Recent Philadelphia Tax Review Board Opinions

1. *Center City Newspaper Distributors*, Opinion 00-L, December 6, 2000.

Wage Tax – Classification - Employee vs. Independent Contractor

The petitioner challenged a Wage Tax assessment for tax years 1995 through 1997. The decision of the Tax Review Board ("TRB") was to deny the petition on its merits. The petitioner appealed to the Court of Common Pleas.

The petitioner was a Philadelphia based company whose primary business was the delivery of nationally published newspapers, such as *The Philadelphia Inquirer* and *The New York Times*. The petitioner hired individuals to make the deliveries. The factors considered pertinent by the TRB in rendering its decision were the following:

- The subscribers delivered to were the customers of the petitioner, not the delivery workers'. Complaints by customers were all directed to the petitioner.
- The delivery workers could not independently increase their business or compensation by adding new customers either through subscriptions or individual sales.
- The petitioner dictated the routes and the time frame for deliveries. The delivery workers could not make their own hours or schedule.
- The delivery workers were paid at a rate of pay unilaterally determined by the petitioner.

Although the petitioner provided the TRB with a copy of the contract it asked the delivery workers to sign stating they were independent contractors, the petitioner's principal was forced to admit under cross examination that the contract's terms were "basically irrelevant" to the actual relationship of the delivery workers to the company.

2. *Brian E. Quinn, Esq., P.C.*, Opinion 01-A, February 15, 2001.

Business Privilege Tax – Net Income Base – Determination of Net Income

The petitioner challenged a Business Privilege Tax assessment for privilege tax years 1996 through 1998. The decision of the TRB was to deny the petition on its merits and the Petitioner has appealed to the Court of Common Pleas.

The petitioner was a Subchapter S corporation engaged in the practice of law within Philadelphia. The sole shareholder was a City resident. The shareholder took dividend distributions from the petitioner in 1995, 1996 and 1997. The shareholder paid School Income Tax ("SIT") on these dividend distributions. The petitioner elected to report net income for Business Privilege Tax purposes under Net Income Method II (i.e. *as returned to and ascertained by the Federal government*). Attached to the filed Business Privilege Tax returns was a *pro forma 1120S* that did not correspond to the actual 1120S return forms filed with the Federal government. The petitioner's actual Federal net income for 1995, 1996 and 1997 was $144,444, $127,008 and $155,586 respectively. The pro-forma S returns showed losses for the years 1995, 1996 and 1997 as $56, $492 and $414 respectively. The petitioner's accountant testified that the pro forma 1120S had reduced net income figures so as to avoid double taxation (since the net income distributions were reported by the shareholder on his SIT return).

The TRB concluded that Philadelphia Code 19-2601 and Business Privilege Tax Regulation 404 required the petitioner to file the net income in accordance with what was reported to the Federal government. The TRB also noted that in this situation, Philadelphia was not taxing the same entity twice. The petitioner was subject to the Business Privilege Tax whereas the shareholder (a separate legal entity) was subjected to the School Income Tax. The TRB stated: *The fact that the source of the income, and indeed the funds themselves, may have been subject to taxation at a separate entity level does not allow the taxpayer the opportunity to pick and choose which taxes it deems fair and equitable to its own situation.*

3. ***New Century Homes, Inc.*, Opinion 01-B, February 23, 2001**

Realty Transfer Tax – Value – Transfer of Land and Building – Successor Corporation – Liability for Tax

The petitioner filed for review of certain tax assessments, including the Realty Transfer Tax. After receiving an unfavorable decision by the TRB, the petitioner appealed to the Court of Common Pleas.

The petitioner was in the business of building and selling modular residential housing in Philadelphia. The modular or prefabricated housing sold by the petitioner is also known as *Industrialized housing* as defined and regulated by the Commonwealth under 35 P.S. § 1651 et seq. They are attached to the land and are permanent real estate. The land and the homes were marketed for one sales price. At each closing, separate documents were prepared and signed for the sale of land and for the sale of the house on the property. The homeowners had traditional mortgages for the full sale price, secured by both the land and the building. The settlement sheets for the homes reflected the total sales price, inclusive of both the value assigned by the petitioner to the land and the value

assigned to the structure. A credit was given for the value of the land since this cost was also on the settlement sheet used for the sale of the land only. Each deed presented to the City of Philadelphia Records Department was only for the transfer of the land and did not include the value of the building on the site. The Realty Transfer Tax was paid only on the land value.

