the 2017 tax year to reduce the number of returns suspended for review to those that truly represent outliers within their respective industries.

In response to the feedback we have received from taxpayers and tax practitioners, the Department has taken steps to improve this process. So far, the Department has:

- Developed [Tips for Successfully Filing PA Schedule C](#) and [Tips for Successfully Filing PA Schedule UE](#), which we continue to refine. (Attached for reference.)
- Extended the deadline for providing additional information from 15 to 30 days.
- Extended the time period between a first and second notice an additional 30 days.
- Refined and adjusted selection criteria based on the data obtained from examinations conducted thus far.

If an individual or a practitioner has received a notice, they should continue to respond with the documentation being requested. The Department strongly urges taxpayers and practitioners to send responses to the Department via fax (717-783-5823) or via email at [ra-bitpitholdcorfaxe@pa.gov](mailto:ra-bitpitholdcorfaxe@pa.gov). Both of these options provide for automatic upload to our system and will expedite the review of returns filed with Schedules C and UE.

At this time, the Department is not planning to expand our review to additional schedules. However, we will continue to analyze the data that is available to us. The ultimate goal is to increase compliance to ensure a level playing field for all taxpayers.

Thank you for the opportunity to share this information with you today.

Since tax year 2015, the Pennsylvania Department of Revenue has been conducting routine and systemic reviews of the PA Schedule C expenses and deductions. Only business expenses are allowable and the expenses must be ordinary, necessary, reasonable and directly related to the production and marketing of the taxpayer's products, goods and services. The department may contact taxpayers to request an explanation or supporting information for any amount reported on the PA-40, Schedule C. The department makes requests for additional information with the expectation that the taxpayer can substantiate the information that they previously provided on their return.

### General Tips

- The amount reported on Line 2, Cost of Goods Sold should be the same for Pennsylvania and federal purposes. If the amount reported is different for Pennsylvania an explanation must be submitted. Itemized spreadsheets or general ledgers outlining the expenses claimed are typically acceptable; however, the department may require actual receipts or invoices to support the amount claimed.
- You may deduct advertising and marketing expenses. The department may require detailed receipts or invoices to support the advertisement expense claimed on Line 6, Advertising.
- You may deduct 100 percent of your actual vehicle expenses or you may use the federal standard mileage rate. If your vehicle is used for both business and personal travel, you may only deduct the business portion. The department may require detailed travel logs, receipts and business purposes to support the expenses claimed on Line 10, Car and Truck Expenses.
- Pennsylvania allows 100 percent of customary and reasonable amounts expensed on business meals, entertainment and travel as opposed to the federal limit of 50 percent. The department may require detailed travel logs, receipts and business purposes for all expenses claimed on Line 31, Travel and Entertainment.
- Pennsylvania allows the deduction of monthly utility bills. If the utilities include both business and personal use, you may only deduct the business portion. The department may require copies of monthly bills for all utility expenses claimed on Line 32, Utilities.
- You may deduct any other costs of doing business or providing professional services that do not fall under the other lines on the PA Schedule C. These expenses must be itemized on Line 37, Other Expenses. The department may require the itemized breakdown and additional documentation to support the amount claimed.

- If you are including income reported on a 1099-MISC as gross receipts or sales on the PA Schedule C, Line 1a, do not list the same information on the form W2-S.

### Submitting Documentation

When submitting the documentation being requested it is important to remember that organizing it in a logical format will help to speed up processing.

- Grouping receipts for a particular line item will help the department review the information quickly.
- Circling the exact line item claimed as a business expense on a receipt will help avoid additional questions.
- Use page separators to differentiate between the expenses for each line item. If submitting a large file electronically send each line in a separate transmission. Files cannot exceed 15MB.
- Include detailed breakdowns of your calculation when prorating or amortizing expenses.

**To prevent delays in processing a tax return, the supporting PA Schedule C documentation may be submitted as a .pdf attachment when the return is electronically filed.**

**If unable to attach the documentation to the electronically filed return, it may be sent to:**

PA Department of Revenue  
Electronic Filing Section  
P.O. BOX 280507  
Harrisburg, PA 17128-0507

Fax: 717-772-4193

E-mail: [ra-bitpitelfcorfaxes@pa.gov](mailto:ra-bitpitelfcorfaxes@pa.gov)

**If the department requested the supporting documentation, please send the information to:**

PA Department of Revenue  
Bureau of Individual Taxes  
P.O. BOX 280501  
Harrisburg, PA 17128-0501

Fax: 717-783-5823

Email: [ra-bitpitholdcorfaxe@pa.gov](mailto:ra-bitpitholdcorfaxe@pa.gov)

For additional information regarding the PA Schedule C go to the department's website at [www.revenue.pa.gov](http://www.revenue.pa.gov) and link to the PA PIT Guide or you can contact our Taxpayer Service and Information Center at 717-787-8201.



