CITY OF PHILADELPHIA
LAW DEPARTMENT
TAX & REVENUE UNIT

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[redacted]

Dear [redacted]

This ruling is issued by the Tax Unit of the City of Philadelphia Law Department and the Technical Staff of the Philadelphia Department of Revenue in response to your March 22, 2023 request for a ruling ("Ruling Request"). You have requested an opinion as to the Philadelphia Business Income and Receipts Tax (BIRT) treatment of the portion of gains from an asset sale that is attributable to goodwill and intangible assets. This opinion is based on the facts provided to the City in your letter dated March 22, 2023.

Facts

Taxpayer is [redacted] ("Taxpayer") which was formed on December 30, 2021. Taxpayer is domiciled in New Jersey but engages in business activity in Philadelphia. On February 10, 2022, units of [redacted] ("Subsidiary") were transferred to Taxpayer and on February 12, 2022, an election was made to treat Subsidiary as a disregarded entity. Prior to December 30, 2021, Subsidiary was a stand-alone company filing Business Income and Receipts Tax returns. Taxpayer's activities are classified under NAICS code 518210 (data processing, hosting, and related services).

On March 20, 2022, Subsidiary was acquired by Akami Technologies, Inc. The sale of Subsidiary was treated as an asset acquisition subject to allocation under Internal Revenue Code §1060. A portion of the purchase price was allocated to intangible assets and goodwill of Subsidiary. Taxpayer has taken the position that Subsidiary's "goodwill, its reputation for example, is attributable over the life of [Subsidiary's] business upon all of its activities in all jurisdictions where it engaged in business prior to the acquisition." (Ruling Request pg. 5).

Questions Presented

Taxpayer acknowledges that the purchase price is business income but seeks guidance on the treatment of the portion of the purchase price that has been allocated to Subsidiary's intangible assets and goodwill. Specifically, Taxpayer raises the following questions:

1. Is gain attributable to the sale of intangible assets and goodwill includible in taxable receipts for purposes of calculating BIRT gross receipts?
2. Is gain attributable to the sale of intangible assets and goodwill includible in the receipts factor for purposes of calculating BIRT net income?
3. If includible, how should the gain attributable to the sale of intangible assets and goodwill be sourced for purposes of calculating BIRT gross receipts and net income?

Law

The Business Income and Receipts Tax (BIRT) is imposed "upon every person engaging in any business in the City of Philadelphia." Phila. Code §19-2603(1). The BIRT is comprised of a gross receipts portion and a net income portion. Phila. Code §19-2604(1).

Receipts are defined as "[c]ash, credits, property of any kind or nature, received from conducting any business or by reason of any sale made. . . or services rendered or commercial or business transactions. . . ." Phila. Code §19-2601. Taxable Receipts exclude receipts attributable to any sales delivered outside of Philadelphia and any services performed outside of Philadelphia, as long as such delivery or performance is not made for the purpose of avoiding payment of the BIRT. Phila. Code §19-2601.

The Department of Revenue's BIRT regulations provide that when a Taxpayer's receipts "both inside and outside Philadelphia are incapable of segregation, the taxpayer may petition for, or the Department may require, the employment of any other method to effect an equitable apportionment of the taxpayer's receipts to accurately and fairly reflect business activity in Philadelphia." BIRT Reg. §327.

Net income is calculated using one of two methods which is elected by the taxpayer. BIRT Reg. §401. Taxpayer's election is irrevocable. Id. Under Method II, Net income is "the portion of the taxpayer's adjusted taxable income (or loss) from any business activity as properly returned to and ascertained by the Federal Government prior to giving effect to the exclusion for dividends received and for net operating losses, which is apportioned to Philadelphia. . . ." BIRT. Reg. §404(A)

For tax years 2015 and later, net income is to be apportioned using a single sales factor. BIRT Reg. §408. Under the BIRT Regulations, software companies are required to use market-based sourcing. "Under market-based sourcing, the gross receipts of a Software Company from the performance of services are included in the numerator of the Single Sales Apportionment Factor if the recipient of the service receives all of the benefits of the service in Philadelphia." BIRT Reg. §408.G.1. Software companies include businesses whose activities are classified under NAICS code 518210. Id.

Discussion

Taxpayer realized income in the 2022 tax year from its sale of Subsidiary. A portion of the purchase price of Subsidiary was allocated to intangible property and goodwill. Taxpayer acknowledges that the value of Subsidiary's goodwill is attributable to the life of Subsidiary's business and upon all its activities in all of the jurisdictions in which it engaged in business. Stated differently, a portion of the value of Subsidiary's intangible property and goodwill derives from Subsidiary's business activities conducted in Philadelphia.

Taxpayer suggests that the gain attributable to Subsidiary's intangible property and goodwill should be excluded from both the BIRT gross receipts calculation and the net income receipts factor because intangible property and goodwill cannot be sourced between the various locations where Subsidiary engaged in business. However, the BIRT regulations provide for situations where receipts are not easily segregated for purposes of sourcing.

When receipts cannot be segregated between Philadelphia and other jurisdictions, BIRT Regulations Section 327 provides for the use of "any other method to effect an equitable apportionment" that will fairly reflect the receipts attributable to business activity in Philadelphia. The alternative apportionment method can be requested by the Taxpayer or required by the Department.

Subsidiary filed BIRT returns reporting Philadelphia receipts for tax years 2018 through 2021. In light of the connection between the value of the goodwill and intangible assets and Subsidiary's business over time and across jurisdictions, the City determines that an equitable apportionment can be achieved by applying a sales factor based on the percentage of receipts attributable to Philadelphia, calculated prior to inclusion of the receipts attributable to the sale of intangible assets and goodwill. Once calculated, the sales factor should be used to apportion the gain received from sale of intangible assets and goodwill for both gross receipts and net profits.

Conclusion

The gain attributable to the Taxpayer's sale of the intangible assets and goodwill of Subsidiary are includible in Taxpayer's gross receipts and net income. Because the receipts attributable to Subsidiary's goodwill and intangible assets are incapable of segregation, Taxpayer should determine the apportionment of those receipts using the formula provided above.

Sincerely,

Frances Ruml Beckley
Chief Revenue Counsel

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