The TRB concluded that the City correctly assessed Realty Transfer Tax on the value of the housing structures transferred. *Real Estate* is defined by the ordinance (at Philadelphia Code 19-1402) as *(a)ll lands, tenements or hereditaments within this City, including without limitation*, *buildings, structures, fixtures…and other improvements, immovables or interests or interests which by custom, usage or law pass with a conveyance or land…* The TRB stated it was clear that the homes built by the petitioner fell within this definition and stated *(t)he contrivance of using two settlement sheets and separating the transaction into two units does not negate the aggregate effect of a transfer of land with a permanent building on it, thus requiring the total value of both be accounted for in the calculation of the correct RTT.*

The petitioner tried to argue that the liability for the RTT belonged to its predecessor, Affordable Residences Inc. ("AFI"). AFI ceased doing business on December 31, 1995. The petitioner argued that when AFI ceased to exist, responsibility for the harm or liabilities it left behind also ceased. AFI engaged in the marketing and sale of modular homes. Its business activities were identical to the petitioner's. The petitioner came into existence on January 2, 1996. Both corporations were owned by the same principal, John Berg. The TRB concluded that Pennsylvania courts have upheld the liability of a corporation for the actions of a previous corporation where the facts support the conclusion that the second corporation is a successor corporation to the first. The TRB concluded that the petitioner was the successor to AFI and therefore liable for the RTT based upon the following factors: (1) centralized control of labor relations; (2) common management: (3) interrelation of operations; and (4) common ownership and financial control.

4. *Refrigerated Foods Distributors, Inc.*, **Opinion 01-C, May 14, 2001.**

Refund of Interest and Penalty – Amended Return – Pro-ration of Payments among Tax, Interest and Penalty

The petitioner sought a refund of $ 81,536 in paid interest and penalty attributable to its amended 1997 Business Privilege Tax return. The petitioner also sought an abatement of the $17,526 tax, interest and penalty that arose because of the City's pro-rating of the payment sent in with the amended return. The TRB decided to refund $ 20,000 of penalty and the petitioner appealed to the Court of Common Pleas.

The petitioner filed and paid their 1997 Business Privilege Tax return in a timely manner. Subsequent to the original filing, the Internal Revenue Service audited the petitioner's applicable Federal income tax return resulting in an increase to taxable income. The IRS audit was completed in August 1998 and the petitioner filed an amended 1997 Business Privilege Tax in June 1999 and sent a check in for $216,000 for the additional tax, interest and penalties. The additional tax to be paid was $134,771. This payment was pro-rated, first paying off the interest and penalty due of $90,547, leaving a balance of tax principal of $9,011, with interest and penalty accruing on this balance. Subsequently the pro-rated tax of $9011 was paid (with interest and penalty paid of $6615). The petitioner's total payments made were $134,771 in tax principal and $96,000 in interest and penalty.

The TRB ruled that since the petitioner had the use of the 1997 Business Privilege Tax monies from April 1997 to June 1999 (i.e. 24 months) the City was entitled to retain the interest accrued against the liability. Though the taxpayer waited from August 1998 until June 1999 to amend the 1997 return, the TRB believed the petitioner acted in good faith and decided to grant a refund of $20,000 paid in penalties. As to the pro-rated payment, the TRB cited Philadelphia Code 19-505(1) which states *(u)nless otherwise provided, when a partial payment is made on account of any delinquent tax, such payment shall be pro-rated between the principal sum of such tax and the penalties and interest accumulated on it.* The TRB concluded that the Revenue Department acted within its authority to pro-rate among tax, interest and penalty.

5. *A&M Berk Tax Service, Inc.*, Opinion 01-D, June 7, 2001.

Business Privilege Tax – Taxable Gross Receipts – Burden of Proof
Wage Tax – Classification – Employee vs. Subcontractor

Pursuant to an audit, the petitioner was assessed additional Business Privilege Tax (1996 through 1998) based on the auditor's finding that additional gross receipts were not accounted for in the petitioner's original filings. Additional Wage tax was assessed due to the auditor reclassifying tax preparers from independent contractors to employees. Petitioner was also assessed for failure to withhold Wage tax for employees who were Philadelphia residents and for nonresident employees who worked in Philadelphia. The petitioner requested review and abatement of these assessments.

