

**CITY OF PHILADELPHIA  
BUSINESS PRIVILEGE TAX REGULATIONS**

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**CITY OF PHILADELPHIA**  
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**SECTION 101. DEFINITIONS.**

The following words and phrases, when used in these Regulations, have the meanings ascribed to them in this section, except where the contents clearly indicate another or a different meaning.

A. "Affiliated group." One or more chains of corporations connected through stock ownership with a common parent corporation if:

- (1) Stock possessing at least eighty (80%) percent of the voting power of all classes of stock and at least eighty (80%) percent of each class of the nonvoting stock of each corporation, except the common parent corporation, is owned directly by one or more of the other corporations.
- (2) The common parent corporation owns directly stock possessing at least eighty (80%) percent of the voting power of all classes of stock and at least eighty (80%) percent of each class of the nonvoting stock of at least one of the other corporations.

As used in this definition, "stock" does not include non-voting stock which is limited and preferred as to dividends.

B. "Allocation." The assignment of nonbusiness income (or losses) within or without the City of Philadelphia.

C. "Apportionment." The process of assigning receipts or business income (or losses) within and without the City of Philadelphia by the use of a formula containing one or more apportionment factors.

D. "Business." Carrying on or exercising for gain or profit within Philadelphia any trade, business, including financial business as hereinafter defined, profession, vocation or commercial activity or making sales to persons within the City of Philadelphia. "Business" shall not include the following:

1. Those activities conducted by a nonprofit corporation or association organized for religious, charitable or educational purposes, if such activities are directly related to its religious, charitable or educational purposes.
2. The business of any political subdivision, or of any authority created and organized under and pursuant to law of this Commonwealth.
3. The specific business conducted by any public utility operating under the laws, rules and regulations administered by the Pennsylvania Public Utility Commission or conducted by a business subject to the jurisdiction of the Interstate Commerce Commission of furnishing or supplying service or services at the rates specified in its tariffs.
4. The business of any insurance company, association or exchange, or any fraternal, benefit or beneficial society of any other state under the laws of which insurance companies,

associations or exchanges or fraternal, benefit or beneficial societies of Pennsylvania doing business in such other state are subjected, by reason of the tax imposed by the ordinance, to additional or further taxes, fines, penalties or license fees by such other state.

5. Any employment for a wage or salary.
  6. Credit Unions chartered by the U.S. Govt. or the Comm. of Pa.
  7. The business of loading or discharging cargo to or from vessels when conducted on piers, wharves or marine terminal facilities in the Port of Philadelphia and related business activities conducted on such premises such as furnishing dockage, wharfage, truck and/or railroad car loading and unloading, and storage of cargo which is to be loaded onto or has been discharged from vessels at a pier, wharf or marine terminal facility in the Port of Philadelphia. (Bill No. 877 introduced 4/3/86 amending Section 19-2601 of the Philadelphia Code.)
  8. Doing business shall not include rental income generated from real property which is the principal residence of the owner and consists of three or less residential units.
- E. "Business Income." Income (or loss) arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income (or loss) from tangible and intangible property if the acquisition, management or disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. In essence, all income which arises from the conduct of trade or business operations of a taxpayer is business income. The income of a taxpayer is business income unless clearly classifiable as nonbusiness income. A Taxpayer's Trade or Business is not limited to corporate charter purpose or principal business activity. A taxpayer may be in more than one trade or business depending upon but not limited to some or all of the following:
- (i) The nature of the taxpayer's activities.
  - (ii) The substantiality of the income derived from activities and transactions and the percentage that income is of the taxpayer's total income for a given tax period.
  - (iii) The frequency, numbers, or continuity of the activities and transactions involved.
  - (iv) The length of time the property producing income was owned by the taxpayer.
  - (v) The taxpayer's purpose in acquiring and holding the property producing income.
- F. "Collector." The Revenue Commissioner of the City of Philadelphia.
- G. "Corporation." A corporation, joint stock association, or joint stock company organized under the laws of the United States, the Commonwealth of Pennsylvania or any other state, territory, or foreign country or dependency.
- H. "Cost of Goods." In the case of a retailer or wholesaler, the cost of goods, wares, commodities, and merchandise purchased by the retailer or wholesaler and resold by him, such cost to include all freight-in charges.
- I. "Cost of Labor." In the case of a retailer or wholesaler, the cost of the labor of his employees used in receiving, storing, shipping, and delivering the goods, wares, commodities or

merchandise purchased for resale and the cost of the salaries or commissions paid to his employees for making the actual sales of the goods, commodities or merchandise.

- J. "Dividends." Any distribution made by a corporation to its shareholders in respect of its stock, whether ordinary, extraordinary or in liquidation.
- K. "Employee." Any officer of a corporation and any individual who, under the usual common-law rules applicable in determining the employer-employee relationship has the status of an employee. Generally, a person will be considered to be an employee if he is included by the taxpayer as an employee for the purposes of the payroll taxes imposed by the Federal Insurance Contributions Act; except that, since certain individuals are included within the term "employees" in the Federal Insurance Contributions Act who would not be employees under the usual common-law rules, it may be established that a person who is included as an employee for purposes of the Federal Insurance Contributions Act is not an employee for purposes of this definition.
- L. "Factors and Commission Merchants." A factor, or commission merchant, is an agent employed to sell goods or merchandise consigned or delivered to him, by or for his principal, for a consideration commonly called factorage or commission. Factors, or commission merchants, as distinguished from selling agents, or merchandise brokers, are deemed to be engaged in a financial business, and shall include in the tax base the gross income derived from operations carried on in such capacity. A factor, or commission merchant, differs from a selling agent, or merchandise broker, in the following respects:
1. A factor, or commission merchant, may sell for his principal in his own name as well as in the name of his principal. On the contrary, a selling agent, or merchandise broker, acting as such, may sell only in the name of his principal.
  2. A factor, or commission merchant, is entrusted with possession, management and control of the goods, and has a special property in, and lien on, the goods. The selling agent, or merchandise broker, on the contrary, usually has no such possession, management or control of the goods, nor any such special property or lien.
- M. "Financial Business." The services and transactions of private banks and bankers; building and loan associations; savings and loan associations; credit unions; savings banks; banks; bank and trust companies; trust companies; investment companies registered as such with the Federal Securities and Exchange Commission; holding companies; persons registered under the act of December 5, 1972 (P.L. 1280, No. 284) known as the Pennsylvania Securities Act of 1972, including traders, dealers and brokers in money, credits, commercial paper, bonds, notes, securities and stocks, and monetary metals; factors and commission merchants; consumer discount companies; sales finance companies; purchase money lenders.
- N. "Foreign Commerce." In general, foreign commerce includes trade between the United States and foreign countries. Trade with territories and possessions of the United States is also considered to be foreign commerce.

- O. "Manufacture." The application of skill, science and labor by which raw materials are changed into a new, different and useful article as a result of having undergone a substantial transformation in form, qualities and adaptability in use. The term is limited to that of its common meaning.
- P. "Manufacturer." A person whose business consists in part or in its entirety of the sale of goods, commodities, wares, or merchandise of its own manufacture, growth or production.
- Q. "Monetary Metal Dealers." Dealers in monetary metals are persons engaged in the business of buying and selling gold and silver in bullion or fine state, as distinguished from buying and selling gold and silver which has been processed or manufactured into products or articles for commercial or industrial use.
- R. "Net Income." See Sections 403 and 404 of these provisions.
- S. "Net Operating Loss." See Section 411 of these provisions.
- T. "Nonbusiness Income." All income (or loss) other than business income.
- U. "Person." Any individual, partnership, limited partnership, association, corporation, estate or trust. When used in any provision prescribing or imposing a penalty, the term "person," as applied to associations, shall mean the partners or members thereof, and as applied to corporations, the officers thereof.
- V. "Port of Philadelphia." Piers, wharves and marine terminal facilities entering into or abutting either the Delaware or Schuylkill Rivers which are within the confines of the City of Philadelphia.
- W. "Production." The manufacture of personal property.
- X. "Receipts." See Section 301 of these provisions.
- Y. "Regulated Industry." A person subject to a tax pursuant to Articles VII (Bank Shares Tax), VIII (Title Insurance and Trust Companies Shares Tax), IX (Insurance Premiums Tax) or XV (Mutual Thrift Institutions Tax) of the Tax Reform Code of 1971 or any public utility operating under the laws, rules and regulations administered by the Pennsylvania Public Utility Commission, all or a portion of the activities of which is to furnish or supply service or services at the rates specified in its tariffs, but not including contract carriers.
- Z. "Residence of an Estate or Trust." The residence of an estate or trust is deemed to be in the county of the court which has jurisdiction of the estate or trust, if no court has assumed jurisdiction the place of residence of the testator or settlor.
- AA. "Retail." The sale of goods, commodities, wares or merchandise other than at wholesale and other than goods, commodities, wares or merchandise of the seller's own manufacture, growth or production.
- BB. "Retailer." A person whose business consists in part or in its entirety of the sale of goods, commodities, wares, or merchandise at retail.
- CC. "Sale." Transfer of title to goods, wares, commodities or merchandise, regardless of where accomplished, the delivery of which is made within the City of Philadelphia. If the other party to the transaction is within the City of Philadelphia, delivery to a location not maintained by the

other party to the transaction outside the City of Philadelphia shall be deemed to be delivery within the City of Philadelphia. "Sale" shall not include any intra-company transfers.

- DD. "Taxpayer." A person required by ordinance or regulations to file a Business Privilege Tax Return.
- EE. "Tax Year." A 12-month period from January 1 to December 31, inclusive.
- FF. "Temporary, Seasonal, or Itinerant Business." Any business that is conducted for a total of less than 30 consecutive or intermittent days in any one tax year.
- GG. "Wholesale." The sale of goods, commodities, wares or merchandise to a dealer or vendor of such goods, commodities, wares or merchandise.
- HH. "Wholesaler." A person whose business consists in part or in its entirety of the sale of goods, commodities, wares or merchandise at wholesale.

## ***SECTION 102. TO WHOM THE ORDINANCE APPLIES.***

Both the license and tax provisions of the Ordinance apply to:

- (1) Wholesale dealers or vendors.
- (2) Retail dealers or vendors.
- (3) Manufacturers.
- (4) Persons registered under the Pennsylvania Securities Act of 1972.
- (5) Regulated industries, which include banks, title insurance companies, trust companies, insurance companies, mutual thrift institutions, and public utilities.
- (6) All other persons doing business in Philadelphia.

## ***SECTION 103. WHAT CONSTITUTES DOING BUSINESS (HAVING NEXUS) IN PHILADELPHIA.***

### **A. GENERAL**

The presence of taxable activity in the City within the meaning of the Business Privilege Tax ("BPT") Ordinance is essentially a factual determination to be made on a case by case basis. In general, taxable activity includes any trade, business, profession, vocation or any manufacturing, commercial, service, financial or utility business or activity that originates from, is carried on through, directed from or otherwise attributable to Philadelphia.

Any person who engages in a taxable activity in Philadelphia or attributable to Philadelphia is subject to this tax whether or not such person is a resident and whether or not such person has a permanent place of business in Philadelphia. Any person is subject to this tax if such person carries on a taxable activity in Philadelphia or attributable to Philadelphia, whether or not such person is licensed to do business in Philadelphia. Whether such taxpayer is subject to the full BPT tax or only to the Gross Receipts portion depends on the level and the nature of the taxpayer's activity within Philadelphia.

