PHILADELPHIA TAX CASE DEVELOPMENTS

Court Decisions

1. *Philadelphia Eagles Football Club, Inc. v. City of Philadelphia*, 2000 Pa. Commw. LEXIS 420, No. 243 C.D. 1999; No. 361 C.D. 1999, July 26, 2000.

Business Privilege Tax – Receipts – Service Fees vs. Royalties – Net Income – Deductibility of Expenses
Wage Tax – Allocation for Nonresident Employee - Documentation

The Philadelphia Eagles and the City of Philadelphia both appealed a final order of the Court of Common Pleas of Philadelphia County, which reversed in part and affirmed in part a decision of the Philadelphia Tax Review Board. The issues raised by the Eagles and the City can be divided into four categories: Media Receipts; Deductibility of Airplane Expenses; Wage Tax; and Interest and Penalty.

Media Receipts

As a member of the National Football League (NFL), the Eagles shared in a percentage of the revenues received by the NFL from its contract (Network Contract) with a major television network for the right to televise all league games. The NFL had twenty-eight (28) teams for the period in question (i.e. 1986-1992) and each team received an equal share of these media receipts. The Eagles played one-half of their games in Philadelphia and the other half at other teams' venues. The earlier Tax Review Board (Board) decision held that only one-half of the media receipts received by the Eagles should be included in the Business Privilege Tax (BPT) as fees for services rendered within Philadelphia. The City appealed and the Common Pleas Court (trial court) concluded that the Board made an error in law. The trial court concluded that the media receipts should be classified as "royalties" all of which are subject to taxation under BPT Regulation 322 (i.e. Philadelphia commercial domicile).

The starting point for the Commonwealth Court was to determine whether the media receipts were fees from the licensing of a property right. Based upon its review of Section 1 of the Network Contract entitled *Television Rights Transferred*, the Commonwealth Court concluded that the media receipts were fees for the transfer of the right to telecast live games. The Court also

relied on prior case law that established that the contractual relationship between the networks and the NFL clubs as a contract for the sale of broadcast rights. Applying a detailed analysis of the 1976 Copyright Act [17 USC § 201(d)] and noting that the Network Contract expressly provides that the *League on behalf of its member clubs is deemed owner of copyright on live telecasts made under this agreement,* the Court concluded that the media receipts were *copyright royalties* subject to full taxation under BPT Regulation 322.

Deductibility of Airplane Expenses

The Eagles had purchased an airplane to accommodate the various activities of the Team and its owner, Norman Braman. Mr. Braman used the airplane to travel to and from his home in Florida and various sites where the Team played. In addition, Mr. Braman used the plane to attend meetings across the country for various NFL committees. Mr. Braman also used the plane for other business interests unrelated to the Eagles, vacation trips and other personal trips. The plane was also chartered to third parties. The Eagles had deducted 100% of the depreciation and expenses attributable to operating their airplane for BPT net income purposes. The Board held that the Eagles could deduct charter expenses to the extent of charter income, but only depreciation and expenses related to the business use were deductible for BPT net income purposes. Therefore, the depreciation and expenses related to Mr. Braman's personal usage were not deductible. However, to the extent that any personal usage of the plane would be treated as additional compensation to Mr. Braman, the expenses and depreciation should be allowed. The trial court upheld the Board's decision and the Eagles appealed. However, the City believed the non-business use of the airplane by Mr. Braman should not be classified as deductible business expense (i.e. compensation) but as a nondeductible dividend and filed a cross appeal.

The Eagles elected to compute net income under Method I and used GAAP as its method of accounting. The Eagles argued that under GAAP, 100% of the expenses were deductible. The Commonwealth Court noted that deductibility under GAAP does not necessarily equate to deductibility for tax purposes. The Eagles ignored the language, which provides only allowable costs, *and expenses* are deductible for purposes of the BPT. The Court stated that the inclusion of the word *allowable* makes it clear that only business related expenses are allowable deductions. Therefore, the airplane depreciation and other expenses not attributable to the Eagles business (i.e. vacation and charter flights) would not be deductible in calculating their taxable BPT net income.

