

NET INCOME INSTRUCTIONS

IRREVOCABLE ELECTION OF "NET INCOME" COMPUTATION METHOD FOR BPT EZ, PAGE 2, LINES 1 AND 2; BPT SCHEDULE A, PAGE 7, LINE 1, AND BPT SCHEDULE B, PAGE 4, LINE 1.

The taxpayer must elect one of two methods for computing net income on the first Business Privilege Tax return they file. The same method must then be used by the taxpayer in all subsequent years.

Net Income for Method I and Method II

Method I. This is the net profit (or loss) from the operation of a business according to the accounting system of the business. It is the net income after provision for all costs and expenses incurred in the conduct of business, but without any deduction for taxes which are themselves based on net income. Taxpayers who elect this method should complete Schedule A, Page 7. BPT-EZ filers should use Page 2, Line 2.

Method II. This is the net profit (or loss) properly reported to the Federal Government. Taxpayers who elect this method should complete Schedule B, Page 4. BPT EZ filers should use Page 2, Line 1.

Partnerships, joint ventures, associations, syndicates, pools and "S" Corporations should use ordinary taxable income as reported to the Federal Government on Form 1065 or Form 1120S and modified by the specific adjustments which are outlined in Section 404 of the Business Privilege Tax Regulations.

DEDUCTIBILITY OF TAXES TO COMPUTE THE BUSINESS PRIVILEGE TAX

Method I: Taxpayers electing Method I may **not** deduct taxes based on Net Income such as Philadelphia Net Profits Tax, other local, state and Federal income taxes, but may deduct the Business Privilege Tax and all other taxes that are considered to be ordinary and necessary business expenses.

Method II: Taxpayers electing Method II may deduct all taxes which are considered ordinary and necessary business expenses in accordance with the Internal Revenue Code. Taxes which are **not** deductible under Method II include but are not limited to the following:

1) For Individuals: Philadelphia Net Profits Tax, and Federal and State Income Taxes. The Philadelphia Net Profits Tax and State Income Tax are personal deductions for individuals under the Internal Revenue Code, not business expenses.

2) For Partnerships: Taxes described in Internal Revenue Code Section 901, paid or accrued to foreign countries and to possessions of the United States.

3) For Corporations: Corporation Federal Income Tax and (for prior years) excess profits tax.

Page 5, Schedule C-1 Apportionment of Income (BPT Regulations - Section 408)

The taxpayer's net income after adjustments and allocation of nonbusiness income is apportioned to Philadelphia on Schedule C-1 through a modified three part formula composed of a property factor, payroll factor and double-weighted receipts factor.

Property Factor (Page 5, Line 8C) - The property factor includes all real and tangible personal property (except coin and currency) owned or rented by the taxpayer which was used or was available for use during the income year in the regular course of business. Property or equipment under construction are not included. However, raw materials and reserve inventories of materials must be included. Property used in connection with the production of nonbusiness income is excluded from the property factor.

Payroll Factor (Page 5, Line 9C) - The payroll factor includes all compensation paid or accrued by the employer in the regular course of business. Such compensation includes wages, salaries, commissions and any benefits which are classified as employee income by the Internal Revenue Code. However, compensation does not include payments to employees in connection with the production of nonbusiness income.

Receipts Factor (Page 5, Line 10C, 10D) - The receipts factor should include all business receipts (as defined in Section 301 of the regulations) received from operations everywhere. Receipts associated with nonbusiness income should not be included.

Averaging of Factors (Page 5, Line 12) - The percentages for the includible factors should be added together and divided by the number of includible factors. **The receipts factor will count as two factors.** This average is then multiplied by the net income (or loss) after adjustments and allocation of nonbusiness income.

Excludible Factors - If any of the factors has a denominator which is zero, that factor should be omitted from the computation. If the numerator is zero, then the resulting factor is zero and should be included in the computation. **It is highly unlikely that Line 8B is zero.**

Other Methods of Apportionment - If the apportionment method does not fairly represent the taxpayer's business activity in Philadelphia, the taxpayer may request, or the Revenue Department may require, certain variations on the apportionment method. See Section 408 of the Regulations if you feel that the above formula results in an apportionment factor that does not fairly represent your Philadelphia business activity.