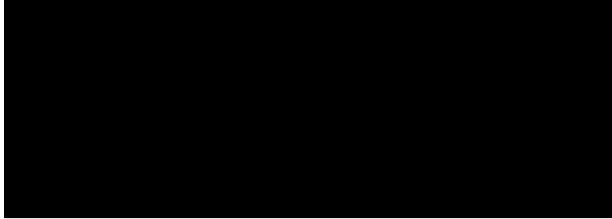





April 29, 2021






**Re: Apportionment of Business Income and Receipts Tax Net Income
Attributable to Goodwill and Gross Receipts Attributable to IRC § 338
(h)(10) Sale Transaction**

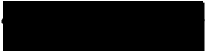

Dear 


This ruling is issued by the Tax & Revenue Unit of the Law Department and the Technical Staff of the Department of Revenue and responds to your request for a ruling on 1) the proper apportionment of net income realized by , Inc. () from the sale of its stock to the extent the income is attributable to goodwill and 2) whether the amounts from the sale of  stock are subject to the gross receipts portion of the Business Income and Receipts Tax.

Summary Conclusions

- 1) 's net income from the sale of its stock that is attributable to goodwill should be apportioned to the City of Philadelphia based on the ratio of its receipts in the City of Philadelphia to its receipts everywhere during the year of the sale.
- 2) The amount from the sale of  stock is subject to the gross receipts portion of the Business Income and Receipts Tax. The amount should be apportioned in a manner consistent with the ratio of 's Philadelphia sales to its sales everywhere during the year of the sale.

Facts

This ruling is based upon the following facts as detailed in 's letter of April 9, 2021, as well as 's revised letter of April 21, 2021.

-  is a Delaware corporation with its commercial domicile in Philadelphia, Pennsylvania.

- [REDACTED] is the sole owner of [REDACTED], LLC (“LLC”), which is a single member limited liability company engaged in the business of providing critical engineering, information technology, and management of complex technology.
- LLC is a disregarded entity that is treated as an S corporation for federal and Pennsylvania income tax.
- All of [REDACTED]’s voting stock is owned by [REDACTED], Inc. Employee Stock Ownership Trust (“MDG”).
- MDG owns 99.1 percent of [REDACTED]’s issued and outstanding stock.
- MDG is an Employee Stock Ownership Trust.
- MDG entered into an agreement to sell 100% of the stock of [REDACTED] to a third party (“Sale Transaction”).
- As part of the Sale Transaction, MDG intends to make an IRC § 338(h)(10) election, which recharacterizes a stock purchase as an asset purchase for federal income tax purposes.
- [REDACTED] expects the Sale Transaction will result in a gain for [REDACTED] for federal income tax purposes.
- Nearly all of the gain from the Sale Transaction will be attributable to goodwill; only one percent of the proceeds from the Sale Transaction will be allocated to tangible assets [REDACTED] used in its business.
- [REDACTED] has approximately 40 locations and more than 500 employees situated throughout the United States, who perform work at [REDACTED]’s offices, customer locations, and at employees’ home offices.
- [REDACTED] is a Method II taxpayer for City of Philadelphia tax purposes.

Conclusion One

[REDACTED]’s net income from the Sale Transaction that is attributable to goodwill should be apportioned to the City of Philadelphia using the ratio of its receipts in the City of Philadelphia to its receipts everywhere during the year of the sale.

Discussion

Section 19-2604 of The Philadelphia Code (“Code”) imposes the Business Income and Receipts Tax upon taxpayers’ gross receipts and net income. Consistent with constitutional

requirements¹, business income is apportioned to accurately and fairly tax the income attributable to doing business in the City of Philadelphia.² For the years 2015 and after, the City of Philadelphia utilizes a single sales factor to apportion a taxpayer's business income.³ The single sales factor apportions business income "based solely on the ratio of [t]axable [r]eceipts of the business from within the City of Philadelphia to the total [r]eceipts of the business everywhere."⁴ The single sales factor ratio "includes business income from the sale of inventory or the performance of services as well as interest, dividends, rentals, royalties, capital gains, or any other income that given the taxpayer's business activity would be classified as business income."⁵ In the context of business income received from intangible property, the Pennsylvania Supreme Court found that apportionment fails to comport with constitutional requirements when it taxes business income resulting from underlying activities that occurred in other taxing jurisdictions in a manner that is "out of all proportion" or otherwise bears "no rational relationship" to the business transacted in the City of Philadelphia.⁶

