

Amending Section 101, Section 201 and Adding a new Section to General Provisions of the City of Philadelphia Business Privilege Tax Regulations

AMENDMENT TO THE CITY OF PHILADELPHIA BUSINESS PRIVILEGE TAX REGULATIONS

CITY OF PHILADELPHIA BUSINESS PRIVILEGE TAX REGULATIONS

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Section 101 of the City of Philadelphia Business Privilege Tax Regulations is amended to read as follows:

SECTION 101. DEFINITIONS.

The following words and phrases, when used in these Regulations, have the meanings ascribed to them in this section, except where the contents clearly indicate another or a different meaning.

A. "Affiliated group." One or more chains of corporations connected through stock ownership with a common parent corporation if:

- (1) Stock possessing at least eighty (80%) percent of the voting power of all classes of stock and at least eighty (80%) percent of each class of the nonvoting stock of each corporation, except the common parent corporation, is owned directly by one or more of the other corporations.

D. "Business." Carrying on or exercising for gain or profit within Philadelphia any trade, business, including financial business as hereinafter defined, profession, vocation or commercial activity or making sales to persons within the City of Philadelphia. "Business" shall not include the following:

1. Those activities conducted by a nonprofit corporation or association organized for religious, charitable or educational purposes, if such activities are directly related to its religious, charitable or educational purposes.

10. Any hobby or other not-for-profit activity, as set forth at 26 C.F.R. § 1.183-2 and under Section 19-2601 of The Philadelphia Code. The determination of whether an activity is engaged in for profit is made by reference to objective factors, taking into account all of the facts and circumstances of each case. The relevant, non-exclusive factors set forth in 26 C.F.R. § 1.183-2 and in Section 105 of these regulations are: (i) the manner in which the person carries on the activity; (ii) the expertise of the person carrying on the activity or such person's advisors; (iii) the time and effort expended by the person in carrying on the activity; (iv) the expectation that assets used in the activity may appreciate in value; (v) the success of the person in carrying on other similar or dissimilar activities; (vi) the person's history of income or losses with respect to the activity; (vii) the amount of occasional profits, if any, which are earned from the activity; (viii) the financial status of the person carrying on the activity; and (ix) elements of personal pleasure or recreation in carrying on the activity.

Section 105 is added to the City of Philadelphia Business Privilege Tax Regulations to read as follows:

SECTION 105. PERSONS ENGAGED IN HOBBIES AND OTHER NOT-FOR-PROFIT ACTIVITIES

- A. Any hobby or other not-for-profit activity as set forth at 26 C.F.R. § 1.183-2 is excluded from the definition of "Business". A person exclusively engaged in a hobby or other not-for-profit activity as set forth in § 19-2601 of The Philadelphia Code and Section 101(D) of these regulations shall not be required to file a Business Privilege Tax Return.
- B. Relevant Factors. In determining whether an activity is engaged in for profit, all facts and circumstances with respect to the activity are taken into account. No one factor is determinative in making this determination. It is not intended that only the factors described in this paragraph are to be taken into account in making the determination, or that determination is to be made on the basis that the number of factors (whether listed or not listed in this paragraph) indicating a lack of profit objectives exceeds the number of factors indicating a profit objective, or vice versa. Factors which should normally be taken into account include the following:
 1. Manner in which the person carries on the activity. The fact that the person carries on the activity in a businesslike manner and maintains complete and accurate books and records may indicate that the activity is engaged in for profit. Similarly, where an activity is carried on in a manner substantially similar to other activities of the same

nature which are profitable a profit motive may be indicated. A change of operating methods, adoption of new techniques or abandonment of unprofitable methods in a manner consistent with intent to improve profitability may also indicate a profit motive.

