

November 26, 2008

IN RE: **ACE AMERICAN INSURANCE COMPANY, INC.**  
DOCKET. NO: **36WMMERZZ9625**

**STATEMENT OF RECORD:**

1. ACE American Insurance Company, Inc. (hereafter "Petitioner") filed a petition for review of a Philadelphia Wage Tax assessment, interest and penalties on August 18, 2004.
2. The principle amount due was \$518,462, with interest due of \$389,002.13 and penalties of \$546,979.20 through June 10, 2008.
3. A Stipulation of Facts and briefs were submitted by both parties. Oral argument was held before the Tax Review Board on June 10, 2008 following which the matter was taken under advisement.
4. On July 15, 2008, the Tax Review Board announced its decision to deny the petition.
5. Petitioner filed an appeal to the Philadelphia Court of Common Pleas.

**FINDINGS OF FACT:**

1. The Tax Review Board hereby incorporates by reference the Stipulation of Facts signed by the parties on May 22, 2007.

**SUMMARY:**

Petitioner is a corporation located in Philadelphia. During the tax years in question it offered 2 deferred compensation plans to certain employees and officers. Eligible employees could choose to receive their compensation immediately as earned or choose to defer a portion of their earned compensation into one of the Petitioner sponsored plans.

The election to defer was made in the year prior to when the services were rendered. Salary deferrals were deducted from the employee's paycheck and credited toward the deferral account of their election.

Funds could be withdrawn only in the case of an unforeseeable emergency or upon separation from employment.

Philadelphia Wage Tax was not withheld from the earnings that were deferred into these plans. The City is seeking Wage Tax on the deferred income as of the time the income was earned.

**CONCLUSIONS OF LAW:**

It is the finding of the Tax Review Board that the compensation which Petitioner's employees elected to defer to individual deferred accounts was subject to Philadelphia Wage Tax in the years those wages were earned.

The City of Philadelphia imposes its Wage Tax on "salaries, wages, commissions and other compensation due" to City residents regardless of their place of employment, and non-City residents employed in the City. The Philadelphia Code Chapter 19-1502(1).

The Philadelphia Code Chapter 19-1501(10) provides the following definition:

“Salaries, Wages, Commissions and Other Compensation. All salaries, Wages, commissions, bonuses, incentive payments, fees and tips that *may accrue or be received...* for services rendered...” (emphasis added).

Certain employees of Petitioner were offered the opportunity to elect to defer a portion of their earned compensation. Such election was required to be made in the year prior to when that income was to be earned and was then irrevocable for that year.

These elections to defer income provided certain federal and state benefits not provided in The Philadelphia Code as it pertains to the Wage Tax.

The City of Philadelphia taxes all types of deferred compensation regardless of the taxation decisions of the federal government and the Commonwealth of Pennsylvania to exclude deferred compensation from the definition of “compensation” and to provide different rules for taxing this income. The City is not required to tax this compensation in the same way as the federal or state governments.

It is the finding of the Tax Review Board that the Philadelphia Wage Tax ordinance and regulations do not provide for Wage Tax deferral on deferred compensation of this nature.

There are certain specific exclusions set forth in The Philadelphia Code Chapter 19-1501(10) and in the City of Philadelphia Income Tax Regulations Section 104. Earned income deposited in deferred compensations plans such as those provided by Petitioner are not included in these exclusions.

The Philadelphia Code Chapter 19-1501 provides that the Philadelphia Wage Tax is assessed in the year the compensation was earned. The employees exercised choice to defer compensation to another year and although not actually received by the employee it is constructively received by him/her in the year it is earned and credited to the deferred compensation account. Participants in both plans voluntarily chose to not take their full pay and to defer receipt of the monies they earned to another tax year by investing in Petitioner’s deferred compensation plans. But for this election, the employee would have received the money in the year it was earned and therefore it is subject to Wage Tax in the year it was earned. The requirement of The Philadelphia Code is quite clear that the income is considered earned and taxable if it “may accrue or be received”. The fact that Petitioner’s employees chose not to receive it at that time does not alter its taxable status for purposes of the Wage Tax.

Petitioner argued that the funds were not constructively received by the employees in the year that the compensation was earned because they elected in the prior year to have it deferred and therefore were no longer eligible to receive it without either substantial penalty or having to show an unforeseen emergency. Petitioner argued there is no constructive receipt if the participant has no right to receive the cash being deferred once the election is made and the deferral is agreed to before the compensation is earned. But the employees in the instant case did have the right to the cash but chose to defer receipt.

The doctrine of constructive receipt provides that a payment is deemed received if the funds were available to the recipient. The Petitioner's employees could have chosen to receive the funds and had a legal right to the funds but chose to defer actual receipt. They exercised control over the funds due and owing to them by making their election to defer.

The Petitioner cited Tax Review Board Opinion 79-2, In Re: Pauline Kunkel, among other authorities, to support its position that the deferred compensation is not subject to tax and to show that the Tax Review Board has already so ruled. This case is distinguishable from the current case in that it involves taxation of monies from a profit sharing plan at the time of distribution not prior to or at the time that services are rendered and monies credited or withheld for the future benefit of the employee. Petitioner cited this case for the proposition that there is no constructive receipt if the Participant has no right to the cash when he or she makes the election. The Tax Review Board stated, in that opinion, that "(i)t is our opinion in the circumstances that the First Pennsylvania Bank should have withheld on those amounts it contributed to the plan. The fact that it did not do so is not the issue here. The issue here is the liability for City wage taxes on the amounts contributed to Mrs. Kunkel's account. For the reasons stated above it is our opinion that the lump sum she received is taxable in full." So although not the direct issue before them, the Tax Review Board in the Kunkel case did acknowledge that, in their opinion, the Wage Tax should have been withheld on the amounts contributed to the plan, and then went on to find the lump sum distribution received by the petitioner to be subject to Wage Tax as that was the issue before them.

The responsibility to collect and remit the Wage Tax to the City of Philadelphia rests with "(e)ach employer within the City who employs one or more persons on a salary, wage, commission or other compensation (and who) shall deduct at the time of payment thereof, the tax imposed by this Chapter on the salaries, wages, commissions and other compensation due from said employer to the said employee..." The Philadelphia Code Chapter 19-1504(1). The responsibility rested with Petitioner, the employer, to withhold and remit Wage Tax on the compensation earned by its employees and deposited into the deferred income accounts.

The decision of the Tax Review Board was to deny the petition.

**Concurred:**

Monique DeLapenha, Esq., Chair  
T.Davis Williams, Esq.  
LaVon Wells-Chancy, CPA  
Joseph Ferla  
Mary Mason