The Commonwealth Court concluded that Mr. Braman's personal usage of the airplane constituted "*other compensation"* under Philadelphia Code § 19-1501(8). As such, this compensation should be taxed to Mr. Braman for

Wage tax purposes and the depreciation and expenses related to the personal usage of the airplane be allowed as a deduction.

Wage Tax

Norman Braman owned and operated the Eagles' organization for the tax years in question (i.e. 1986-1991). In 1991, he was paid an annual salary of $5 million. The Eagles claimed 75% of that salary, or $3.75 million, as an exclusion. The Eagles justified this on the basis that Mr. Braman, a Florida resident, spent only 25% of his time in Philadelphia. During the audit by the City, the Eagles presented no records to substantiate the time Mr. Braman spent in Philadelphia. The auditor assessed Wage Tax at 40%, using as a guide the amount the team owner had reported for the previous five tax years. The Eagles filed an appeal with the Board and Mr. Braman worked with his accountant to reconstruct his whereabouts during 1991. The summaries of his time where, admittedly, estimations of his activities with some inaccuracies and conflicting information. The Board ultimately determined the taxable percentage to be 30.5 (i.e. 61 of 200 working days in Philadelphia). The trial court affirmed the Board's decision.

The Commonwealth Court upheld the Board's (and trial court's) Philadelphia Wage Tax percentage for Mr. Braman. The Court noted that the Board's percentage was supported by substantial evidence and does not constitute an abuse of their fact-finding discretion.

Interest and Penalty

The Eagles contended that the Board erroneously refused to abate interest and penalties. The Board did not believe that the Eagles acted in good faith since they should have known it was not reasonable to deduct 100% of the airplane expenses when over 70% of its use was for purposes other than its own business activities. In addition, the Board found that the Wage Tax issue could have been resolved at the audit had the Eagles and Mr. Braman provided the time logs and calculations.

The Commonwealth Court stated that the Board <u>may</u> abate in whole or in part interest or penalties, or both, where the petitioner acted in good faith. The Court also stated that based upon their review of the record and in light of their disposition of the case, the Board did not abuse their discretion in denying relief.

2. *The Provident Mutual Life Insurance Company v. Tax Review Board*, 750 A.2d 942, No. 622 C.D. 1999, April 28, 2000.

Realty Transfer Tax – Exemption – Deed in Lieu of Foreclosure

The Provident Mutual Life Insurance Company (Provident) appealed an order of the Court of Common Pleas of Philadelphia (common pleas court) that affirmed the Tax Review Board's decision that denied a refund for the Realty Transfer Tax.

Covenant Life Insurance Company (Covenant) loaned money for the purchase of several properties located in the vicinity of 18th & Walnut Streets, Philadelphia. Covenant issued an original purchase money mortgage that secured the loan. Prior to July 13, 1995, Covenant merged with Provident with Provident the surviving entity. As a result of the merger, Provident was now the holder of the mortgage on the properties.

On July 13, 1995, Provident acquired the properties by deed in lieu of foreclosure. At the time of the foreclosure, the properties had an assessed value of $2,452,864 and an actual monetary worth of $8,535,968 (i.e. the assessed value multiplied by the common level ratio factor). The City assessed $256,079 in Realty Transfer Tax that Provident paid on or about July 19, 1995. On December 31, 1995, Provident sold the properties to an unaffiliated business, at arm's length, at a fair market value (FMV) of $6,150,000.

On May 5, 1997, Provident petitioned for a refund contending that its acquisition by deed in lieu of foreclosure was exempt from the tax under Philadelphia Code § 19-1405(14). That section exempts from the tax transactions involving the transfer of real estate *by a mortgagor to the original grantor holding the purchase money mortgage whether such transfer is pursuant to a deed in lieu of foreclosure or a transfer pursuant to a judicial sale.* Provident contended that Covenant was the original grantor and after the merger Provident stood in Covenant's shoes. The Board found that the tax exclusion did not survive the merger and was unavailable to the surviving corporation. The Board reasoned that when Covenant ceased to exist at the time of the merger, the tax exclusion ceased to exist as well.

Provident also contended that if the transaction were subject to tax, the amount of the tax should be determined by the FMV at the sale six months later. The Board disagreed and found under Philadelphia Code § 19-1402(14)(b) the taxable value of a property transferred for consideration at less than the actual monetary worth is computed by adjusting the assessed value by the common level ratio factor. The Board denied the taxpayer's petition and on appeal, the common pleas court affirmed the Board's decision.