Goodwill is "[a] business's reputation, patronage, and other intangible assets that are considered when appraising the business . . . for purchase."⁷ Goodwill is "an intangible asset that is only realized at the time a business is sold."⁸

██████████ is a Method II taxpayer for City of Philadelphia tax purposes, and ██████████ acknowledges that it will realize taxable gain on the Sale Transaction for federal income tax

¹ Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

² Sections 405 (A-B), 408 (H) of the City of Philadelphia Business Income and Receipts Tax Regulations.

³ Section 408 (G) of the City of Philadelphia Business Income and Receipts Tax Regulations.

⁴ Id.

⁵ Id.

⁶ Philadelphia Eagles Football Club, Inc. v. City of Philadelphia, 823 A.2d 108, 131 (Pa. 2003).

⁷ Sys. & Computer Tech. Corp. v. Com., 41 A.3d 961, 965 (Pa. Commw. Ct. 2012).

⁸ Id.

purposes.⁹ As a result, the taxable gain recognized for federal tax purposes must be recognized for City of Philadelphia tax purposes, as well, subject to proper apportionment. [REDACTED] maintains its commercial domicile in the City of Philadelphia, and it has approximately 40 locations and more than 500 employees situated throughout the United States, who perform work at [REDACTED]'s offices, customer locations, and at employees' home offices. As a result, [REDACTED] generates some business income that is attributable to its activities within the City of Philadelphia and other business income that is attributable to activities conducted outside of the City of Philadelphia. The goodwill component of the Sale Transaction reflects the value of factors such as [REDACTED]'s reputation and client relationships, which were developed and enhanced by business activity carried out by [REDACTED] executives and employees situated within the City of Philadelphia and elsewhere over several years; however, ultimately, goodwill is realized at the time of the Sale Transaction. As a result, the goodwill component of the Sale Transaction should be apportioned using the single sales factor ratio for the year of the Sale Transaction.¹⁰

Based on the foregoing, any gain on the Sale Transaction attributable to goodwill should be apportioned using the single sales factor ratio for the year in which the Sale Transaction occurs.

⁹ See Section 404(A) of the City of Philadelphia Business Income and Receipts Tax Regulations (“Method II Net Income shall be 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 . . .”).

¹⁰ The use of [REDACTED]'s single sales factor ratio for the year of the Sales Transaction assumes that the ratio for the year of the Sales Transaction is roughly representative of [REDACTED]'s business activities during the preceding years, when the goodwill was created, so that it does not grossly distort the income from goodwill attributable to Philadelphia. See Section 407 (H) of the City of Philadelphia Business Income and Receipts Tax Regulations (“if the applicable formula will lead to a grossly distorted result in a particular case, a fair and accurate alternative method is appropriate.”).

Conclusion Two

The amount from the Sale Transaction is subject to the gross receipts portion of the Business Income and Receipts Tax. The amount should be apportioned in a manner consistent with the ratio of [REDACTED]'s Philadelphia sales to its sales everywhere during the year of the Sale Transaction.

Discussion

The definition of “receipts” set out in the City of Philadelphia Business Income and Receipts Tax Regulations (“Regulations”) is broad and inclusive.¹¹ However, Section 302 of the Regulations provides several enumerated, exclusionary carve-outs from that broad and inclusive definition of “receipts.”¹² Specifically, Section 302(R)(4) excludes “capital gains” from “receipts,” but solely for insurance businesses.¹³

The Department of Revenue’s interpretation of its own regulations are controlling and entitled to “great deference” unless “plainly erroneous or inconsistent.”¹⁴ Pennsylvania law sets forth that “[e]xceptions expressed in a statute shall be construed to exclude all others.”¹⁵ Further, Pennsylvania courts have endorsed the “longstanding application” of the maxim of *expressio unius est exclusio alterius* when interpreting statutes and regulations.¹⁶ *Expressio unius est exclusio alterius* stands for the proposition that “all omissions should be understood as exclusions.”¹⁷ Additionally, Pennsylvania law counsels that parts of a single authority are *in pari materia* and should be construed together when the parts relate to the same persons or things or

¹¹ See Section 301 of the City of Philadelphia Business Income and Receipts Tax Regulations.