A taxpayer is subject to the Gross Receipts portion of the BPT when it has sufficient contact with the City to be taxed without violating the United States Constitution. A taxpayer is subject to the Net Income portion of the BPT when it has sufficient contact with the City to be taxed without violating the United States Constitution and Public Law 86-272. Only the sale of tangible personal property is afforded immunity under Public Law 86-272. The provision of services for a fee, the sale of other than tangible personal property, the leasing, renting, licensing or other disposition of tangible, intangible or any other type of property is not immune from taxation by reason of Public Law 86-272.

Carrying on or engaging in business contemplates activities such as but not limited to:

1. Making sales in the City or performing activities in the City which affect sales; and/or
2. Providing services or performing activities in the City which affect the rendition of services in the City; and/or
3. Performing acts regularly and continuously in the City for the purpose of making a profit.

## B. NEXUS STANDARDS

Effective July 1, 1998, for the purpose of this tax, no more than an “active presence” is required to constitute “doing business” in Philadelphia. Following is a list of business activities that will subject an out-of-Philadelphia business to the Philadelphia Business Privilege Tax when it engages in any one of such activities. The description of activities in these examples shall not be construed as limiting the meaning of the term “doing business” to those specifically enumerated. Also, the determination of whether or not certain of such activities exceeds “solicitation” depends on the nature of the activity and the facts of each case and has to be made on a case by case basis.

Examples:

1. An out-of-Philadelphia business will be deemed to have created “nexus” if it regularly and systematically conducts business activity in Philadelphia through employees, agents, representatives, independent contractors, brokers or others acting on its behalf, whether or not these individuals or organizations reside in Philadelphia;
  - a. Regular and systematic business activity exists if 10 or more days of business activity occurs in Philadelphia on an annual (“annual” meaning a 12 month taxable year) basis;
  - b. Regular and systematic business activity may exist, depending on the facts and circumstances of the taxpayer, if less than 10 days of business activity occur in Philadelphia on an annual (“annual” meaning a 12 month taxable year) basis;
    - (1) When examining the facts and circumstances of the business activity in Philadelphia, conducting any of the following activities in Philadelphia for between 3 and 10 days on an annual basis will be rebuttably presumed to constitute regular and systematic business activity:
      - (a) Soliciting sales;
      - (b) Making repairs or providing maintenance or service to property sold or to be sold;
      - (c) Collecting current or delinquent accounts related to sales of tangible personal property through assignment or otherwise;

- (d) Installing or supervising installation at or after shipment or delivery;
  - (e) Conducting training for employees, agents, representatives, independent contractors, brokers or others acting on its behalf, or for customers or potential customers related to sales activities;
  - (f) Providing customers any kind of technical assistance or service including, but not limited to, engineering assistance, design service, quality control, product inspections, or similar services related to sales activities;
  - (g) Investigating, handling, or otherwise assisting in resolving customer's complaints related to sales;
  - (h) Providing consulting services related to sales;
  - (i) Having goods delivered to Philadelphia in vehicles it owns, rents, leases, uses, or maintains or delivered by a related party acting as its representative;
- (2) Conducting any of the activities listed in subparagraph 1.b. (1) in Philadelphia for 10 days or more will constitute regular and systematic business activity.
- c. The activities of lawyers, accountants, investment bankers, and other similar independent professionals who perform services in Philadelphia for an out-of-Philadelphia business in their independent professional capacity shall not subject, on its own, the out-of-Philadelphia business to the Philadelphia Business Privilege Tax. These activities, however, would subject the independent professionals to the Business Privilege Tax.
2. If none of the business activities in Philadelphia fall under subparagraph 1.b. (1) and the only contact with Philadelphia is conducting any of the activities listed below for less than 10 days, such contacts will be presumed not to create nexus. Conducting any of the activities listed below for 10 or more days will not necessarily create nexus. Whether or not nexus has been created will depend on the facts and circumstances of the business activity in Philadelphia.
- a. Meeting with suppliers of goods or services in Philadelphia;
  - b. Meeting in Philadelphia with government representatives in their official capacity;
  - c. Attending occasional meetings in Philadelphia (e.g., Board meetings, general internal corporate policy meetings and training, retreats, seminars and conferences sponsored by others, etc.);
  - d. Holding recruiting or hiring events in Philadelphia; or
  - e. Attending and/or participating at trade show in Philadelphia at which no orders for goods are taken and no sales are made.

C. ACTIVE PRESENCE AND SOLICITATION PLUS STANDARDS IN CONNECTION WITH THE SALE OF TANGIBLE PERSONAL PROPERTY

In connection with the sale of tangible personal property, the test for nexus (sufficient contact to be subject to the Business Privilege Tax) will be administered in two steps: Active Presence will subject a taxpayer to at least the Gross Receipts portion of the tax; activity rising to the level of “solicitation plus” will result in the imposition of both the Gross Receipts and Net Income portions of the tax.

1 Active Presence

“Active presence” means purposeful, regular and continuous efforts in Philadelphia in the pursuit of profit or gain and the performance in Philadelphia of activities essential to those pursuits. Limited activities of a taxpayer’s sales force in Philadelphia, such as anticipating the needs and requirements of the customer and following up regarding any difficulties the customer may have after delivery, may be sufficient nexus to sustain the levy of this tax. This is true as long as sales force physically performs some activities in Philadelphia, even if the taxpayer’s sales force does not take any sales orders from its customers in the City and all orders are made, paid, and fulfilled outside the City. Active presence is deemed to exist to the extent that the activities of the sales force in the City make possible the realization and continuance of valuable contractual relations between the taxpayer and its customers in the City. The maintenance of an office or property in the City is not necessary to establish “active presence”. Any person who is otherwise subject to the Business Privilege Tax under the “active presence” test but whose business activities in Philadelphia are limited to mere “solicitation” shall not be subject to the net income portion of the tax.

The following are examples of activities that meet the “Active Presence” standard:

- a. Having agents, representatives, independent contractors, brokers or others, acting on behalf of an out-of-Philadelphia business own, rent, lease, use or maintain an office or other establishment in Philadelphia, when such establishment is used in the representation of the out-of-Philadelphia business in Philadelphia and is significantly associated with its ability to establish and maintain a marker in Philadelphia;
- b. Having employees own, rent, lease, use, or maintain an office or in-home office or other establishment in Philadelphia, even if the business does not pay (directly or indirectly) for the use of the property;
- c. Having independent contractors or representatives with in-home offices in Philadelphia, where the business reimburses the independent contractors or representatives only for telephone or travel expenses.

2 Solicitation Plus

When the business activities of a taxpayer in Philadelphia exceed solicitation, the taxpayer is subject to both the gross receipts and the net income portion of the tax. For example, obtaining sales through salespersons who solicit orders on the business’s behalf and/or displaying the business’s merchandise in leased space on a prolonged or recurring basis is deemed to exceed “solicitation” and would subject the business to both the gross receipts and the net income portion of the tax.

For the purpose of this tax, solicitation means (1) speech or conduct that explicitly or implicitly invites an order; and (2) activities that neither explicitly nor implicitly invite an order, but are

entirely ancillary to requests for an order. Ancillary activities are those activities that serve no independent business function for the seller apart from their connection to the solicitation of orders; activities that seek to promote sales are not ancillary.

The following activities meet the “Solicitation Plus” standard:

- a. Owning, renting, leasing, maintaining, or having the right to use and using tangible personal or real property physically located in Philadelphia;
- b. Having employees own, rent, lease, use, or maintain an office or in-home office or other establishment in Philadelphia, if the use of such property is paid for directly or indirectly by the business;
- c. Having independent contractors or representatives with in-home offices in Philadelphia where the business reimburses the independent contractors or representatives for expenses other than just telephone or travel.

**D. EXAMPLES OF ACTIVITIES, OTHER THAN THE SALE OF TANGIBLE PERSONAL PROPERTY, WHICH CONSTITUTE DOING BUSINESS IN PHILADELPHIA AND SUBJECT THE TAXPAYER TO THE FULL BUSINESS PRIVILEGE TAX**

1. Contracting: Performance of a contract in Philadelphia regardless of whether the person brings its own employees into the City, hires local labor, or subcontracts with another.
2. Providing services:
  - a. Providing any service in Philadelphia, regardless of whether the employees, independent contractors, agents, or other representatives performing the services reside in Philadelphia;
  - b. Maintaining or repairing property located in Philadelphia whether under warranty or by separate contract; or
  - c. Installing, erecting, or modifying property in Philadelphia;
3. Inventory in the City: Having an inventory in Philadelphia or having spot inventory for the convenient delivery to customers, even if the bulk or orders are filled from outside of the City;
4. Dealings in real estate: Holding, acquiring, leasing, or disposing of any property located in Philadelphia;
5. Shows and performances: The staging of shows, theatrical performances, or other events in Philadelphia;
6. Transportation:
  - a. Carrying passengers or freight (any personal property including oil and gas transmitted by pipeline) from one point in Philadelphia to another point inside or outside the City, if pickup or delivery, regardless of origination or ultimate destination, occurs in Philadelphia; or
  - b. Having facilities and/or employees, independent contractors, agents, or other representatives in Philadelphia, regardless or whether they reside in Philadelphia for:
    - (1) Storage, delivery, or shipment of goods;

- (2) Servicing, maintaining, or repair of vehicles, trailers, containers, and other equipment;
  - (3) Coordinating and directing the transportation of passengers or freight; or
  - (4) Doing any other business of the person;
7. Franchisors: Entering into one or more contracts with persons, corporations, or other business entities located in Philadelphia, by which:
    - a. The franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan or system prescribed in substantial part by the franchisor; and
    - b. The operation of a franchisee's business pursuant to such plan is substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising, or other commercial symbol designating the franchisor or its affiliate;
  8. Processing: Assembling, processing, manufacturing, or storing goods in Philadelphia;
  9. Advertising: Entering Philadelphia to place or display advertising when the advertising is for the benefit of another and in the ordinary course of business (e.g., the foreign corporation makes signs and brings them into Philadelphia, sets them up, and maintains them);
  10. Contracting for processing and shipment: Sending materials to a Philadelphia manufacturer, processor, repairer, or printer to be processed and stored in completed form awaiting orders for their shipment;
  11. Loan production activities: Soliciting sales contracts or loans, gathering financial data, making credit checks, or performing other financial activities in Philadelphia through employees, independent contractors, or agents, regardless of whether they reside in Philadelphia or have a permanent place of business in Philadelphia;
  12. Holding companies: Maintaining a place of business in Philadelphia or managing, directing, and/or performing services in Philadelphia for subsidiaries or investee corporations;
  13. Place of business: Maintaining a place of business in Philadelphia;
  14. Federal enclaves: Doing business in any area in Philadelphia, even if the area is leased by, owned by, ceded to, or under the control of federal government;
  15. Consignments: Having consigned goods in Philadelphia;
  16. Leasing: leasing tangible personal property that is used in Philadelphia.

