

October 19, 2015

IN RE: Jonathan B. Freedman

DOCKET NUMBERS: 36SIMERZZ9875; 36SIREFZZ9972

Statement of Record

- 1) Jonathan B. Freedman ("Petitioner") filed a Petition for Appeal with the Tax Review Board ("TRB") on May 13, 2014 requesting review of an assessment for School Income Tax (SIT) for the years 2007 through 2012. This petition was assigned TRB Docket No: 36SIMERZZ9875.
- 2) Petitioner filed a second Petition for Appeal with the TRB on October 31, 2014 requesting review of a refund denial by the Department of Revenue for a School Income Tax payment made by Petitioner for the tax year 2013. This petition was assigned TRB Docket No: 36SIREFZZ9972.
- 3) A hearing for both petitions was held before the TRB on February 10, 2015. At the conclusion of this hearing, the matter was taken under advisement and the record held open for 30 days for any additional material the parties wished to provide.
- 4) On July 21, 2015, the TRB announced the following decisions:

As to Docket No: 36SIMERZZ9875, for the tax years 2007 through 2012, the Board abated $\frac{1}{2}$ of the interest and all penalty accrued against the tax principal. Non-taxable interest should be excluded from taxation as conceded by the City of Philadelphia in the amount of \$ [REDACTED] must arrange installments in 30 days.

As to Docket No: 36SIREFZZ9972, the decision of the Board was to deny the petition.
- 5) Petitioner filed an appeal to the Court of Common Pleas on August 11, 2015 for both docket numbers.
- 6) The TRB issued a corrected decision for Docket No. 36SIMERZZ9875 on August 14, 2015, as follows "to address a mathematical/clerkly computation error". Interest income to be excluded from taxation in the amount of \$ [REDACTED]
- 7) The City of Philadelphia filed an appeal to the Court of Common Pleas on August 21, 2015 for docket number 36SIMERZZ9875.

Findings of Fact

- 1) Petitioner filed 2 Petitions for Appeal requesting:
 - a. Review of a School Income Tax assessment for the years 2007 through 2012; and
 - b. Review of a denial of his refund request for a School Income Tax payment for 2013.
- 2) The petition for review of the assessment covering years 2007 through 2012 had due \$ [REDACTED] in principal, interest of \$ [REDACTED] and penalties of \$ [REDACTED] as of the date of the TRB hearing, for a total due of \$ [REDACTED].
- 3) The petition for the refund and covering 2013 was for the amount of \$ [REDACTED].
- 4) Petitioner is a minority shareholder of a Subchapter S Corporation domiciled in Philadelphia.
- 5) The Subchapter S Corporation filed Business Income and Receipts Tax (BIRT) returns with the City of Philadelphia and paid the appropriate tax amounts for all years in question.
- 6) During the tax years in question, the Subchapter S Corporation distributed dividend income to Petitioner.
- 7) Petitioner testified that he was actively involved with the business of the corporation.
- 8) The only income Petitioner received from the corporation was the dividend income.
- 9) Petitioner did not report the Subchapter S Corporation dividend income to the City of Philadelphia as taxable income under the City's SIT during the years 2007 through 2012. He testified that his accountant did not tell him this dividend income was subject to SIT and that it therefore should be reported on his annual SIT return. Petitioner did file SIT returns for the years in question with other covered income.
- 10) When contacted, petitioner cooperated fully with the City of Philadelphia auditor. After the completion of the audit and receipt of a delinquent SIT assessment for these tax years, Petitioner filed his appeal with the TRB that was assigned Docket No: 36SIMERZZ9875.
- 11) For the tax year, 2013, Petitioner reported the Subchapter S dividend income on his SIT filing and paid the tax amount. He then requested a refund of that amount from the City of Philadelphia. The denial of that refund by the Department of Revenue was the basis for the second TRB petition assigned Docket No: 36SIREFZZ9972.
- 12) Separate and apart from any dividend income earned as a shareholder in the Subchapter S Corporation, Petitioner also earned varying amounts of interest income

each year from savings, checking or money market accounts on which the City's audit also assessed SIT.

- 13) At the TRB hearing, Petitioner submitted documentation regarding the interest income, including the dollar values earned and submitted as the total due the amount of \$ [REDACTED] which was accepted on its face by the TRB. In reality, accepting all of Petitioner's individual earnings figures as accurate, the correct total was \$ [REDACTED]

Conclusions of Law

The City of Philadelphia School Income Tax is imposed pursuant to The Philadelphia Code Chapter 19-1804 as follows:

(2) *Imposition of the Tax.*

(a) Except as excluded in subsection (3), the Board is authorized to impose a tax for the following Fiscal Years for general school purposes, on every person who is a resident of the School District of Philadelphia on the net income from the ownership, lease, sale or other disposition of real property and tangible and intangible personal property, received or credited to said person during the corresponding Tax Year as set forth in the table below, including the net income paid to any beneficiary of a trust or estate and the income of any trust or estate and of which such person is the substantial owner...

A. Petitioner argued that the SIT assessment on the dividend income specifically received from a Subchapter S Corporation is unlawful double taxation because such a corporation is subject to Philadelphia's BIRT before distribution of the dividend income to the shareholders.