The petitioner was in the business of preparing tax returns for clients and had seven (7) offices within the City of Philadelphia and one (1) in Maple Glen, Pennsylvania. The petitioner hired individual preparers to work during tax season, recruiting them from local colleges and newspaper advertisements.

Each preparer filed and signed an application that stated if hired, they would be considered an independent contractor (i.e. no taxes would be withheld as the applicant would be solely responsible for his/her own tax liabilities). All applicants were tested and had to have at least two years of college accounting to be considered. Each year the petitioner sent the preparer a Federal Form 1099. They were compensated on either a per hour or commission basis. The petitioner required the preparers to attend training sessions in December and January of each year. The preparers could not take work home with them but had to complete their work in the petitioner's office during the assigned work shift. Separate from the tax preparers, the petitioner had workers classified as W-2 employees. Bonuses were paid to these employees, but were put on Federal Form 1099s. No Wage tax was withheld from the Philadelphia resident employees or from the nonresidents who worked in Philadelphia.

The TRB concluded that the petitioner owed Wage Tax for the W-2 employees who were residents of Philadelphia and for those nonresidents who worked in Philadelphia. The bonuses paid to these employees on Federal Form 1099 were also subject to the Wage Tax pursuant to Income Tax Regulation 203(d). The TRB also concluded that the tax preparers employed seasonably were not independent contractors but employees. The level of control exercised by the petitioner over these preparers (i.e. mandatory training, specific schedules, all work completed in assigned office, etc.) convinced the TRB that the preparers were in effect employees, subject to Wage Tax withholding.

The Business Privilege Tax issues involved underreported receipts attributable to the petitioner's participation in a rapid refund program. From time to time calculation errors were made. For example, if petitioner's employee made a data entry error that overstated the fee charged to the client and the petitioner received an incorrect amount from the bank, the problem would be corrected by issuing a separate check to the client for the amount of the overpayment. The tax return and initial bank account documentation would reflect a higher fee and thus a higher gross receipt than the petitioner actually received for that return. The petitioner's former president testified that his would happen 80 to 90 times a year. There were also some problems attributed to clients who sought to cash their refund checks with the petitioner. The petitioner would have the client endorse the back of the bank refund check and then deposit the check in its own account. The TRB concluded that the petitioner failed to meet its burden of proof to explain a $35,000 discrepancy between it bank deposits and reported gross receipts. The TRB felt that while the rapid refund problems did account for some of the discrepancy, it did not appear sufficient to account for the full discrepancy. The TRB did however reduce the BPT tax principal assessment of $4,674 by one-half.

6. *Arnold Berkowitz*, **Opinion 01-E, June 7, 2001.**

Business Privilege Tax - Net Profits Tax – Income Classification - Taxable Income

Pursuant to an audit, the Revenue Department assessed Business Privilege Tax and Net Profits Tax against the petitioner. The basis of the assessment was income to the petitioner labeled as rental income on Federal 1099s issued by A&M Berk Tax Service Inc., a company with whom the petitioner was closely affiliated. This income was labeled as rental income on the petitioner's personal Federal income tax returns. The petitioner argued that the income was royalties not taxable by the City because the place of business to which the royalties were attributable was outside of Philadelphia.

The petitioner was an accountant and principal of A&M Berk Tax Service Inc. In 1988, the petitioner prepared what he referred to as a *tax manual* to be used by tax preparers working for him at A&M Berk Tax Service. This manual was prepared in the Maple Glen office of the petitioner. The manual consisted of photocopied pages of various IRS instructions for filing returns, a list of fees for A&M Berk services, and tax tables. It was updated each year as needed. The petitioner presented an agreement between himself, as licensor, and A&M Berk, as licensee, entered into June 30, 1989. The agreement described the compensation to be received by the petitioner for the use of the manual. A&M Berk did not have separate representation for this agreement. The agreement described the compensation to be received as a royalty equal to 1/3 of the licensee's gross receipts computed annually on a fiscal year basis. Income received pursuant to this contract was $129,001, $245,970 and $262,097 for 1995 through 1997 respectively. Each year, A&M Berk issued a 1099 to the petitioner with an amount indicated in the box designated for rents. This amount then appeared on the joint Federal income tax filed by the petitioner and his wife on Schedule E as *rents received*. This occurred in 1995, 1996 and 1997. In 1996 and 1997 the federal return indicated that the rents were for 105 West Chelten Ave. Philadelphia. The petitioner testified that he did not own the property at that time even though it was one of the offices of A&M Berk. The petitioner testified that classifying these monies as rental income was a mistake.