**SECTION 104. COMPLETE TERMINATION OR LIQUIDATION OF A BUSINESS.**

- a. Liquidation of a business is a taxable activity. A business is deemed to continue engaging in business until all of its normal operations which produce revenue have ceased. In the case of a business which owns inventory, normal operations are deemed to continue until all inventory is liquidated. For the purpose of determining when a business has terminated, the mere collection of accounts receivable or notes receivable by a person who is not engaged in the business of lending money, during the process of liquidation, does not constitute engaging in a taxable

activity; however, income received prior to cessation of normal operations must be included in the measure of the tax for any business which continues into the following tax year.

b. When a business is terminated during a tax year, the tax for that year shall be computed as follows;

1) If the taxpayer was engaged in business in Philadelphia more than one full year preceding the tax year, the tax base shall be computed by multiplying the taxable receipts and taxable net income of the preceding year by a fraction, the numerator of which shall be the number of days engaged in business in Philadelphia in the tax year, and the denominator of which shall be the number of days in the tax year.

Example: "A" terminated business on February 28, 1985. His taxable gross receipts during 1984 amounted to \$150,000. His taxable receipts for the 1985 tax return would be computed as follows:

$$\$150,000 \times 59 \text{ days} / 365 \text{ days} = \$24,247$$

Example: "B" terminated business on June 30, 1985. His net income after adjustments, allocation and apportionment for the fiscal year ended September 30, 1984, amounted to \$15,000. His taxable net income for the 1985 tax return would be computed as follows:

$$\$15,000 \times 181 \text{ days} / 365 \text{ days} = \$7,438$$

2) Taxpayers Who Commenced Engaging in Business in Philadelphia During the Calendar Year Preceding the Tax Year.

(a) The gross receipts tax base for businesses which were engaged in business for at least 365 days before terminating, is computed by multiplying the taxable receipts of the first 365 days by a fraction, the numerator of which shall be the number of days engaged in business in Philadelphia in the final tax year and the denominator of which shall be 365 days.

Example: "A" commenced business on April 1, 1984, and terminated business on June 30, 1985. His taxable gross receipts for the first 365 days of business amounted to \$150,000. His taxable receipts for the 1985 tax return would be computed as follows:

$$\$150,000 \times 181 \text{ days} / 365 \text{ days} = \$74,384$$

(b) The gross receipts tax base for businesses which commenced in the calendar year prior to the tax year, but terminated business before completion of a full 365 day period, is computed by multiplying the taxable receipts for the full period engaged in business by a fraction, the numerator of which shall be the number of days in business in the final tax year, and the denominator of which shall be the total number of days engaged in business in Philadelphia during the final tax year and the preceding year.

Example: "B" commenced business on July 1, 1984, and terminated business on April 30, 1985. His taxable gross receipts during 1984 and 1985

amounted to \$48,000. "A's" taxable receipts for the 1985 tax return would be computed as follows:

$$\$48,000 \times 120 \text{ days} / 304 \text{ days} = \$18,947$$

- (c) Net Income Tax Base - Calendar Year Taxpayers. The net income reportable shall be the net income (or loss) for the calendar year, which is concurrent with the tax year.
- (d) Net Income Tax Base - Fiscal Year Taxpayers
  - (.1) The net income reportable shall be computed by multiplying the taxable net income for the first full twelve month fiscal period ending within the tax year, which is used for reporting net income to the Federal Government, by a fraction, the numerator of which is the number of days in business in the tax year, and the denominator of which is 365 days.
  - (.2) In the event the taxpayer commences business with a fiscal period shorter than twelve months, which ends within the year preceding the tax year, and terminates business within the tax year before completing a full twelve month fiscal period, the net income reportable for the tax year shall be computed by multiplying the taxable net income for the period ending within the tax year by a fraction, the numerator of which is the number of days in business in the tax years and the denominator of which is the number of days in the period for which the net income was calculated.
  - (.3) In the event the taxpayer commences business with a fiscal period shorter than twelve months, which ends within the tax year, and terminates business before the end of the tax year, the net income reportable for the tax year shall be computed by multiplying the total taxable net income for both periods by a fraction, the numerator of which is the number of days in business in the tax year, and the denominator of which is the total number of days in both periods.

- 3) Taxpayers who Commenced and Terminated Business in Philadelphia During the Same Tax Year.
  - (a) Gross Receipts Tax Base - See Section 203(B)(4) of these Regulations.
  - (b) Net Income Tax Base - See Section 203(A)(4) of these Regulations.

## RETURNS

### SECTION 201. WHO MUST FILE A RETURN.

Every individual, partnership, association, and corporation, and every receiver, trustee, assignee and other person acting in a fiduciary capacity, whether appointed by a court or otherwise, and any combination of persons, carrying on or engaging in any trade, business, profession, vocation or any manufacturing, commercial, service, financial, insurance or utility business or activity in Philadelphia or attributable to Philadelphia, must file a Business Privilege Tax return on the prescribed form available from the Department of Revenue.

The method shall reflect the gain (or loss) resulting from the activity of a business, profession or enterprise which occurs during the usual operations; inclusive of the sale, exchange or disposition of assets of an ongoing or terminated entity. Transactions must be identifiable, necessary and reasonable to the business, after allowance for applicable costs.

### SECTION 202. DUE DATES FOR FILING RETURNS.

A. Except as provided in subsections B, C and D, each person engaged in business is required to file a Business Privilege Tax Return on or before the 15th day of April of each tax year.

B. Persons Who Commenced Engaging in Business in Philadelphia During the Calendar Year Preceding the Tax Year.

Each person who commences engaging in business during the calendar year preceding the tax year is required to file a tax return for that tax year on or before April 15 of the year following the tax year.

Example: "C" started in business April 15, 1984. Her tax return for the tax year 1985 must be filed on or before April 15, 1986.

Example: "D" was engaged in business outside Philadelphia before opening a branch office in Philadelphia on September 1, 1985. Its tax return for the privilege year 1986 must be filed on or before April 15, 1987.

C. Persons Who Commenced Engaging in Business in Philadelphia During the Current Tax Year.

Each person who commences engaging in business at any time during a tax year is required to file a tax return for that tax year on or before April 15th of the year following the tax year.

Example: "A" started in business February 1, 1985. His tax return for the tax year 1985 must be filed on or before April 15, 1986.

Example: "B" was engaged in business outside Philadelphia for 10 years prior to engaging in business in Philadelphia on July 1, 1985. Her tax return for the tax year 1985 must be filed on or before April 15, 1986.

D. Persons Engaged in a Temporary, Seasonal, or Itinerant Business.

Each person engaged in a temporary, seasonal or itinerant business is required to file a tax return for each tax year within thirty (30) days of the day completing each business during any tax year.

**SECTION 203. PERIOD USED IN COMPUTING TAX.**

The determination or computation of net income or taxable receipts depends upon the period of time during which the taxpayer was engaged in business in Philadelphia.

A. Tax on Net Income

1. Persons Who Commenced Engaging in Business in Philadelphia More Than One Full Year Prior to the Beginning of a Tax Year.

a. Persons Filing with the Federal Government on a Calendar Year Basis.

The net income reportable shall be the net income (or loss) for the calendar year preceding the tax year.

b. Persons Filing with the Federal Government on a Fiscal Year Basis.

The net income reportable shall be the net income (or loss) for the most recent twelve month fiscal year used for reporting net income (or loss) to the Federal Government, which fiscal year ends on or before December 31 of the year preceding the tax year.

In the event that the taxpayer was engaged in business in Philadelphia during the entire preceding calendar year, but commenced business in Philadelphia with a fiscal period shorter than twelve months, and did not complete a full twelve month fiscal period during the preceding calendar year, the taxpayer shall compute and report net income in accordance with the rules set forth in subsection A.2.b.

2. Persons Who Commenced Engaging in Business in Philadelphia During the Calendar Year Preceding a Tax Year.

a. Persons Filing with the Federal Government on a Calendar Year Basis.

The net income reportable shall be the net income (or loss) for the calendar year which is concurrent with the tax year.

b. Persons Filing with the Federal Government on a Fiscal Year Basis.

The net income reportable shall be the net income (or loss) for the first full twelve month fiscal period ending within the tax year, which is used for reporting net income (or loss) to the Federal Government.

In the event the taxpayer commences business with a fiscal period shorter than twelve months, and does not complete a full twelve-month fiscal year by the end of the tax year, the following rules shall apply:

- (1) If the initial short fiscal period is more than 180 days, the net income reportable shall be the net income (or loss) for the short fiscal period divided by the number of days in that fiscal period and multiplied by 365 days.
- (2) If the initial short fiscal year is 180 days or less, the net income reportable shall be the net income (or loss) for the first 365 days of business. Taxpayers who elect Net Income Method II shall compute and report net income (or loss) as would have been properly returned to and ascertained by the Federal Government for the first 365 days of business.

3. Persons Who Commence Engaging in Business in Philadelphia During a Tax Year.

The net income reportable for that tax year shall be the net income (or loss) for that portion of the tax year during which the taxpayer was engaged in business in Philadelphia. A taxpayer authorized to file tax returns with the Federal Government on a fiscal year basis, but whose first fiscal year does not end until the year following the tax year, shall make an election to report net income under Net Income Method I or Net Income Method II. Taxpayers who elect Net Income Method II shall compute and report net income (or loss) as would have been properly returned to and ascertained by the Federal Government for that portion of the current tax year during which the taxpayer was engaged in business. In the event that the taxpayer commences business in Philadelphia with a fiscal period shorter than twelve months, which ends within the current tax year, the following rules shall apply:

- a. If the number of days in the initial short fiscal period is equal to 50% or more of the total number of days in business in Philadelphia during the current tax year, the net income reportable shall be the net income (or loss) for the short fiscal period, divided by the number of days in the short fiscal period, and multiplied by the total number of days in business in the current tax year.
- b. If the number of days in the initial short fiscal period is less than 50% of the total number of days in business in Philadelphia during the current tax year, the net income reportable shall be the net income (or loss) for that portion of the tax year during which the taxpayer was engaged in business in Philadelphia. Taxpayers who elect Net Income Method II shall compute and report net income (or loss) as would have been properly returned to and ascertained by the Federal Government.

4. Persons Engaged in a Seasonal, Temporary or Itinerant Business.

The net income reportable for the tax year shall be the net income for that portion of the tax year in which the business was actually conducted.

B. Tax on Receipts

1. The tax is based on each person's taxable receipts of the entire preceding calendar year, except for those persons:
  - a. Who commenced engaging in business in Philadelphia during a tax year, or
  - b. Who commenced engaging in business in Philadelphia during the calendar year preceding the tax year, or
  - c. Whose business in Philadelphia is temporary, seasonal or itinerant.
2. Every person who commenced engaging in business during the calendar year preceding the tax year shall compute his taxable receipts for the tax year on the taxable receipts received by him during the first 365 days in business.
3. Every person who commenced engaging in business in Philadelphia during a tax year shall compute his taxable receipts for that tax year on the taxable receipts received by him from the date of commencing business in Philadelphia through December 31 of that year.
4. Every person engaged in Philadelphia in a temporary seasonal or itinerant business shall compute his taxable receipts for each tax year on the taxable receipts received by him during that tax year.

#### **SECTION 204. CONSOLIDATED RETURNS.**

No Corporation is permitted to use the net income or net loss reported on a consolidated U.S. Corporation Income Tax Return to determine net income or net operating loss for purposes of the Business Privilege Tax.

