

## **NET PROFITS TAX: Taxation of Check-the-box entities**

**Q:** Are Partnerships and LLCs that elect to be treated as Corporations under the federal check-the-box rules (see Treas. Reg. § 301.7701-3) subject to the Philadelphia Net Profits Tax? Are LLCs that are treated as partnerships subject to the NPT?

**A:** *The issue of whether or not an LLC is subject to the Net Profits Tax (NPT) is more a function of the Commonwealth of Pennsylvania's tax structure. Prior to Pennsylvania's Act 7 of 1997, all LLCs were treated as "corporations" by the Pennsylvania Department of Revenue and were, therefore, subject to the Corporate Net Income Tax (CNI). This was true even for LLCs that under the Federal check-the-box regulations were classified as "partnerships". The CNI levy by the Commonwealth effectively preempted the City of Philadelphia from imposing the NPT since the Sterling Act (see 53 P.S. § 15971) prohibits a city of the first class (i.e. Philadelphia) from imposing a tax on a privilege or transaction that is subject to a state tax or license fee.*

*Pennsylvania's Act 7 (effective for tax years beginning on or after January 1, 1998) brought the Commonwealth into conformity with the Federal check-the-box regulations. That is, the LLC (being treated as a partnership for Federal purposes) would no longer be subject to the CNI tax. (**Note:** This change had no impact upon the LLC's liability for Capital Stock/Franchise Tax and such a taxpayer must still file). With the effective date of this amendment to the Commonwealth's statutes, the Commonwealth's preemption is no longer at issue and the City is now free to impose its NPT upon those LLCs that would not be subject to the CNI. Therefore, for tax years beginning on or after January 1, 1998, LLCs classified as "partnerships" under the Federal check-the-box-regulations will be subject to the NPT. In line with this, LLCs classified as corporations under Federal check-the-box regulations (and for Pennsylvania CNI purposes) will be exempt from the NPT. (**Warning:** Prior to Pennsylvania's Act 7 of 1997, the Restricted Professional Company (RPC) class of LLC was treated for Pennsylvania purposes as a limited partnership. As such, they were not subjected to the CNI and, therefore, were subject to the NPT for tax years beginning on or before January 1, 1998.)*