2. The expertise of the person or his advisors. Preparation for the activity by extensive study of its accepted business, economic, and scientific practices, or consultation with those who are expert therein, may indicate that the person has a profit motive where the person carries on the activity in accordance with such practices. Where a person has such preparation or procures such expert advice, but does not carry on the activity in accordance with such practices, a lack of intent to derive profit may be indicated unless it appears that the person is attempting to develop new or superior techniques which may result in profits from the activity.
3. The time and effort expended by the person in carrying on the activity. The fact that the person devotes much of his personal time and effort to carrying on an activity, particularly if the activity does not have substantial personal or recreational aspects, may indicate an intention to derive a profit. A person's withdrawal from another occupation to devote most of his energies to the activity may also be evidence that the activity is engaged in for profit. The fact that the person devotes a limited amount of time to an activity does not necessarily indicate a lack of profit motive where the person employs competent and qualified persons to carry on such activity.
4. Expectation that assets used in activity may appreciate in value. The term "profit" encompasses appreciation in the value of assets, such as land, used in the activity. Thus, the person may intend to derive a profit from the operation of the activity, and may also intend that, even if no profit from current operations is derived, an overall profit will result when appreciation in the value of land used in the activity is realized since income from the activity together with the appreciation of land will exceed expenses of operation. See, however, paragraph (d) of 26 C.F.R. § 1.183-1 for definition of an activity in this connection.
5. The success of the person in carrying on other similar or dissimilar activities. The fact that the person has engaged in similar activities in the past and converted them from unprofitable to profitable enterprises may indicate that he is engaged in the present activity for profit, even though the activity is presently unprofitable.
6. The person's history of income or losses with respect to the activity. A series of losses during the initial or start-up stage of an activity may not necessarily be an indication that the activity is not engaged in for profit. However, where losses continue to be sustained beyond the period which customarily is necessary to bring the operation to profitable status such continued losses, if not explainable, as due to customary business risks or reverses, may be indicative that the activity is not being engaged in for profit. If losses are sustained because of unforeseen or fortuitous circumstances which are beyond the control of the person, such as drought, disease, fire, theft, weather damages, other involuntary conversions, or depressed market conditions, such losses would not be an indication that the activity is not engaged in for profit. A series of years in which net income was realized would of course be strong evidence that the activity is engaged in for profit.

7. The amount of occasional profits, if any, which are earned. The amount of profits in relation to the amount of losses incurred, and in relation to the amount of the person's investment and the value of the assets used in the activity, may provide useful criteria in determining the person's intent. An occasional small profit from an activity generating large losses, or from an activity in which the person has made a large investment, would not generally be determinative that the activity is engaged in for profit. However, substantial profit, though only occasional, would generally be indicative that an activity is engaged in for profit, where the investment or losses are comparatively small. Moreover, an opportunity to earn a substantial ultimate profit in a highly speculative venture is ordinarily sufficient to indicate that the activity is engaged in for profit even though losses or only occasional small profits are actually generated.
8. The financial status of the person. The fact that the person does not have substantial income or capital from sources other than the activity may indicate that an activity is engaged in for profit. Substantial income from sources other than the activity (particularly if the losses from the activity generate substantial tax benefits) may indicate that the activity is not engaged in for profit especially if there are personal or recreational elements involved.
9. Elements of personal pleasure or recreation. The presence of personal motives in carrying on of an activity may indicate that the activity is not engaged in for profit, especially where there are recreational or personal elements involved. On the other hand, a profit motivation may be indicated where an activity lacks any appeal other than profit. However, it is not necessary that an activity be engaged in with the exclusive intention of deriving a profit or with the intention of maximizing profits. For example, the availability of other investments which would yield a higher return, or which would be more likely to be profitable, is not evidence that an activity is not engaged in for profit. The mere fact that the person is engaged in an activity for purposes or motivations other than solely to make a profit is not evidence that the person's activity is to be treated as not engaged in for profit. Also, the fact that the person derives personal pleasure from engaging in the activity is not sufficient to cause the activity to be classified as not engaged in for profit if the activity is in fact engaged in for profit as evidenced by other factors whether or not listed in this paragraph.

C. Examples. The provisions of this section may be illustrated by the following examples:

1. The person is a wealthy individual who is greatly interested in philosophy. During the past 30 years he has written and published at his own expense several pamphlets, and he has engaged in extensive lecturing activity, advocating and disseminating his ideas. He has made a profit from these activities in only occasional years, and the profits in those years were small in relation to the amounts of the losses in all other years. The person has very sizable income from securities (dividends and capital gains) which constitutes the principal source of his livelihood. The activity of lecturing, publishing pamphlets, and disseminating his ideas is not an activity engaged in by the person for profit.