Likewise, the consolidated net gain or net loss from the operations of more than one corporation, as determined by Net Income Method I, may not be used to determine net income or net operating loss of any corporation for purposes of the Business Privilege Tax.

#### **SECTION 205. CHANGE OF REPORTED NET INCOME BY FEDERAL GOVERNMENT.**

Any taxpayer who has elected to file a Business Privilege Tax return on the basis of net income and/or net operating losses as returned to and ascertained by the Federal Government, and who subsequently files an amended return with the Federal Government, or experiences a correction in the amount of net income (or loss) as returned to the Federal Government, shall, within 75 days after filing an amended return or final determination of corrected net income or loss by the Internal Revenue Service or any other agency or court of the United States, file an amended Business Privilege Tax return with the Revenue Commissioner, reporting the corrected net income (or loss), and shall remit any additional tax due.

## **TAX ON RECEIPTS**

### **SECTION 301. DEFINITION OF RECEIPTS.**

"Receipts." Cash, credits, property of any kind or nature, received from conducting any business or by reason of any sale made, including re-sales of goods, wares or merchandise taken by a dealer as a trade-in or as part payment for other goods, wares or merchandise or services rendered, or commercial or business transactions without deduction therefrom an account of the cost of property sold, materials used, labor, service or other cost, interest or discount paid or any other expense. For the purpose of determining receipts from the business of insurance, such receipts shall mean those from premiums received from risks within Philadelphia, whether by mutual or stock companies, domestic or foreign, without any deductions therefrom for any cost or expenses whatsoever; except, premiums shall not include return premiums, dividends paid or credited to policyholders, if such dividends are in the nature of an adjustment of the premiums charged, and premiums received for reinsurance. Receipts of a person engaged in the business of insurance shall also include receipts from rental real estate situated in Philadelphia but shall not include interest, dividend and capital gain receipts. Nothing in this definition shall preclude the taxation of other non-premium business receipts of persons engaged in the business of insurance.

### **SECTION 302. EXCLUSIONS FROM RECEIPTS.**

The following receipts shall be excluded from "receipts" as defined in Section 19-2601 of the Philadelphia Code and shall be omitted from the tax base in computing the tax on gross receipts.

- (1) Reimbursement of expenses, but only if the taxpayer actually incurred such expenses and did so as agent of another from whom he receives reimbursement in the exact amount he expended.
- (2) Taxes collected as agent for the United States of America, Commonwealth of Pennsylvania, or City of Philadelphia, where the customer or ultimate consumer pays the tax. Such taxes shall include but not be limited to:
  - (a) Federal taxes on admissions and dues;
  - (b) Federal excise taxes on jewelry, furs and fur articles, toilet preparations and luggage;
  - (c) Federal tax on transportation of property;
  - (d) Federal tax on safe deposit boxes;
  - (e) Federal tax on gasoline;
  - (f) Pennsylvania Sales and Use Tax;
  - (g) Pennsylvania Liquid Fuels Tax;
  - (h) City of Philadelphia Amusement Tax;
  - (i) City of Philadelphia Hotel Room Rental Tax;
  - (j) City of Philadelphia Parking Tax.

- (3) The amount of any allowance made for goods, wares or merchandise taken by a dealer as a trade-in or as part payment for other goods, wares and merchandise in the usual and ordinary course of his business.
- (4) A broker may exclude any commission paid by him to another broker on account of a contract of purchase or sale initiated, executed or cleared in conjunction with the other broker, except where either is an employee of the other. Likewise, an agent may exclude any commissions paid by him to another agent on account of purchase or sale initiated, executed or cleared in conjunction with the other agent, except where either is an employee of the other. A broker may not exclude a commission paid to an agent, and an agent may not exclude a commission paid to a broker.
- (5) An attorney may exclude any fee or portion of a fee paid to another attorney where a matter has been forwarded either from or to the first attorney to or by the second
- (6)
  - (a) Receipts or the portion thereof attributable to any item of sale involving the bona fide delivery of goods, commodities, wares and merchandise to a location regularly maintained by the other party to the transaction outside the limits of the City of Philadelphia and not for the purpose of evading payment of the tax or any portion thereof.
  - (b) Receipts or that portion thereof received for any services actually performed outside the limits of the City of Philadelphia, and not for the purpose of evading payment of the tax or any portion thereof.
- (7) In the case of financial businesses or a person which is described as being subject to a tax imposed pursuant to Article VII, VIII, or XV of the Tax Reform Code of 1971:
  - (a) The cost of securities and other intangible property and monetary metals sold, exchanged, paid at maturity or redeemed, but only to the extent of the total gross receipts from securities and other intangible property and monetary metals sold, exchanged, paid out at maturity or redeemed;
  - (b) Moneys or credits received in repayment of the principal amount of deposits, advances, credits, loans and other obligations;
  - (c) Interest received on account of deposits, advances, credits, loans and other obligations made to persons resident or having their principal place of business outside Philadelphia;
  - (d) Interest received on account of other deposits, advances, credits, loans and other obligations but only to the extent of interest expenses attributable to such deposits, advances, credits, loans and other obligations;
  - (e) Payments received on account of shares purchased by shareholders.
- (8) Amount of principal received by the holder of bonds at redemption to the extent of the purchase price of the bonds, and moneys or credits received in repayment of the principal amount of deposits, advances, credits, loans and other obligations.
- (9) Refunds, credits or allowances given by a seller to a purchaser on account of goods returned or defects in goods sold may be excluded from the seller's gross receipts only if the seller's receipts from the original sale of such goods are or were included in taxable receipts in the current or any previous year's tax base. If receipts from the sale of goods were or are excluded from taxable receipts by virtue of any provision of these regulations, then any refunds, credits or allowances attributable to such sales may not be excluded from the seller's gross receipts.

- (10) Trade discounts allowed to customers may be deducted in ascertaining the amount to be reported as receipts from sales. Trade discounts include:
- (a) Discounts deducted from the face amount of the bill as a medium of adjusting the list price;
  - (b) Discounts unconditionally deducted by customers upon settlement of their bills and allowed as a matter of established custom of a trade, without regard to the due date of such bills or to the form or terms in which such discounts are described or stated on bills or invoices. Discounts allowed to customers as cash discounts for prompt payment of their bills may not be deducted from receipts unless such discounts are taken at the time of sale.
- (11) Freight, delivery or other transportation charges may not be deducted from gross receipts except as provided in subsection (12):
- (a) If the seller contracts to deliver the property sold to some designated place, or is obligated under the terms of the contract to pay transportation charges to some designated place, the freight, delivery or other transportation charges so incurred by the seller may not be deducted from gross receipts.
  - (b) If property is sold on terms requiring the seller to deliver such property to a designated place but the purchaser pays the amount of freight, delivery or other transportation charges in the first instance, and deducts such charges from the invoice price in making remittance to the seller, no deduction from gross receipts may be taken therefore by the seller.
- (12) Where the seller advances the freight, delivery or other transportation charges for the account of the purchaser in accordance with the terms of the contract of sale, such charges may be excluded from gross receipts provided:
- (a) That such charges are the actual charges incurred and are billed as such to purchaser, and
  - (b) That the books and records of the taxpayer clearly indicate such facts.
- (13) Receipts from transactions in foreign commerce (as distinguished from interstate commerce) are excluded only to the extent such transactions may not be taxed under the provisions of the United States Constitution.

- (14) Receipts by a corporation which is a member of an affiliated group from other members of the same affiliated group.

Illustration:

A parent corporation owns:

80% of all classes of voting and nonvoting stock of "A" corporation.

55% of all classes of voting and nonvoting stock of "B" corporation.

60% of all classes of voting and nonvoting stock of "C" corporation.

85% of all classes of voting and nonvoting stock of "D" corporation.

Corporation "A" owns 30% of the voting and nonvoting stock of "B" corporation.

Corporation "B" owns none of the voting and nonvoting stock of the affiliated group.

Corporation "C" owns none of the voting and nonvoting stock of the affiliated group.

Corporation "D" owns 25% of the voting and nonvoting stock of "C" corporation.

Receipts by any one of the five affiliated corporations from one or more of the other four affiliated corporations are excludable from gross receipts.

- (15) (a) Dividends, interest and royalties received by one corporation from a corporation of the same affiliated group.
- (b) Dividends, interest and royalties received by a corporation or a partnership from a corporation of which the receiving corporation or partnership owns at least twenty (20%) percent of the voting power of all classes of stock and at least twenty (20%) percent of each class of non-voting stock.

Illustration:

On January 2, 2000, "A" Corporation and "B" partnership each owned 25% of the voting and non-voting stock of "H" corporation. On that date, "H" corporation declared a cash dividend. The amount of such dividend, which A Corporation and B partnership received, is excludable from gross receipts.

- (16) Receipts by dealers from sales to other dealers in the same line, where the dealer transfers title or possession at the same price for which he acquired the goods, wares or merchandise.
- (17) Commissions and similar charges received by persons registered under the Pennsylvania Securities Act of 1972, on account of transactions effected for persons resident or having their principal place of business outside Philadelphia.

- (18) In the case of an insurance business:
  - (a) Premiums received from risks outside Philadelphia;
  - (b) Premiums received from risks inside Philadelphia to the extent they consist of return premiums, dividends paid or credited to policyholders, if such dividends are in the nature of an adjustment of the premiums charged, and premiums received from reinsurance.
  - (c) Receipts derived from rental real estate situated outside Philadelphia.
  - (d) Capital gains.
  - (e) Dividends and interest.
- (19) Receipts from the business of loading or discharging cargo to or from vessels when conducted on piers, wharves or marine terminal facilities in the Port of Philadelphia and from related business activities conducted on such premises such as furnishing dockage, wharfage, truck and/or railroad car loading and unloading, and storage of cargo which is to be loaded onto or has been discharged from vessels at a pier, wharf or marine terminal facility in the Port of Philadelphia.
- (20) Receipts or the portion of receipts, attributable to a bonafide delivery of fiber, yarn, fabric or materials that have been dyed by a chemical mechanical process, to a location regularly maintained by the other party to the transaction outside the limits of the City of Philadelphia and not for the purpose of evading or avoiding payment of the tax or any portion thereof.
- (21) Distributive share of net income received by a partner from a partnership where the receiving partner's ownership of capital at the end of the year is at least twenty-percent (20%) as reported on Schedule K-1 of Federal Form 1065, of the distributing partnership.

**SECTION 303. RECEIPTS FROM RENTAL OR LICENSE OF TANGIBLE PERSONAL PROPERTY.**

Persons doing business in the City of Philadelphia who own, lease or license tangible personal property which is leased or licensed to others are required to report the gross receipts from the rental or license to use such property according to the following rules:

- (1) Where the original situs of the property is within the limits of the City of Philadelphia, the receipts from tangible personal property leased or licensed to others are:
  - (a) Wholly taxable receipts, if the property is delivered to lessees or licensees within the Commonwealth of Pennsylvania;
  - (b) Excludable receipts, if the property is delivered to lessees outside of Pennsylvania.
- (2) Where the original situs of the property is outside Philadelphia, the receipts from tangible personal property leased or licensed to others are:
  - (a) Wholly taxable receipts if the property is delivered to a lessee within Philadelphia.
  - (b) Excludable receipts, if the property is delivered to lessees outside Philadelphia.
- (3) The term "original situs," as used herein, means the point at which the property is warehoused when not leased to others and to which point the property is returned upon termination of the

lease. If there is no such established point, the term "original situs" shall mean the principal office of the taxpayer.