## TIPS FOR SUCCESSFULLY FILING PA SCHEDULE UE

**A. Include detailed documentation for each line item (including copies and a summary page) at the time the return is filed. Examples of proper documentation, supporting specific line items, can be found at: [www.revenue.pa.gov](http://www.revenue.pa.gov).**

**B. Documentation should clarify unreimbursed expense responsibilities.**

Letters from employers should identify:

- Whether or not an employee is required to incur the expenses to perform the duties of the position;
- If there is any reimbursement of the expenses; and
- The method by which the reimbursement is determined.

In lieu of a letter from the employer, the department will accept a copy of the employer's employee expenses reimbursement policy or a signed affidavit. Templates for the employer letter and the affidavit will be available, during filing season, at [www.revenue.pa.gov](http://www.revenue.pa.gov).

**C. If mileage is reimbursed by an employer, even at a rate less than the federal rate, it should not be claimed as UE.**

The amount of the expense determined at the federal rate less the amount reimbursed is not a deductible expense. The expense should not be reported on a taxpayer's PA Schedule UE.

**D. Reminder: PA does not follow IRS rules for per-diem expenses.**

If a taxpayer receives a reimbursement for any expenses where the reimbursement is based upon a per-diem rate or fixed dollar amount, the expense is not allowable and should not be included on PA Schedule UE.

**E. Commuting expenses are not deductible in PA.**

Commuting expenses, including mileage to and from work and parking expenses, are not allowable. For tradesmen, commuting expenses includes the mileage expense to and from any job site not more than 35 miles from the closer of the union hall or the taxpayer's home to the jobsite. Travel to a second job is considered commuting.

**F. Review REV-637 for a listing of common unallowable expenses.**

There is an extensive list of non-allowable business expenses detailed in REV-637, the department's brochure on UE expenses. The most common errors include:

- Claiming dues and subscriptions for professional organizations or magazines; and
- Cable or internet costs (Unless there are separate cable or internet bills for a home office).

**G. Cell phones may be claimed, but, only for business purposes.**

Cell phone expenses claimed should be limited to calls made for business purposes when required by an employer. The employee should maintain the type of cell phone coverage that is reasonably related to the needs of the employer's business, and the unreimbursed expense amount claimed must be reasonably calculated so as to not exceed expenses the employee actually incurred in maintaining the cell phone. Monthly phone bills may be requested. Costs for family plans, bundles, or for additional lines are not reimbursable.

**H. Include breakdowns of all miscellaneous expenses.**

Many software vendor programs are not supplying a breakdown of the miscellaneous expenses if there are more than two items of expense. If software supports pdf attachments, please include the breakdown via that method. If software doesn't support pdf attachments, fax the information to the department using the DEX-93, Bureau of Individual Taxes Fax Cover Sheet.

**I. A separate PA Schedule UE is necessary for each taxpayer.**

Taxpayer and spouse cannot file and report their expenses on a single PA Schedule UE. Taxpayers working for multiple employers – and not working out of a union hall, the only exception to this rule – must also provide separate PA Schedules UE to report expenses. Excess expenses for one employer are not deductible against the income received from a second employer.

**BONUS: Department Expands Review of Personal Income Tax Deductions**

For tax year 2015, the Department of Revenue will expand its systemic review of personal income tax expense deductions to include examination of PA-40 Schedule C expenses. This is in addition to the unreimbursed employee business expenses and incorrectly reported wages or withholding from W-2s that were the primary focus of enhanced review last tax year.

In cases where the department believes expenses may have been erroneously reported or claimed, it will contact taxpayers to request additional supporting information before tax examiners make any adjustments. Taxpayers and practitioners may see an increase in correspondence from the department related to these expense claims.

# Department of Revenue Examination of Personal Income Tax Return Schedules C and UE



## What are PA-40 Schedules C & UE?

*Schedule C is used to report income or losses from a business that a taxpayer operates, or from a profession the taxpayer operates as a sole proprietor.*

*Schedule UE is used to report unreimbursed employee business expenses incurred in the performance of the duties of the taxpayer's job or profession. Those may include union dues or agency fees, work clothes, professional license fees and mileage, among other expenses.*