The TRB concluded that the bulk of the income paid to the petitioner during the years in question was income earned pursuant to business activity within the City of Philadelphia. (The TRB did allow $12,000 of these payments to be classified as a royalty for the manual.) The TRB noted that during the years in question the petitioner took thousands of dollars in *rental income* from A&M Berk with no other compensation despite his numerous corporate duties and responsibilities. The TRB was not convinced that a tax return preparation service with 99% of its business activity attributable to 6 Philadelphia offices could be effectively managed by the petitioner exclusively from the Maple Glen office.

7. *Celebrity Parking, Inc.*, Opinion 01- F, June 12, 2001.

Parking Tax - Parking Transaction – Operator

Celebrity Parking Inc. filed two petitions for review of Parking Tax assessments attributable to valet parking operations conducted in the Manayunk area from 1993 to 1996. Both petitions were consolidated into this opinion. The decision of the TRB was to deny the petitions on the merits and deny the refund claim. The petitioner appealed to the Court of Common Pleas.

The petitioner conducted two separate valet parking operations. In the first case, the petitioner provided valet parking by verbal agreement with the Manayunk Development Corporation ("MDC") using a lot leased by MDC from SEPTA. For some of the years in question, the petitioner remitted the Parking Tax but was now requesting a refund. This valet service operated along Main Street at three locations, specified by MDC, for patrons of Manayunk businesses. MDC specified to the petitioner the days and hours of operation, staffing levels, fees to be charged, etc. Only the petitioner's employees were involved in the valet parking operations and no MDC employees were present for to do any management, supervision or parking of cars. The petitioner maintained its own insurance for claims of missing items or damage to cars. MDC was responsible for any vandalism at the lot.

The second case involved valet parking services provided for the River Deck Café, a Manayunk restaurant. The verbal agreement was for the petitioner to provide parking for the restaurant's patrons on an adjacent lot and in turn, the petitioner paid a monthly fee of $2,000 to the River Deck Café's owner, Barry Geften for the exclusive use of the lot. The petitioner hired and trained the valet staff to park the cars and collect the $5 parking fee. The lot was for the exclusive use of patrons of the River Deck Café.

With respect to the MDC lot, the TRB concluded that the petitioner was the *operator* of the parking lot as defined by Philadelphia Code 19-1201(3) and therefore liable for the collection of the Parking Tax. The petitioner was the person *conducting or operating a parking facility.* The petitioner argued that the operator of the parking facility was MDC, who leased, maintained and provided security for the lot. However, the TRB noted that MDC did not have any of its employees at the lot to supervise its use. Though MDC hired security personnel, the security people did not get involved in the actual parking of the cars. The TRB stated that the lack of an ownership or leasehold interest in the lot on which the cars were being parked or stored did not preclude the petitioner from being the operator subject to tax. It was the petitioner, through its employees, who were engaging in the taxable parking transactions.

As to the River Deck Café, the petitioner argued it was entitled to a $2,000 credit for the monthly fee paid to Mr. Geften for the use of the lot. The TRB noted that

the ordinance states that the tax is to be collected by the *operator* from the person who is parking or storing the car and concluded that there was no provision under the ordinance or Parking Tax Regulation 102 that would allow the petitioner to deduct or claim as a credit the monthly fee paid for the use of the lot. The TRB distinguished this case from *City of Philadelphia vs. OLS hotel partners, L.P t/a The Four Seasons Hotel*, Case No. 9904-3244 (Philadelphia Court of Common Pleas). In that case, the City agreed and the Court affirmed the arrangement, that Parking Tax was due from the hotel, which was providing valet parking to its guests, on the difference between the fee charged to the guests and the amount paid by the hotel to the lot owners, since the City had already received Parking Tax on the portion paid by the lot owner. In this particular instance, Mr. Geften never paid any amount of the monthly fee to the City as Parking Tax and there was no evidence that he had anything to do with the lot other than to own it and to engage the petitioner to provide valet parking for his customers.