2. The person, very successful in the business of retailing soft drinks, raises dogs and horses. He began raising a particular breed of dogs many years ago in the belief that the breed was in danger of declining, and he has raised and sold the dogs in each year since. The person recently began raising and racing thoroughbred horses. The losses from the person's dog and horse activities have increased in magnitude over the years, and he has not made a profit on these operations during any of the last 15 years. The person generally sells the dogs only to friends, does not advertise the dogs for sale, and shows the dogs only infrequently. The person races his horses only at the "prestige" tracks at which he combines his racing activities with social and recreational activities. The horse and dog operations are conducted at a large residential property on which the person also lives, which includes substantial living quarters and attractive recreational facilities for the person and his family. Since (i) the activity of raising dogs and horses and racing the horses is of a sporting and recreational nature, (ii) the person has substantial income from his business activities of retailing soft drinks, (iii) the horse and dog operations are not conducted in a businesslike manner, and (iv) such operations have a continuous record of losses, it could be determined that the horse and dog activities of the person are not engaged in for profit.

3. A, an independent oil and gas operator, frequently engages in the activity of searching for oil on undeveloped and unexplored land which is not near proven fields. He does so in a manner substantially similar to that of others who engage in the same activity. The chances, based on the experience of A and others who engaged in this activity, are strong that A will not find a commercially profitable oil deposit when he drills on land not established geologically to be proven oil bearing land. However, on the rare occasions that these activities do result in discovering a well, the operator generally realizes a very large return from such activity. Thus, there is a small chance that A will make a large profit from his soil exploration activity. Under these circumstances, A is engaged in the activity of oil drilling for profit.

4. C, a chemist, is employed by a large chemical company and is engaged in a wide variety of basic research projects for his employer. Although the work he engages in for his employer does not concern the development of new plastics, he has always been interested in such development and has outfitted a workshop in his home at his own expense which he uses to experiment in the field. He has patented several developments at his own expense but as yet has realized no income from his inventions or from such patents. C conducts his research on a regular, systematic basis, incurs fees to secure consultation on his projects from time to time, and makes extensive efforts to "market" his developments. C has devoted substantial time and expense in an effort to develop a plastic sufficiently hard, durable, and malleable that it could be used in lieu of sheet steel in many major applications, such as automobile bodies. Although there may be only a small chance that C will invent new plastics, the return from any such development would be so large that it induces C to incur the costs of his experimental work. C is sufficiently qualified by his background that there is some reasonable basis for his experimental activities. C's experimental work does not involve substantial personal or recreational aspects and is conducted in an effort to find practical applications for his work. Under these circumstances, C may be found to

be engaged in the experimental activities for profit.

Section 201 of the City of Philadelphia Business Privilege Tax Regulations is amended to read as follows:

SECTION 201. WHO MUST FILE A RETURN.

Every individual, partnership, association, and corporation, and every receiver, trustee, assignee and other person acting in a fiduciary capacity, whether appointed by a court or otherwise, and any combination of persons, carrying on or engaging in any trade, business, profession, vocation or any manufacturing, commercial, service, financial, insurance or utility business or activity in Philadelphia or attributable to Philadelphia, must file a Business Privilege Tax return on the prescribed form available from the Department of Revenue.

The method shall reflect the gain (or loss) resulting from the activity of a business, profession or enterprise which occurs during the usual operations; inclusive of the sale, exchange or disposition of assets of an ongoing or terminated entity. Transactions must be identifiable, necessary and reasonable to the business, after allowance for applicable costs.

A person exclusively engaged in a hobby or other not-for-profit activity, excluded from the definition of business set forth in § 19-2601 of The Philadelphia Code and in Section 101(D) of these regulations shall not be required to file a return. Any such person may, in response to any enforcement activity of the Department, submit a certification in form satisfactory to the Department (which certification shall include, if the Department so requires, documentation that the person has not taken deductions for such activity on the person's federal tax return) that the person is not engaged in business within the City, as defined in § 19-2601 of The Philadelphia Code and in Section 101(D) of these regulations; and, to the extent the person's total receipts derived from hobby or other not-for-profit activity are less than \$3,000, the Department shall accept such certification as presumptive proof of no business income. The Department reserves the right to rebut this presumption by evaluating the relevant factors as outlined in Section 105 of these regulations with the particular facts and circumstances. (This provision does not exclude persons engaged in an activity for profit -- in Philadelphia or attributable to Philadelphia -- whose total receipts are less than \$3,000; such persons are subject to the tax and shall be required to file a return.)

Signature Keith J. Richard

Date 11/14/11

Legend: Underline denotes addition