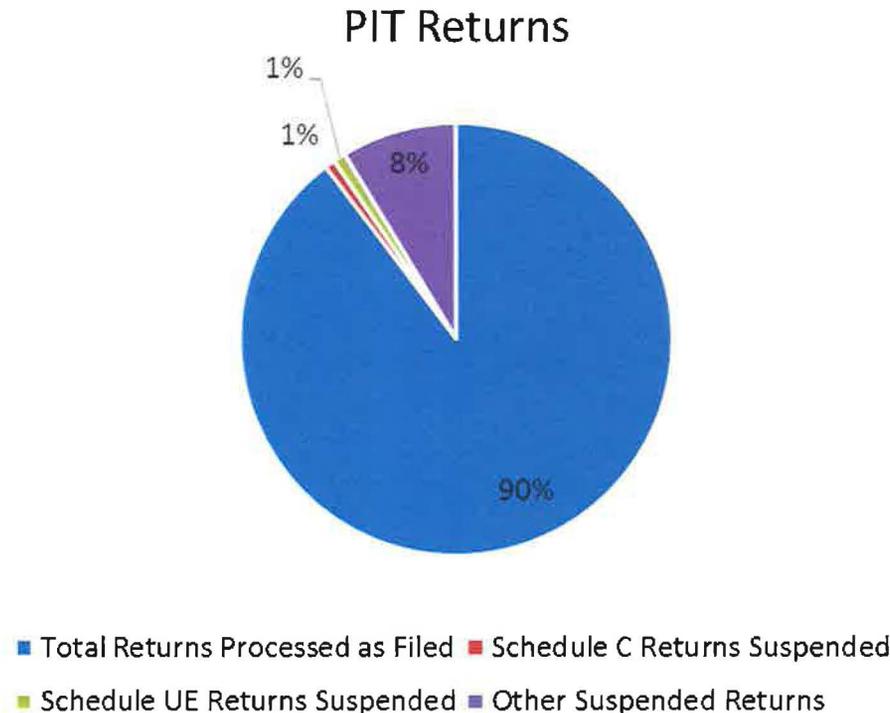
# Why are Schedules C & UE being examined?

*The schedules are being examined as they represent areas where non-compliance and tax loss can potentially be occurring.*

*Due to the recent availability of analytical tools, the department has been able to expand our review of Schedule C and UE.*

*Pennsylvania's Tax Reform Code, Act 2 of 1971, at Section 338 requires the department to make inquiries, determinations and assessments of all the taxes imposed under Article III (Personal Income Tax). The review of Schedules C and UE are part of the department's ongoing efforts to fulfill this mandate and ensure compliance with Pennsylvania reporting requirements.*

# How many Schedules C and UE are being examined?



*Of the roughly 6 million personal income tax returns filed with the department in tax year 2016, 540,000 returns were filed with Schedule C. Of those returns, approximately 46,000 were suspended for review. 1,032,000 returns were filed with Schedule UE. Of those returns, approximately 58,000 were suspended for review.*

# How is the department selecting Schedules C & UE to be reviewed?

*Our data analytics tools identify average expenses claimed in a particular industry. The returns that are suspended for examination are the ones that are identified as outliers.*

*Put simply, if you are a business owner and your Schedule C return lists expense that is well outside the expected range for the industry that you work in, your return will be suspended for review. The department has not limited its reviews to a particular industry or level of income.*

*The same rationale holds true for the department's review of Schedule UE.*

## Did the department notify taxpayers/ practitioners of this review?

*Schedule UE reviews have been going on since TY 2013.*

*A pilot review of Schedule C was performed for the 2015 tax year on refund only returns. Information was published in the January 2016 Tax Update regarding the upcoming Schedule C Reviews.*

*This topic was included in Fall Tax Seminar Presentations and quarterly/annual meetings with the PICPA, PSTAP, and PSEA.*

# Does the department really want individual invoices?

*The department will accept general ledgers, schedules, summaries, logs, canceled checks, bank statements, and/or credit card statements etc., that tie back to the line item in question.*

*All of the information we are requesting is information that would have been necessary to prepare the tax return.*

*The department reserves the right to request detailed receipts if it is determined necessary.*

*The department will clarify our position on supporting documentation further for the 2018 filing season.*

# Why is it taking the department so long to review my information?

*The average response time is about 3 months from the time the response is received from the taxpayer. Responses are worked first-in-first-out.*

*The Department of Revenue strongly suggests sending responses via FAX (717-783-5823) or via email to the resource account: [ra-bitpitholdcorfaxe@pa.gov](mailto:ra-bitpitholdcorfaxe@pa.gov).*

# Why does the department indicate that they did not receive my information when it has been submitted?

*The 2nd notices are an area where the department has heard taxpayer and practitioner concerns, and has already made changes. The department has lengthened the timeframe for which the second notices are sent to 90 days.*

# What is the department doing in response to all of the public outcry?

*The department has developed "TIPS for Successfully Filing PA Schedule C" and "TIPS for Successfully Filing PA Schedule UE"*

*We have agreed to extend the deadline for providing additional information from 15 days to 30 days.*

*We have extended the time period between a first and second notice an additional 30 days.*

*If the return has been processed as originally filed, the department will advise the taxpayer that no adjustments were made.*

*The department has been reevaluating current year suspensions and has started making adjustments.*