The Commonwealth Court (Court) had to deal with four (4) arguments advanced by Provident before the common pleas court:

- The acquisition of the properties through a deed in lieu of foreclosure was excluded from taxation under Philadelphia Code § 19-1405(14);
- If the transaction is not excluded from taxation, then the tax exceeds the City's authority;
- The General Assembly's legislation on mergers preempts the City from this area of law;
- If the tax is applicable, the taxable value was inflated and violates the uniformity requirements of the Pennsylvania Constitution.

The Court agreed with the common pleas court (and the Board) that the exclusion from tax which would have been available to Covenant (as the original grantor) did not survive the merger with Provident because Section 1929(a) of the *Business Corporation Law of 1988* (15 Pa. C.S. § 1929) provides that *upon the merger or consolidation becoming effective…the separate existence of all constituent parties to the merger or consolidation shall cease, except that of the surviving corporation in the case of a merger.*

The Court also struck down Provident's second argument - - that since Pennsylvania excludes from the state real estate transfer tax a transfer by a mortgagor in default to the mortgage holder by a deed in lieu of foreclosure, the City had exceeded its authority. The Court agreed with Provident that Philadelphia's authority to impose the tax (at 72 P.S. § 4750.1301) is the same as for the state under the Tax Reform Code of 1971. However, the Court noted that the law also allows the City to impose the tax on *additional classes or types of transactions…if the tax was or is imposed by the city…pursuant to…the Sterling Act.* The Court ruled that the City had not exceeded its authority.

Provident's third and fourth arguments fared no better. The Court stated that *…there is no evidence that the legislature's pervasive regulation of the law of mergers preempted Philadelphia's imposition of its realty transfer tax.* Finally, the Court stated that the method used to compute the real estate transfer tax is *reliable, uniform and not in violation of the Pennsylvania Constitution*.

3. *Kennedy Boulevard Associates I, L.P. v. Tax Review Board of the City of Philadelphia*, 2000 Pa. Commw. LEXIS, No. 1939 C.D. 1999, May 9, 2000.

Realty Transfer Tax – Value – Actual Monetary Worth

Kennedy Boulevard Associates I, L.P. (Kennedy) appealed an order of the Court of Common Pleas of Philadelphia County (common pleas court) that denied Kennedy's appeal and affirmed the decision of the Tax Review Board (Board) to deny a refund of Realty Transfer Tax.

Kennedy, a Pennsylvania limited partnership, is the owner of a 29-story building located at 1801-45 John F. Kennedy Boulevard known at the time of the acquisition as *the Carlton House*. The property consists of 537 apartment units, retail and office space and basement space leased for use as a parking garage. Kennedy acquired the Carlton House on November 30, 1995 by a deed in lieu of foreclosure.

At the time of the transfer, the Carlton House was assessed at $7.2 million on the basis of an implied market value of $22.5 million. Even though the market value of the property for assessment purposes was being actively contested by a market value appeal, then pending with the Philadelphia Board of Revision of Taxes (BRT), the Philadelphia Recorder of Deeds would not accept the deed for filing unless Philadelphia transfer tax was computed by applying the applicable common level ratio (3.48) to the assessment to arrive at a market value for transfer tax purposes of $25,056,000. Transfer tax of $751,680 was paid on or about December 6, 1995.

On April 10, 1996, the implied market value of the property was reduced by the BRT from $22.5 million to $20.25 million with the assessed value similarly reduced from $7.2 million to $6.48 million. Not satisfied, Kennedy appealed the BRT's decision to common pleas court. Following this appeal, the City's Law Department, BRT and Kennedy settled the market value, as of January 1, 1996 at $18 million with the assessed value being $5.76 million. Kennedy filed a refund claim with City of Philadelphia – Department of Revenue (Revenue) for $ 211,680 that was denied. The basis for denial was that the transfer occurred on November 30, 1995 and the tax should be based on the "*actual monetary worth"* in effect for that date (i.e. BRT's assessed value x the common level ratio). The $ 5.76 million assessed value was effective January 1, 1996 that is, 31 days subsequent to the taxable transfer. The Board and common pleas court upheld Revenue's denial of the refund claim, and Kennedy appealed to Commonwealth Court (Court). The Court reversed and remanded, on the parties' binding stipulation that the value was not more than $18 million on the date of transfer.