- (4) This Section 303 does not apply to conditional sales of tangible personal property.

#### **SECTION 304. TAXABILITY OF RECEIPTS FROM SALES OF TANGIBLE PERSONAL PROPERTY.**

- (1) General Rule.

All receipts from the sale of goods, commodities, wares and merchandise shall be included as taxable receipts, except for receipts or any portion of receipts attributable to sales involving the bona fide delivery of goods, commodities, wares or merchandise to a location regularly maintained by the other party to the transaction or his agent outside of Philadelphia, and not for the purpose of evading or avoiding payment of this tax or any portion of this tax.

- (2) What Constitute Receipts Excludable By Virtue Of A Bona Fide Delivery To A Location Regularly Maintained By the Purchaser Or His Agent Outside Of Philadelphia?

- (a) If a delivery occurs within Philadelphia, then the receipts attributable to such sale constitute taxable receipts, unless both the purchaser and seller are located outside of Philadelphia and the delivery is made to the purchaser's customer inside of Philadelphia, in which case the seller's receipts constitute excludable receipts.
- (b) If a delivery occurs outside of Philadelphia to a location regularly maintained by the purchaser or the purchaser's agents, then the receipts attributable to such sale constitute excludable receipts.
- (c) If a delivery occurs outside of Philadelphia to the purchaser's customer, or at a location not regularly maintained by the purchaser or his agent, then delivery shall be deemed to be in Philadelphia and the receipts from such sale shall be taxable receipts, unless the purchaser is located outside of Philadelphia, in which case the receipts shall be excluded from taxable receipts.

- (3) Delivery By Carrier.

- (a) Delivery to a common carrier destined for a location shall constitute delivery to that location regardless of which party to the transaction selects or pays the common carrier and regardless of whether the goods are sold "f.o.b. shipping point" or "f.o.b. destination point."
- (b) Delivery to a contract carriers, under contract to the seller, destined for a location, shall constitute delivery to that location. Delivery to a contract carrier under contract to a party other than the seller, or delivery to an agent (except a common carrier) of the purchaser or the purchaser's customer, or delivery to the purchaser or his employee, where delivery is made to the party or to a vehicle or carrier operated by such parties, shall constitute delivery to such other party at the location where physical possession is transferred, including the location at which the property is placed on such vehicle or carrier.

**SECTION 305. ALTERNATIVE RECEIPTS TAX COMPUTATIONS**

- (1) Taxpayers who are engaged in manufacturing, and/or who make wholesale and/or retail sales are entitled to compute the tax on receipts by one or more of the alternative methods of tax computation provided in subsection (2).
  - (a) For purposes of determining which alternative method or methods may be used by a taxpayer, the classification of a taxpayer as a manufacturer, and/or a wholesaler, and/or a retailer shall be made on the basis of the type or types of sales made by the taxpayer. Each alternative method of computation may be used to compute the gross receipts tax only on that type of sale which qualifies the taxpayer to use that alternative method of computation. For example, a taxpayer who makes wholesale sales and retail sales may elect the wholesaler's alternative method of computation for wholesale sales only. That taxpayer may also elect to use the retailer's alternative method of computation for retail sales only.
  - (b) A taxpayer who elects to use an alternative method of computing the tax on receipts must use that method of computation for all of the taxable receipts of that type. For example, a taxpayer may not elect to use the wholesaler's alternative method for certain of its wholesale sales and use the regular method for its other wholesale sales. Either the alternative method must be used for all taxable wholesale sales or the regular method must be used for all taxable wholesale sales.
  - (c) A taxpayer who elects to use an alternative method of computing the tax on receipts may deduct only the cost of goods and cost of labor applicable to such receipts. For example, a taxpayer who uses the alternative method to compute the receipts tax on retail sales may not include any costs of goods or labor attributable to wholesale sales or receipts from services. In computing the alternative method tax base, the amount of the costs of goods and costs of labor which are deductible from each type of receipts is computed by multiplying the total cost of goods and cost of labor attributable to that type of receipts by the percentage derived from dividing the taxable receipts of that type by the total receipts of that type.

Example:

Wholesales Sales	\$1,000,000
Taxable Wholesale Sales	600,000
Total Cost of Goods Attributable to Wholesale Sales	900,000
Total Cost of Labor Attributable to Wholesale Sale	50,000

Applicable Cost of Goods:

$$600,000/1,000,000 \times 900,000 = 540,000$$

Applicable Cost of Labor:

$$600,000/1,000,000 \times 50,000 = 30,000$$

- (2) The following expenses are includible in "cost of goods" of a wholesales or retailer:
- (a) The cost of goods, wares, commodities and merchandise purchased by the retailer or wholesaler and resold by him.
  - (b) Freight charges paid for delivery to the taxpayer. Expenses for delivery to the customer are not includible in cost of goods sold.
  - (c) Direct costs incurred to independent contractors or suppliers who process, repair, recondition, dye, assemble, fabricate, work on or prepare goods, wares, commodities and merchandise owned by and sold by the taxpayer.
  - (d) Container or packaging costs, but only when the container or packaging is an integral part of the thing sold, not only for purposes of transportation to the consumer, but also for purposes of use by the consumer. Incidental wrapping and shipping materials and supplies such as cartons or boxes in which the individual packages are transported, or which are primarily for the purpose of transportation, are not considered a part of the "cost of goods".
- (3) Expenses includable in the "Cost of labor" of a wholesaler or retailer.
- (a) The following expenses are includible in cost of labor if paid to or on behalf of a taxpayer's own employees who are used in receiving, storing, shipping, delivering and making the actual sales of the goods, wares, commodities or merchandise purchased for resale, including the proportionate part of the expenses paid to or on behalf of officers and administrative employees to the extent that they are engaged directly in receiving, storing, shipping, selling and delivering the goods, wares, commodities or merchandise purchased for resale:
    - (i) Salaries, wages, commissions or other compensation.
    - (ii) Contributions by an employer under the Pennsylvania Unemployment Compensation Act.
    - (iii) Taxes paid by an employer under the Federal Unemployment Tax Act.
    - (iv) Premiums paid by an employer under the Worker's Compensation Act.
    - (v) Taxes paid by an employer under the Federal Insurance Contributions Act.
    - (vi) Contributions by an employer into a pension plan, profit sharing plan, savings plan, deferred compensation plan, annuity plan, 401K, I.R.A., etc.
    - (vii) Medical, dental and hospital expenses and insurance premiums.
    - (viii) Life insurance premiums.
    - (ix) Disability income insurance premiums.
    - (x) Payments based upon a percentage of payroll or hourly rate made by an employer to a union or an employee association under a collective bargaining agreement.

- (xi) Uniform and tool allowances.
- (xii) Other benefits provided under the contract of employment.
- (b) Payments to subcontractors, independent contractors or other persons who are not employees of the taxpayer cannot be deducted as cost of labor.
- (c) The value of services rendered by an individual proprietor or by partners in a partnership, including guaranteed payments to partners, cannot be deducted as cost of labor.

**SECTION 306. RECEIPTS FROM GOVERNMENTAL AGENCIES AND NONPROFIT ORGANIZATIONS.**

Receipts from sales made or services rendered to governmental bodies, and to religious, charitable and educational corporations and associations shall not be excluded from the tax base. Commissions from sales of Pennsylvania lottery tickets must be included in the tax base. The law does not grant any exemption to taxpayers transacting business with such agencies or institutions.

**SECTION 307. CONDITIONAL AND INSTALLMENT SALES.**

- (1) A person making conditional sales or other installment sales of property is required to report the total selling price of such sales as gross receipts for the tax year in which the contracts of sale are entered into, without regard to the fact that the seller may arrange to receive payment from the purchaser on an installment basis, or that such contracts may be discounted or pledged with, or sold to, a finance company.
- (2) Property Repossessed. Where tangible personal property sold under a conditional or other installment sales contract is repossessed by the seller, and the repossessed property is subsequently sold, the receipts from such sales are to be included in the measure of the tax only to the extent that the amount of the sale exceeds the balance due on the original sale at the time of repossession. No deduction from gross receipts may be taken for any unpaid balance due at the time of repossession.

**SECTION 308. CONSIGNMENT TRANSACTION.**

The status of a person accounting for receipts from consignment transactions will depend on the terms and conditions expressly set forth in the contract between the consignor and the consignee. Where the contract does not clearly set forth the status of the parties thereto, then the consignor will be deemed to have sold to the consignee at the time the consignee sells the goods to his (the consignee's) customer.

### **SECTION 309. LEASED DEPARTMENT.**

- (1) Return by lessor. Where a person leases a department of his business to another, such person may include in his return the gross receipts from business done and sales made by the lessee. When the business of such leased department is included in the return made by the lessor, a schedule must be attached to the return containing the name of the lessee, a description of the department operated, and a statement to the effect that the lessor assumes liability for reporting the gross receipts and paying the tax accruing against the lessee of such department. The lessee, however, is not relieved from his liability under the Business Privilege Tax Ordinance if the lessor fails to make a proper return or fails to pay the tax due. Should a change occur in the ownership or status of any leased department, the lessor shall notify the Commissioner of Revenue promptly.
- (2) Return by Lessee. If the lessee wishes to file return independently, such lessee is required to include in his return the entire gross receipts collected by such lessee, without deducting any expenses or commissions charged to him by the lessor. To expedite the examination and audit of returns filed by such lessee, the Commissioner of Revenue may require the lessor to furnish a statement of the entire gross receipts collected on behalf of the lessee.
- (3) Lessor's Commission or Rentals. The lessor is required to include in his return all commissions charged to the lessee for services rendered, property furnished or supplied, etc.

### **SECTION 310. PERSONS ENGAGED IN PROFESSIONS OR VOCATIONS OR IN RENDERING PERSONAL SERVICES.**

- (1) A person who is engaged in a profession or vocation or in rendering services in Philadelphia in any capacity, other than as an employee of another, or who has an office or place of business in Philadelphia, is subject to tax under the ordinance and all compensation received as a result of such professions, vocations or services which are attributable to Philadelphia must be included in the tax base as follows:
  - (a) Receipts or that portion thereof attributable to any services actually performed within the limits of the City, regardless of where such business activity originated, must be included in the tax base.
  - (b) Receipts or that portion thereof attributable to services actually performed outside the limits of the City, and not for the purpose of evading payment of the tax or any portion thereof, shall be excluded from the tax base.

### **SECTION 311. PRINCIPAL AND AGENT.**

- (1) (a) General. Receipts from sales made, or services rendered by an agent for the account of his principal, are to be reported by the principal. It is immaterial in such cases whether the customer or client remits directly to the principal, or to the agent for transmittal to the principal. The agent is required to report as gross receipts only the commissions withheld

by him as compensation for his services before remitting to his principal and any commission paid to him after remittance to the principal by the agent or the customer or the client.

