

Pennsylvania Personal Income Tax Will Follow Federal Rules for Like Kind Exchanges under Internal Revenue Code Section 1031 for Tax Years 2023 and Subsequent

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Background:

The accounting rules for the Pennsylvania Personal Income Tax do not follow the Federal Tax Code. Instead, they follow generally accepted accounting principles. The Pennsylvania Department of Revenue has taken the position that those rules do not allow like kind exchanges that are exempt from tax under Internal Revenue Code Section 1031 exchanges to be exempt from tax under the Pennsylvania Personal Income Tax (PIT Bulletin 2006-07 October 20, 2006). The matter is currently being litigated (Pearlstein v. Commonwealth, in the Commonwealth Court of Pennsylvania 741-743 FR 2017). A three-judge panel recently found against the taxpayer. Exceptions were filed on January 3, 2022. The case will be next heard by a seven-judge panel of the Commonwealth Court sometime in the next year. The losing party has an automatic appeal, as a matter of right, to the Pennsylvania Supreme Court.

It is impossible, at this time, to predict the outcome of these cases.

New Legislation:

House Bill 1342 was enacted into law in July 2022. This legislation adopts the federal income tax rules for Section 1031 exchange for tax years 2023 and subsequent.

Cases Under Prior Law:

At present, it appears that the Department of Revenue will deal with pending cases for tax years 2022 and prior under the prior law. Parties with active appeals, or those taxpayers who are considering filing refund claims for tax years prior to 2023, should contact their tax advisors. Taxpayers may want to consider filing a protective refund claim with the Board of Appeals. This type of claim will hold the claim in suspense until the final resolution of the Pearlstein case.

For additional information contact Chuck Potter.