It was the findings of the TRB that the School Income Tax assessment levied by the School District of Philadelphia on dividend income received by a shareholder of a Subchapter S Corporation is not duplicative of the Business Income and Receipts Tax assessments that may be levied on the Subchapter S Corporation itself by the City of Philadelphia. Different taxes assessed against different categories or classes of taxpayers by different taxing authorities does not constitute double taxation nor is it a violation of the Uniformity Clause of the Pennsylvania Constitution.

A tax is in violation of the Pennsylvania Constitution's uniformity clause and is considered a double taxation situation if two similarly situated taxpayers are classified differently for tax purposes and this classification is considered unreasonable. The S Corporation and the Petitioner-Shareholder in this case are separate classifications of taxpayers and may be treated as such for taxation purposes..

The SIT assessment for Petitioner on the income he has received from the Subchapter S Corporation was imposed by the School District of Philadelphia (Philadelphia Code §19-1804.

The tax is specifically imposed on a "Person", defined as "any individual other than a corporation who is beneficially entitled to income." (Philadelphia Code §19-1804 (1) (d)).

The BIRT assessment on income of the Subchapter S Corporation is imposed by the City of Philadelphia pursuant to the Philadelphia Code §19-2600 et seq. It is imposed on the income of the corporation that is the result of doing business in the city.

The imposition of BIRT by the City of Philadelphia on a Philadelphia based Subchapter S Corporation's business income does not prohibit the School District of Philadelphia from imposing the SIT, a separate tax, on dividends, a separate category of income received by resident shareholders of the same Subchapter S Corporation. Dividends are payments to shareholders based on the proportionate number of shares owned, and not the same category of funds as the income received by a corporation for services or goods rendered as part of its business activity.

In the current case, the taxes, the taxing authorities and the taxpayers are separate and distinct and separate entities, thus negating Petitioner's argument of double taxation.

As stated by the TRB in the case of Brian Quinn, Esq. (February 2001), and affirmed by the Court of Common Pleas "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." As in that case, the Petitioner here, as an individual shareholder, is a completely separate legal entity from the Subchapter S Corporation.

Petitioner was particularly vexed by the fact that the majority shareholder of the corporation, as a non-resident of Philadelphia, was not subject to the SIT. However it was the shareholders or corporate owners who chose the corporate structure, not the city, and no doubt, there were other considerations, tax or non-tax related that influenced this decision. There was ample opportunity to consider all tax ramifications. The city is not responsible if at this date, Petitioner has regrets or dissatisfaction with that choice.

Petitioner also argued that he performed significant services for the S Corporation and therefore this income should not be classified as unearned dividend income. If, in fact, this income should have been characterized as earned income, the onus to so classify it does not fall to the City but to the corporation and the taxpayer. The City determination and analysis was based on the corporation's and the taxpayer's own reporting, not on the City's independent analysis of what services Petitioner may or may not have performed for the corporation. This income was classified by the corporation and accepted by Petitioner as a dividend, and therefore accepted as such by the City. It is not linked to any services provided.

B. In conducting the audit, SIT was assessed on interest income earned by Petitioner from various interest bearing savings, money market and checking accounts.

The Philadelphia Code lists, inter alia, the following exclusions from the SIT in Chapter 19-1804(3) as follows:

(b) Interest and dividends received or credited on savings deposits and savings certificates issued by any private bank, building and loan association, savings and loan association, credit union, savings bank, bank and trust company, or trust company ...

The City conceded that this interest income was not assessable purposes of SIT and the Tax Review Board decision affirmed that Petitioner's interest income was not subject to the SIT.

At the hearing, using Petitioner's figures from his trial memorandum, the interest figure to be excluded was stated as \$ [REDACTED] and this figure was memorialized in the original Tax Review Board decision. At that time, while the City's attorney conceded the overall issue that the interest income was not subject to the SIT, he qualified his statement that he only conceded that the excludable figure was \$ [REDACTED] "assuming that he added it up correctly, which I'm not actually sure he did... Notes of Testimony, February 10, 2015, Page 44.

A further review of Petitioner's memorandum after the hearing and the issuance of the decision on July 21, 2015, brought to light a mathematical error by Petitioner in adding the column of figures that listed the various amounts of interest to be excluded from the SIT. The City and the TRB accept the individual interest figures, as provided by and agreed to by Petitioner, which actually total \$ [REDACTED]

To correct the record, the TRB issue a corrected decision letter on August 14, 2015 listing the individual interest amounts and the corrected total of \$10,015 to be excluded from the SIT calculations. Petitioner does not get the benefit of his own mathematical error which misstated the total amount of his interest income.

However, the City conceded and the TRB memorialized that the actual income earned of \$ [REDACTED] is not subject to SIT.

The decision of the TRB as to Docket Number 36SIMERZZ9875 was to abate ½ interest and all penalty as Petitioner, through both his testimony, his history of SIT filings and his cooperation with the City's audit requests demonstrated that he met the standard of good faith, lack of negligence and no intent to defraud the City expressed in The Philadelphia Code Chapter 19-1705 that provides authority for the Tax Review Board to abate interest and/or penalty wear it deems the circumstance warrant such abatement.

Concurred:

Nancy Kammerdeiner, Chair

Joseph Ferla

Martin Bednarek

Kaitlin McKenzie-Fiumara, Esq.