- (b) No deduction from gross receipts may be taken by the principal for commissions paid to, or withheld by, the agent. A manufacturer's representative is taxable on his gross commissions unless his relationship to his principal is that of employer and employee.
- (2) Undisclosed principal. A person selling property, including real property, or rendering services, for an unknown or undisclosed principal, is subject to tax as a principal, unless there is disclosed in the agent's return the identity of the principal and amount of the sale made on his behalf.
- (3) Conditions as to recognition of agency. A person will be regarded as acting as agent or broker in promoting or soliciting sales or rendering services for the account of a principal only when it appears:
  - (a) That the contract or agreement between such persons clearly established the relationship of principal and agent;
  - (b) That books and records of the agent or broker show the name of the actual owner of the property on whose behalf the sale is made;
  - (c) That the credit risk is assumed by the actual owner of the property; and
  - (d) That the books and records of the agent or broker show the amount of gross sales and the amount of commission due thereon.
- (4) Collections by agent. Money or property received by a taxpayer, as agent, for transmittal to a third party is not to be reported by such taxpayer as gross receipt, but any commission received by him for his services as agent must be included in gross receipts.

**SECTION 312. PERSONS ERECTING BUILDINGS OR OTHERWISE ALTERING, REPAIRING OR IMPROVING PROPERTY.**

- (1) General. A general contractor or subcontractor, resident or nonresident, engaged in Philadelphia in the business of erecting buildings, or otherwise altering, repairing or improving real property, is required to report as gross receipts all receipts derived from the performance of such contracts. The amount of receipts to be included in the tax base shall be the full contract price, that is, the total amount received or receivable by way of a fixed determinable amount under the terms of the contract. The contract price will be considered to include all charges made by a general contractor, or subcontractor, for materials, labor, supervision, overhead costs and profits and also any payments made directly by the owner for materials, labor or other obligations for which the contractor becomes liable in the performance of the contract. In the case of a general contractor, no deduction may be made with respect to amounts paid to subcontractors and materialmen.
- (2) Cost-plus contracts. A general contractor performing contracts on the basis of "cost-plus-a-fixed-fee" or "cost-plus-a-percentage" or "construction management" is required to report as gross receipts the full contract price as provided in subsection 312(1), unless the owner of the property and/or the general contractor, acting pursuant to authorization by the owner, purchases the materials, or hires all labor or engages all subcontractors, and the owner (a) pledges his credit

and is liable in the first instance to the materialmen, suppliers, laborers or subcontractors as distinguished from merely guaranteeing payments to them or undertaking to reimburse the general contractor for the cost of such materials, services or subcontracts, and (b) agrees to make payment directly to the materialmen, suppliers, laborers or subcontractors. Such sales or services will be regarded as made directly to the owner, in which case the general contractor will not be required to include such payments in his gross receipts.

- (3) Government contracts. Receipts from the performance of contracts entered into with the City of Philadelphia, or the Commonwealth of Pennsylvania, or the United States Government or any subdivision of such Governments, are to be included in the measure of the tax.

### **SECTION 313. CONTRACTORS PERFORMING LONG-TERM BUILDING OR CONSTRUCTION CONTRACTS.**

- (1) Neither the completed contract method nor the percentage of completion method of accounting for income, nor a combination thereof, may be used as the basis for computing gross receipts received during the year used as the measure of the tax. A person who keeps his books on the completed contract or percentage of completion method of accounting, or a combination thereof, must report receipts either on the basis of receipts actually or constructively received (cash basis) during the period used as the measure of the tax, or on the basis of billings rendered (accrual basis) during the period used as the measure of the tax. The method used must be that one which is consistent with the basis used for reporting receipts on the 1984 Mercantile License Tax. A taxpayer who keeps his books on the completed contract or percentage of completion method of accounting, or a combination thereof, and who was not liable for the 1984 Mercantile License Tax, shall report receipts on the accrual basis.

### **SECTION 314. CONTRACTORS WHO REPAIR, ALTER AND IMPROVE TANGIBLE PERSONAL PROPERTY.**

Persons engaged in business in Philadelphia as contractors who repair, alter and improve tangible personal property for the account of others are subject to tax under the provisions of the Business Privilege Tax Ordinance. When contractors perform labor or services on articles of tangible personal property furnished by the other party to the contract, such contractors are required to report only the amount due them for labor or services rendered.

### **SECTION 315. REAL ESTATE.**

- (1) Real estate brokers and agents are required to include in taxable receipts the commissions and fees received for services rendered as agent in promoting the purchase and sale of real property for others.
- (2) If a person is engaged in the business of taking title to real property and selling same, he is required to include the gross selling price of the property as taxable receipts. The same person may be taxed both as a broker and as a seller, depending on the nature of the transactions. If he

acts as a broker or agent, his tax is based on commissions. If he buys and sells real estate either in his own name or in the name of a straw party, he is taxed on the gross selling price of the real estate.

**SECTION 316. BUILDINGS, HOTELS, APARTMENT HOUSES, BOARDING HOUSES, NURSING HOMES, ETC.**

- (1) Persons operating hotels, apartment houses, boarding houses, nursing homes, rooming houses and all other such establishments must include receipts from renting of rooms, furnishing of meals and any other services rendered.
- (2) Any person carrying on the business of renting buildings, offices, space, stores, dwellings, houses, etc., shall include gross rentals received in the tax base. No deductions may be made for depreciation, cost of maintenance, repairs, etc.
- (3) Persons operating private hospitals, nursing homes and sanitariums are subject to tax. The law exempts such institutions only when they are operated by a non-profit corporation or association organized for religious, charitable or educational purposes.

**SECTION 317. INSURANCE COMPANIES.**

- (1) Insurance companies, whether mutual or stock companies, domestic or foreign, are subject to tax for the privilege of carrying on business in Philadelphia. The tax for the privilege of writing insurance is based on premiums received from risks in Philadelphia, without any deductions therefrom for any cost or expenses whatsoever.
- (2) Reinsurance assumed shall not be included in the tax base; reinsurance ceded is not deductible from gross receipts.
- (3) Receipts from premiums include gross direct premiums less return premiums thereon. Dividends credited to policyholders may be deducted if such dividends are in the nature of an adjustment of the premiums charged.
- (4) Receipts from servicing mortgages, operating hotels and other non-premium business receipts are to be included in the tax base.

**SECTION 318. INSURANCE AGENTS, BROKERS AND UNDERWRITERS.**

- (1) Subject to the provisions of subsections 302(4) and 302(6), agents for insurance companies are required to report as gross receipts the entire commissions received as compensation for their own efforts on policies sold by them directly, and the over-riding commissions received by them upon business produced by brokers or sub-agents.
- (2) Brokers or Subagents. Subject to the provisions of subsections 302(4) and 302(6), brokers or sub-agents are required to report as gross receipts the commissions received as compensation for their services.

- (3) Employee of a single company. A person who represents a single insurance company is subject to tax hereunder unless he:
  - (a) is considered by the company to be its employee; and
  - (b) does not employ solicitors, subagents or other persons to whom he pays salaries, commissions or other compensation in connection with insurance business solicited.

#### **SECTION 319. THEATERS AND MOTION PICTURE HOUSES.**

Persons operating theaters or motion picture houses in Philadelphia, whether as owner or lessee, are required to report as gross receipts the entire box receipts, less admissions taxes collected. No deduction may be taken for commissions, house or film rentals, or any other expenses paid or incurred in connection with exhibitions. Receipts from other sources, such as revenue from the sale of candies, drinks, cigarettes, etc., and commission received on public telephone booths and vending machines, must also be included in the tax base.

#### **SECTION 320. DIVIDENDS.**

- (1) Except as otherwise provided, where a taxpayer, whether a domestic or foreign corporation or any other type of business entity, maintains its commercial domicile in Philadelphia, all dividends are to be included in the measure of the tax, unless attributable to business conducted at a place of business regularly maintained by the taxpayer outside of Philadelphia. Where the commercial domicile of the taxpayer is located outside of Philadelphia, such receipts are to be excluded unless attributable to business conducted at a place of business regularly maintained by the taxpayer within Philadelphia.
- (2) A dividend received in additional stock of the declaring corporation is not to be included in the tax base by a person subject to the provisions of the Business Privilege Tax Ordinances, unless it gives the stockholder an interest different from that represented by his former stockholding. Common stock issued on common stock of the same class, rights and priorities shall be excluded from the tax base, but common stock or preferred stock received as a dividend on preferred stock, or preferred stock received as a dividend on common stock, is subject to inclusion therein at the fair market value thereof.
- (3) Dividends received in partial or complete liquidation of a corporation shall be included in the measure of the tax to the extent of the gain realized on the investment. If a loss is sustained, it may not be offset against gross receipts derived from other sources.

### **SECTION 321. INTEREST.**

- (1) Except as otherwise provided, where a taxpayer, whether a domestic or foreign corporation or any other type of business entity, maintains its commercial domicile in Philadelphia, all interest received is to be included in the measure of the tax, unless attributable to business conducted at a place of business regularly maintained by the taxpayer outside of Philadelphia. Where the commercial domicile of the taxpayer is located outside of Philadelphia, such receipts are to be excluded unless attributable to business conducted at a place of business regularly maintained by the taxpayer within Philadelphia.
- (2) Interest received on obligations of the United States or its possessions or any governmental agency created by act of Congress, or of the Commonwealth, any public authority, commission, board or other agency created by the Commonwealth, any political subdivision of the Commonwealth of any public authority created by such political subdivision is to be excluded from the tax base.
- (3) Interest received on obligations of States other than Pennsylvania, or political subdivisions, authorities, commissions, boards or agencies thereof, or of foreign governments, shall be included in the tax base.

### **SECTION 322. ROYALTIES.**

Except as otherwise provided, where a taxpayer, whether a domestic or foreign corporation or any other type of business entity, maintains its commercial domicile in Philadelphia, all patent, copyright and trademark royalties received are to be included in the measure of the tax unless attributable to business conducted at a place of business regularly maintained by the taxpayer outside of Philadelphia. Where the commercial domicile of the taxpayer is located outside of Philadelphia, such receipts are to be excluded unless attributable to business conducted at a place of business regularly maintained by the taxpayer within Philadelphia.

### **SECTION 323. RECEIPTS FROM SECURITIES TRANSACTIONS.**

- (1) Except as otherwise provided, where a taxpayer, whether a domestic or foreign corporation or any other type of business entity, maintains his commercial domicile in Philadelphia, all gross profits realized from stocks, bonds and other securities, commodity futures, options, commercial paper, notes or other evidences of indebtedness, monetary metals, royalty interests in oil, gas and mineral deposits, etc., sold, exchanged, paid at maturity or redeemed, are to be included in the measure of the tax, unless attributable to business conducted at a place of business regularly maintained by the taxpayer outside of Philadelphia. Where the commercial domicile of the taxpayer is located outside of Philadelphia, such receipts are to be excluded unless attributable to business conducted at a place of business regularly maintained by the taxpayer within Philadelphia.