In arriving at its conclusion, the Court analyzed the ordinance's definition of *value* as set forth in Philadelphia Code § 19-1402(14). Essentially the ordinance provides three (3) different ways to calculate value. The first subsection (a) applies to a bona fide sale of real estate at arm's length and taxable value is the actual consideration (i.e. purchase price). The second method subsection (b) applies to transfers by gift, foreclosure of a mortgage, transactions without consideration or for less than the actual monetary worth, by merger, consolidation or acquisition. In those cases, the actual monetary worth as noted above must be calculated and used (i.e. assessed value x common level ratio). The third definition is the catch-all provision and is used when value *is not determinable under clause (a) or (b)* and is *the actual monetary worth of such interest.* After analyzing all this language, the Court concluded, that the deed in lieu of foreclosure did not fall under either subsection (a) or (b), and therefore applied subsection (c) and concluded that the *actual monetary worth* had to be applied. On the basis of that decision, the stipulated settlement value of $18 million was held to be the proper value to be applied. It reached its conclusion by rejecting the City's argument that a deed in lieu of foreclosure is the *functional equivalent* of a foreclosure sale. The Court invoked the doctrine of statutory construction that enumerated classes should be strictly construed and refused to expand the class beyond those plainly stated.

4. ***City of Philadelphia vs. OLS Hotel Partners, L.P., City of Philadelphia vs. Central Parking Systems of Pennsylvania, Inc.***, 2001 WL 838195(Pa. Cmwlth), Nos. 249 C.D. 2000, 379 C.D. 2000, 584 C.D. 2000, July 26, 2001.

Hotel Tax – Parking Facility – Transaction - Operator

The City of Philadelphia ("City"), OLS Hotel Partners, L.P. t/a The Four Seasons Hotel Philadelphia ("OLS") and Central Parking Systems of Pennsylvania, Inc. ("Central Parking") appealed orders from the Court of Common Pleas of Philadelphia County, which affirmed in part and reversed in part the June 29, 1999 decision of the Tax Review Board ("TRB") relating to the extent that OLS, Central Parking and Standard Parking Corporation (Standard Parking) are liable for the City's Parking Tax.

OLS was the owner of the Four Seasons Hotel in Philadelphia, which offered its guests valet parking service. The valet parking service was made possible because of a December 21, 1983 easement agreement between OLS and the owner of a parking garage located at 18th and Cherry Streets in Philadelphia. By a separate agreement (dated

September 23, 1996), OLS agreed to pay the owner of the parking lot $33,000 per month, plus an additional $8 for each use in excess of 60,000 uses per year. During the period at issue, valets at the hotel parked the vehicles of registered guests and transient guests in the parking garage, and OLS made the required payment to the parking garage operator. The parking charges were added to the registered guests' invoice charges and were paid at the hotel's front desk. The hotel charged transient guests based on the number of hours parked and collected the parking fee when the guests returned to pick up their vehicles.

On November 1, 1991, Standard Parking entered into a management agreement with the owner of the parking garage that remained in effect until August 31, 1997. On September 1, 1997, Central Parking entered into a management agreement that superseded the arrangement with Standard Parking.

On April 2, 1998, OLS filed a petition for refund with the Revenue Department of the Parking Tax paid for November 1997. The amount of the tax payment for which the refund was now being sought included the valet service receipts. Standard Parking and Central Parking filed refund petitions for the periods March through August 1997 and September through December 1997 respectively. The amount of the refund claims were based on what OLS paid to each of them during the periods in question. All of these petitions were denied by the Revenue Department.

The primary issue of this case was whether any portion of the monies collected by OLS for its valet parking services, less amounts paid to Standard Parking and later to the successor, Central Parking, was subject to the Parking Tax. As to Standard Parking and Central Parking, the issue was whether they were entitled to refunds of the Parking Tax they had paid on the fees paid to them by OLS. They requested refunds based upon the City's assertion (i.e. November 10, 1997 Revenue Department ruling) that the Parking Tax was due from OLS on the entire amount collected by OLS from the parking patrons. The argument advanced by Central Parking and Standard Parking was that if OLS was to be held responsible for the tax on the total gross receipts collected for the valet service, then Central Parking and Standard Parking would be entitled to refunds since, in effect, the City would be seeking to tax the same transaction twice.