¹² See Section 302 (A – X) of the City of Philadelphia Business Income and Receipts Tax Regulations.

¹³ See Section 302 of the City of Philadelphia Business Income and Receipts Tax Regulations.

¹⁴ Joyce Outdoor Advert., LLC v. Dep’t of Transp., 49 A.3d 518, 524 (Pa. Commw. Ct. 2012); City of Philadelphia v. Tax Rev. Bd. to Use of Ace Dump Truck Serv., 631 A.2d 1072, 1076 (Pa. Cmwlth. 1993).

¹⁵ 1 Pa.C.S. § 1924.

¹⁶ Com. v. Ostrosky, 866 A.2d 423, 430 (Pa. Super. 2005), aff’d, 909 A.2d 1224 (Pa. 2006) (“[t]he maxim, *expressio unius est exclusio alterius*, establishes the inference that, where certain things are designated in a statute, all omissions should be understood as exclusions. *The maxim is one of longstanding application, and it is essentially an application of common sense and logic.*”).

¹⁷ Id.

to the same class of persons or things.¹⁸

Here, ██████ will realize a capital gain from the Sale Transaction. By realizing capital gain from the Sale Transaction, ██████ realized a “receipt.” Section 301, which defines “receipts” and Section 302, which provides enumerated exclusions to the definition of “receipts” function together to define the ambit of what constitutes “receipts,” and as a result, should be construed together. Section 302 (R) excludes a single, narrow class of capital gain from “receipts” – capital gains from the conduct of insurance business. The exclusion of this single, narrow class of capital gain from “receipts” is to be construed as preserving the inclusion of all other classes of capital gain within the definition of “receipts.” The carefully tailored Section 302(R) exclusion to the definition of “receipts,” along with the omission of any other type of capital gain from the lengthy list of specific Section 302 exclusions, delimits the exceedingly small universe of capital gains not constituting receipts (*i.e.* capital gains realized by insurance businesses), leaving all other classes of capital gain - *including capital gain realized from a Section 338(h)(10) election* - firmly within the definition of “receipts.” All capital gains other than insurance business capital gains are “receipts” because to hold otherwise would render Section 302(R) superfluous, as there would be no need to specifically exclude insurance business capital gains if capital gains, generally, were not “receipts.”

Consistent with constitutional requirements and facts pertaining to the character of the Sales Transaction and ██████’s business operations previously identified in the discussion section pertaining to Conclusion One of this Ruling, the amount stemming from the Sale Transaction that formed the basis of the capital gain should be apportioned to the City of

¹⁸ 1 Pa.C.S. § 1932.

Philadelphia using the ratio of [REDACTED]'s Philadelphia sales to its sales everywhere during the year of the Sales Transaction.¹⁹

Based on the foregoing, the amount from the Sale Transaction is subject to the gross receipts portion of the Business Income and Receipts Tax. The amount should be apportioned in a manner consistent with the ratio of [REDACTED]'s Philadelphia sales to its sales everywhere during the year of the Sale Transaction.

This ruling was prepared based upon the facts presented and can only be relied upon by the entity named in it and is not to be treated as a precedent in any other context. This ruling is not intended to have nor does it have any precedential value. The City expresses no opinion as to any matters not expressly set forth herein. The ruling will remain in effect as long as the facts presented in this ruling remain unchanged, until a change in the law dictates a different treatment or until the Revenue Department or the Law Department informs the taxpayer in writing that the ruling is no longer applicable. The City retains the rights to audit the entity named in this ruling.

Sincerely yours,



Frances Ruml Beckley, Esq.
Chief Counsel to the Revenue Department

¹⁹ See supra Note 10.