- (a) If losses are sustained from stocks, bonds, etc., sold, exchanged, paid at maturity, or redeemed, such losses may be offset against gains from such transactions but may not be offset against other receipts.
  - (b) For the purpose of determining the gross profit, the cost of stocks, bonds, etc., shall be deducted from the amount realized on sale, exchange, redemption or maturation.
  - (c) The amount realized shall consist of the gross receipts therefrom less any brokerage fees or commissions paid on the transfer.
  - (d) The costs shall consist of the purchase price of the property plus any brokerage fees or commissions paid on acquisition.
- (2) Sale by issuing corporations. The proceeds derived by a corporation from the original sale of capital stock do not constitute gross receipts, within the meaning of the Business Privilege Tax Ordinance. However, profits realized from the sale of a corporation's own stock, after issuance and repurchase by the corporation, must be included in the measure of the tax.
- (3) Retirement of bonds. When a corporation purchases its own bonds for retirement at a price less than the issuing price or less than face value, the difference between the purchase price and the issuing price or face value must be included in the tax base. Conversely, if a corporation issues bonds at their face value and purchases for retirement any of such bonds at a price in excess of the issuing price or face value, the difference between the issuing price and the purchase price may be deducted, but only to the extent of the profits realized on other securities transactions.
- (4) Hedging transactions. Gains or losses realized on hedging transactions are gains or losses from securities transactions within the meaning of this section.
- (5) U.S. Government and Pennsylvania Obligations. Profits made on the sale, exchange, redemption or payment at maturity of obligations of the United States or its possessions or any governmental agency created by act of Congress, or of the Commonwealth, any public authority, commission, board or other agency created by the Commonwealth, any political subdivision of the Commonwealth or any public authority created by such political subdivision shall be excluded from the tax base.

### **SECTION 324. SALE OF CAPITAL ASSETS.**

Except as otherwise provided, the gains (not gross proceeds) resulting from the sale of capital assets, such as plant, machinery and equipment, furniture and fixtures, vehicles, etc., are to be included in the tax base if the property is located in Philadelphia at the time of the sale. Losses sustained on such sales may be offset against gains from other sales of capital assets, but may not be offset against gross receipts from other sources. In computing the gains or losses from the sale of a capital asset, the cost of the asset, less allowable depreciation, is deductible from the gross proceeds of the sale.

## **SECTION 325. PROCEEDS FROM INSURANCE POLICIES.**

Amounts received on insurance policies as compensation for business property destroyed or damaged shall be excluded to the extent of the depreciated cost of such property. The excess, if any, together with amounts received on insurance policies as compensation for loss of business or loss of income, shall be included in the tax base.

## **SECTION 326. PERSONS REGISTERED UNDER THE ACT OF DECEMBER 5, 1972 P.L. 1280 (KNOWN AS THE PENNSYLVANIA SECURITIES ACT OF 1972), REFERRED TO IN THIS SECTION AS SECURITIES DEALERS.**

- (1) General Rule. Except as otherwise provided, securities dealers are subject to the tax on gross receipts in the same manner and at the same rates as applicable to businesses generally and to financial businesses, subject to the Special Apportionment rules provided in subsection (2).
- (2) Special Apportionment Rules.
  - (a) Securities dealers doing business both within and outside Philadelphia shall apportion commissions, brokerage fees and similar charges which are not otherwise excludible pursuant to any other section of these provisions, on the following basis:
    - (i) 40 percent of commissions, brokerage fees and similar charges from orders originating from a location of the securities dealer outside of Philadelphia, and transmitted to Philadelphia for execution on a Philadelphia exchange, shall be included in the tax base.
    - (ii) 60 percent of commissions, brokerage fees, and similar charges from orders originating from a location of the securities dealer in Philadelphia, and transmitted for execution on an exchange located outside of Philadelphia, shall be included in the tax base.
    - (iii) 100 percent of commissions, brokerage fees, and similar charges from orders originating from a location of the securities dealer in Philadelphia, and transmitted for execution on an exchange located within Philadelphia, shall be included in the tax base.
  - (b) Gains or losses from the sales of stocks, bonds, other securities, commercial paper, commodity futures, options, notes, or other evidences of indebtedness, monetary metals, royalty interests in oil, gas or mineral deposits, etc., owned by a person registered under the Pennsylvania Securities Act of 1972 or with respect to which it is a participating underwriter, shall be treated for the purposes of determining taxability or excludability, as sales of goods and merchandise. Losses on excludable transactions may not be offset against taxable receipts from other transactions.

- (3) Computation of Minimum Tax.

In calculating the minimum tax on securities dealers, a securities dealer may not exclude commissions, brokerage fees and similar charges received on account of transactions effected for persons resident or having their principal place of business outside Philadelphia, as provided in subsection 302(17). However, to the extent that such receipts are otherwise excludible under any

other provision, including subsection 326(2), that portion of such receipts may be excluded from the receipts tax base.

**SECTION 327. APPORTIONMENT OF RECEIPTS.**

The foregoing provisions of Article III provide for the computation and segregation of taxable receipts properly attributable to the doing of business in Philadelphia. In the event that these provisions as applied do not fairly represent the taxpayer's business activity in Philadelphia or that the 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.

## **TAX ON NET INCOME**

### **SECTION 401. IRREVOCABLE ELECTION OF "NET INCOME" COMPUTATION METHOD.**

- (1) Net income can be computed by either of two methods, at the option of the taxpayer. Except as otherwise provided in this section, the method which is used by a taxpayer to compute the tax based on net income on the first Business Privilege Tax Return filed by that taxpayer, is the method which must be used by that taxpayer in all consecutive succeeding years.
- (2) A taxpayer who has discontinued engaging in business activity in the City of Philadelphia for the period of at least one full tax year (January 1 to December 31) and then recommences engaging in business activity with the City, may elect to use either method of computing net income for the first Business Privilege Tax Return due after recommencing business activity in the City.

### **SECTION 402. CORPORATIONS PARTICIPATING IN THE FILING OF A CONSOLIDATED RETURN.**

In the case of a corporation participating in the filing of a consolidated corporate return to the Federal Government, net income shall mean either:

- (1) The income from any business activity as it would have been properly returned to and ascertained by the Federal Government by that corporation on a separate return, subject to the adjustments to net income provided in this Article, and as allocated and apportioned as provided in this Article; or
- (2) The net income for that corporation as computed under Net Income Method I.

### **SECTION 403. NET INCOME METHOD I.**

Method I Net Income shall be the net gain from the operation of a business, profession or other activity after provision for all allowable expenses actually incurred in the conduct thereof, either paid or accrued in accordance with the accounting system used, without deduction of taxes based on income, and without deduction of fines and penalties, and as allocated and apportioned as provided in this Article and after adjustment for the distributive share of net income or loss received by one partner from a partnership where the receiving partner's ownership of capital at the end of the year is at least twenty-percent (20%) as reported on Schedule K-1 of Federal Form 1065 of the distributing partnership. The rules and regulations applicable to determining taxable net profits for the Net Profits tax imposed in Chapter 19-1500 of The Philadelphia Code shall be the rules and regulations applicable to determining taxable net income for Net Income Method I.

## SECTION 404. NET INCOME METHOD II.

### (1) General.

- (a) 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, plus the taxpayer's nonbusiness income which is allocated to Philadelphia. The adjustments to taxable income (or loss) are provided in subsections (2)(a) through (2)(f).
- (b) Taxable income as properly returned to the Federal Government means the taxable income (or loss) as should have been reported to the Internal Revenue Service on a tax return form, in accordance with the Internal Revenue Code, the Regulations issued thereunder, applicable rulings and court decisions. In the case of a partnership, joint venture, association, syndicate, pool or similar organization, or an S corporation, taxable income from any business activity as returned to and ascertained by the Federal Government shall mean "Ordinary income (loss)" as reported on Form 1065, U.S. Partnership Return of Income, or on Form 1120S, U.S. Income Tax Return for an S Corporation, subject to the following adjustments to reflect items of income and expense passed through separately on Schedule K-1 to the partners, joint ventures, etc., or shareholders:
  - (i) An increase for:
    - (.1) Guaranteed payments to partners.
    - (.2) Dividends qualifying for exclusion.
    - (.3) Net short-term capital gain.
    - (.4) Net long-term capital gain.
    - (.5) Net gain from involuntary conversions due to casualty or theft.
    - (.6) Other net gain under Section 1231 of the Internal Revenue Code.
    - (.7) Interest.
    - (.8) Other dividends.
    - (.9) Royalties.
    - (.10) Net rental income.
    - (.11) Portfolio income.
  - (ii) A decrease for:
    - (.1) Net short-term capital loss.
    - (.2) Net long-term capital loss.
    - (.3) Net loss from involuntary conversions due to casualty or theft.
    - (.4) Other net loss under Section 1231 of the Internal Revenue Code.

- (.5) Expense deduction for recovery property under Section 179 of the Internal Revenue Code.
  - (.6) Investment interest expense.
  - (.7) Depletion.
  - (.8) Net rental loss.
  - (.9) Other deductions related to portfolio income.
- (c) The above referenced items are not to be construed as an all inclusive list. The tax base is the actual earnings of the business without recognition of Federal characterizations which are commonly referred to as pass through items.
- (d) All businesses must allocate non-business income after making the prescribed adjustments to net income.
- (2) Adjustments to Net Income. The following adjustments are applicable only to the computation of net income under Method II, and may not be used in computing net income under Method I. These adjustments shall be deducted or added in the order provided hereunder, and shall be computed based on receipts and deductions reflected in the computation of taxable income as properly returned to and ascertained by the Federal Government. If the Amount of any of the adjustments in subsections (2)(a) through (2)(g) is less than zero, the taxpayer shall add that amount to the adjusted net income remaining after making the preceding adjustments (increase net income), or shall deduct that amount from the adjusted net loss remaining after making the preceding adjustments (reduce the net loss), as the case may be. If the amount of any of the adjustments in subsections (2)(a) through (2)(g) is more than zero, the taxpayer shall deduct that amount from the adjusted net income remaining after making the preceding adjustments (decrease net income), or shall add that amount to the adjusted net loss remaining after making the preceding adjustments (increase net loss), as the case may be.
- (a) A taxpayer shall reduce net income or increase net loss by the amount of interest and dividends earned on and the net gains from the transfer of all direct obligations of the United States Government, Pennsylvania and its political subdivisions, including stocks, bonds and Treasury notes and other direct obligations of the United States Government or Pennsylvania and its political subdivisions, and a taxpayer shall increase net income or reduce net losses by the amount of any net losses from the transfer of all direct obligations of the United States Government or Pennsylvania and its political subdivisions, including stocks, bonds and Treasury notes and other direct obligations of the United States Government or Pennsylvania and its political subdivisions.
  - (b) A taxpayer shall increase net income or reduce net loss by the amount of any interest expense attributable to direct obligations of the United States Government, Pennsylvania and their political subdivisions, including stocks, bonds, Treasury notes and other direct obligations of the United States Government, Pennsylvania and their political subdivisions, the income from which is exempt from taxation of income under the laws of the United States or of the Commonwealth of Pennsylvania. The increase of income or reduction of net loss under this subsection shall not exceed the deduction claimed in subsection (2)(a) except that if the amount of the adjustment under subsection (2)(a) is less than zero, the adjustment under this subsection shall be zero.