In its written brief and oral argument to the Tax Review Board, the city modified its position so that it sought to tax OLS only on the difference between the receipts collected for valet parking and the amounts paid to Central Parking and Standard Parking. In its decision, the Tax Review Board denied the refund requests of Standard and Central Parking. With respect to OLS, the TRB concluded that OLS was not required to pay the

tax because it is not an *operator* of a *parking facility* under Philadelphia Code 19-1202(1)(b). Therefore the Tax Review Board granted the refund request of OLS.

The City appealed to the Court of Common Pleas for Philadelphia. Standard Parking and Central Parking each appealed the TRB's denial of their respective refund claims. The trial court affirmed the TRB's decision with respect to Standard Parking and Central Parking but reversed the TRB as to OLS. The trial court said that OLS was charging its guests for parking and that the parking *transaction* was subject to the Parking Tax. The City, OLS and Central Parking filed appeals.

On appeal to the Commonwealth Court, the City argued that the trial court erred by failing to address whether OLS, as operator of a valet parking service, is solely liable for the collection and payment of the Parking Tax. OLS argued that the trial court erred in reversing the TRB and contended that Standard Parking and Central Parking must pay the Parking Tax from the payments made to them by OLS. Central Parking argued that OLS was the operator of the exclusive parking facility consisting of ninety spaces in the parking garage and that the easement fee paid to Central Parking by OLS is not a parking charge subject to the Parking Tax.

The Commonwealth Court concluded that Central Parking was the *operator* of the *parking facility* citing the management agreement between them and the parking lot's owner which specifically provided that Central Parking would "operate" the parking garage. Therefore, Central Parking would need to collect the tax. OLS was determined to be the *person* parking the vehicles.

5. *Federal Realty Investment Trust v Tax Review Board of City of Philadelphia*. 769 A.2D 1255, No. 1941 C.D. 99, February 14, 2001.

Realty Transfer Tax – Value

This was an appeal filed by the taxpayer with the Commonwealth Court. Ultimately, the Commonwealth Court affirmed the Tax Review Board's decision. The Pennsylvania Supreme Court subsequently denied the taxpayer's Allowance of Appeal from the Order of the Commonwealth Court.

The dispute centered on the correct valuation of real estate transferred. The taxpayer, Federal Realty Investment Trust ("FRIT") exercised an option to purchase a property from the Hotel Ambassador Company ("HAC"). At the time the option was exercised, the consideration due to

HAC included the purchase price of $4,055,209 as well as satisfaction (by FRIT) of the first and second mortgage encumbrances of $2,812,009 and $2,625,000 respectively.

The Tax Review Board ruled that the taxpayer's initial calculation of the tax, based on the contract sale price did not accurately reflect the actual consideration for the sale of the property. The Board ruled, that since the transaction was a bona fide sale between unrelated parties at arm's length, the "***value***" subject to tax was "***the actual consideration…including liens or other encumbrances thereon existing before the transfer and not removed thereby…"*** [Philadelphia Code § 19-1402(14)]. At the closing of the sale, HAC, as seller, received not only the sale price of over $4 million but also release of the first mortgage and satisfaction of the second mortgage. These two encumbrances were the responsibility of HAC that were transferred to FRIT during the course of the lease and purchase. FRIT not only paid the $4,055,209 end sale price but also assumed the two mortgages as part of the contract. This was a release of HAC from responsibility to repay over $5 million when the property was transferred to FRIT in addition to more than $4 million in cash given to HAC by FRIT. Therefore, the Tax Review Board concluded that these amounts should be totaled to reflect the actual consideration on which the Realty Transfer Tax should be levied (i.e. $9,492,218).

The taxpayer, FRIT, argued that the encumbrances assumed or satisfied should be removed from the taxable consideration since they were removed shortly ***after*** the sale as opposed to ***"removed thereby"***. The Tax Review Board countered that to allow purchasers to deduct from the amount of the consideration the amount of any liens satisfied at closing would lead to an "***absurd result***".