- (c) A public utility shall deduct net income attributable to the receipts from its specific business operations conducted under the laws, rules and regulations administered by the Pennsylvania Public Utility Commission, derived from furnishing or supplying services at the rates specified in its tariffs. A contract carrier is not a public utility. A taxpayer shall deduct net income attributable to receipts from its specific business operations which are subject to the jurisdiction of the Interstate Commerce Commission derived from furnishing services at the rates specified in its tariffs.
- (d) A taxpayer shall deduct net income attributable to its receipts from the business of loading or discharging cargo to or from vessels when conducted at piers, wharves or marine terminal facilities in the Port of Philadelphia and from related business activities conducted on such premises such as furnishing dockage, wharfage, truck and/or railroad car loading and unloading and storage of cargo which is to be loaded onto or has been discharged from vessels at a pier, wharf or marine terminal facility in the Port of Philadelphia.
- (e) When applicable, a corporation or partnership shall deduct the following receipts if, and to the extent, such receipts are included in taxable income as properly returned to and ascertained by the Federal Government as heretofore defined:
  - (i) Dividends, interest, royalties and distributive share of partnership income received from:
    - (.1) Another corporation of the same affiliated group, or
    - (.2) A corporation of which the receiving corporation or partnership owns at least twenty percent (20%) of the voting power of all classes of stock and at least twenty percent (20%) of each class of nonvoting stock.
    - (.3) A partnership of which the receiving corporation or partnership owns at least twenty percent (20%) of the capital at the end of the year as reported on Schedule K-1 of Federal Form 1065 of the distributing partnership.
  - (ii) A corporation may deduct all other receipts received from another corporation which is a member of the same affiliated group.
  - (iii) The extent to which the receipts described in subsection (2)(e)(ii) are included in taxable income (or loss) as properly returned to and ascertained by the Federal Government shall be determined in accordance with a fraction of which the numerator shall be receipts as hereafter described and of which the denominator shall be receipts as hereafter described. The numerator and denominator shall not include any receipts which are not reflected in the computation of taxable income (or loss) as properly returned to and ascertained by the Federal Government, and shall not include any receipts which are reflected in the adjustments to net income (or loss) provided in subsections (2)(a), (2)(c) and (2)(e)(i).
  - (iv) Numerator. Except as otherwise provided, the numerator of the fraction shall include the following receipts:
    - (.1) Except for receipts described in 2(e)(i), all receipts from another corporation which is a member of same affiliated group, including but not limited to:

- (.a) Gross receipts from the sales exchange or transfer of real property and tangible personal property.
  - (.b) Gross receipts from intangible personal property sold, exchanged, transferred, paid at maturity or redeemed.
  - (.c) Gross rents and royalties from real property and tangible personal property.
  - (.d) Patent, copyright and trademark royalties.
  - (.e) Commissions, fees, receipts from services rendered and insurance premiums received by insurance companies.
- (v) Denominator. Except as otherwise provided, the denominator of the fraction shall include all receipts from whatever source, except that the denominator shall not include any receipts which are not reflected in the computation of taxable income (or loss) as properly returned to and ascertained by the Federal Government, and shall not include any receipts which are reflected in the adjustments to net income (or loss) provided in subsections (2)(a), (2)(c) and (2)(e)(i).
- (vi) Application of fraction. The percentage equivalent of the fraction shall be multiplied against the taxable income (or loss) remaining after making the adjustments provided in subsections (2)(a) through (2)(e)(i). If the result is more than zero, the taxpayer shall deduct that amount from the adjusted net income remaining after making the preceding adjustments (reduce the net income). If the result is less than zero, the taxpayer shall deduct that amount from the adjusted net loss remaining after making the preceding adjustments (reduce adjusted net loss).
- (f) Taxpayers registered under the Pennsylvania Securities Act of 1972 shall deduct all net income which is not attributable to commissions, brokerage fees and similar charges on account of transactions effected for persons residing or having their principal place of business within the City of Philadelphia, except to the extent that such deductible net income is attributable to income which is otherwise taken as an adjustment to net income under subsections (2)(a), (2)(b) or (2)(e).
- (g) When applicable, a partnership or corporation receiving a distributive share of a partnership loss from a partnership of which the receiving partnership or corporation owns at least twenty (20) percent of the capital of the distributing partnership at the end of the year, as reported on Schedule K-1 of Federal Form 1065 of the distributing partnership, shall increase net income or reduce net loss of the receiving partnership or corporation to the extent that such loss is included in the net income or net loss of the receiving partnership or corporation.

## **SECTION 405. DIVISION OF INCOME.**

- (1) Method of division of income. Income shall be divided as follows:
  - (a) Business income is apportioned, subject to the limitations set forth in subsection (2).
  - (b) Nonbusiness income is allocated.
- (2) Taxability of Business Income.
  - (a) All of the business income of taxpayers engaged in business solely within Pennsylvania is taxed on an apportioned basis to reflect business income attributable to doing business in Philadelphia.
  - (b) For taxpayers engaged in business both within and without Pennsylvania, all business income is presumed to be taxable on an apportioned basis to reflect business income attributable to doing business in Philadelphia. However, this presumption is subject to the "unitary business principle" as interpreted by the courts. A taxpayer may exclude certain business income from apportionable income if the taxpayer can establish:
    - (i) that such income was earned outside of Pennsylvania;
    - (ii) that such income was earned in the course of activities wholly unrelated (in business and economic sense) to the taxpayer's activities in Pennsylvania; and
    - (iii) generally, that the income was earned in a discrete business enterprise which is not a part of a unitary business of which the taxpayer's Pennsylvania activities form a part.

It is the taxpayer's burden to overcome the presumption that its activities both within and without Pennsylvania are all part of a single unitary business the income of which is fully taxable, on an apportioned basis, in Philadelphia.
- (3) Applications. The applications below illustrate the provisions of this rule relating to whether particular income is business or nonbusiness income. The applications used are illustrative only and do not purport to set forth all pertinent facts used in determination of whether particular income is business or nonbusiness income.
  - (a) Rents from real and tangible personal property. Rental income from real and tangible property is business income if the property with respect to which the rental income was received is used in the taxpayer's trade or business or is incidental thereto and therefore is includible in the property apportionment factor.
  - (b) Gains or losses from sales of assets. Gain or loss from the sale, exchange or other disposition of real or tangible or intangible personal property constitutes business income if the property, while owned by the taxpayer, was used in the taxpayer's trade or business.
  - (c) Interest. Interest income is business income where the intangible with respect to which the interest was received arises out of or was created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the intangible is related to or incidental to such trade or business operations.

- d) Dividends. Dividends are business income where the stock with respect to which the dividends are received arises out of or was acquired in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the stock is related to or incidental to such trade or business operations.
- e) Patent, trademark, and copyright royalties. Patent, trademark and copyright royalties are business income where the patent or trademark or copyright with respect to which the royalties were received arises out of or was created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the patent or trademark or copyright is related to or incidental to such trade or business operations.

#### **SECTION 406. ALLOCATION OF NONBUSINESS INCOME.**

- (1) Nonbusiness income (or loss) shall be allocated within or without Philadelphia according to the following rules. Allocable nonbusiness income (or loss) does not include any receipts, net income, gains or losses taken as an adjustment to net income (or loss) under subsections 404(2)(a), 404(2)(e)(i) and 404(2)(f), and does not include receipts or the net income, gains or losses attributable thereto, which are included in the numerator of the fraction used in computing the adjustment under subsection 404(2)(e)(ii).
  - (a)
    - (i) Net rents and royalties from real property located in Philadelphia are allocable to Philadelphia.
    - (ii) Net rents and royalties from tangible personal property are allocable to Philadelphia if, and to the extent that, the property is utilized in Philadelphia.
      - (.1) The extent of utilization of tangible personal property in Philadelphia is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of the physical location of the property in Philadelphia during the rental or royalty period in the income year and the denominator of which is the number of days of the physical location of the property everywhere during all rental or royalty periods in the income year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, the tangible personal property is deemed to be utilized at the situs in which the property was located at the time the rental or royalty payor obtained possession of the property.
  - (b)
    - (i) Capital gains and losses from sales of real property located in Philadelphia are allocable to Philadelphia.
    - (ii) Capital gains and losses from sales of tangible personal property are allocable to Philadelphia if the property had a situs in Philadelphia at the time of the sale.
    - (iii) Capital gains and losses from sales of intangible personal property are allocable to Philadelphia if the taxpayer's commercial domicile is in Philadelphia.
  - (c) Interest and dividends are allocable to Philadelphia if the taxpayer's commercial domicile is in Philadelphia.

- (d) (i) Patent, copyright and trademark royalties are allocable to Philadelphia if, and to the extent that, the patent or copyright is utilized by the payor in Philadelphia.
- (ii) A patent is utilized in Philadelphia to the extent that it is employed in production, fabrication, manufacturing, or other processing in Philadelphia or to the extent that a patented product is produced in Philadelphia. If the basis of receipts from patent royalties does not permit allocation to specific areas or if the accounting procedures do not reflect areas of utilizations the patent is utilized in the jurisdiction in which the taxpayer's commercial domicile is located.
- (iii) A copyright is utilized in Philadelphia to the extent that printing or other publication originates in Philadelphia. If the basis of receipts from copyright royalties does not permit allocation to specific areas or if the accounting procedures do not reflect areas of utilization, the copyright is utilized in the jurisdiction in which the taxpayer's commercial domicile is located.
- (iv) A trademark is utilized in Philadelphia to the extent that the trademark is applied to the goods in Philadelphia, or if the trademark is not applied to the goods, to the extent that the goods are placed in a package or container bearing the trademark in Philadelphia. If the basis of receipts from trademark royalties does not permit allocation to specific areas or if the accounting procedures do not reflect areas of utilization, the trademark is utilized in the jurisdiction in which the taxpayer's commercial domicile is located.

#### **SECTION 407. COMPUTATION OF TAXABLE NET INCOME OR LOSS.**

- (1) (a) If the net total amount of nonbusiness income, whether allocable within or without Philadelphia, is more than zero, the taxpayer shall deduct that amount from the adjusted net income (decrease the adjusted net income) to compute the apportionable net income or loss; or shall deduct that amount from the adjusted net loss (increase the adjusted net loss) to compute the apportionable net income or loss.
- (b) If the net total amount of nonbusiness income, whether allocable within or without Philadelphia, is less than zero, the taxpayer shall add that amount to the adjusted net income (increase the adjusted net income) to compute the apportionable net income or loss; or shall deduct that amount from the adjusted net loss (reduce the adjusted net loss) to compute the apportionable net income or loss.
- (2) After apportionment of net income to Philadelphia, nonbusiness income or losses allocable to Philadelphia shall be added to or deducted from apportioned net income or losses to determine taxable net income or loss in accordance with whichever one of the following rules is applicable:
  - (a) Nonbusiness income shall be added to apportioned net income.
  - (b) Nonbusiness income shall be added to apportioned net losses so as to reduce the net loss.
  - (c) Nonbusiness losses shall be deducted from apportioned net income.
  - (d) Nonbusiness losses shall be added to apportioned net losses so as to increase the net loss.

**SECTION 408. APPORTIONMENT OF INCOME BY ALL PERSONS OTHER THAN PERSONS WHO ARE SUBJECT TO A TAX PURSUANT TO ARTICLES VII (BANK SHARES TAX), VIII (TITLE INSURANCE AND TRUST COMPANIES SHARES TAX), IX (INSURANCE PREMIUMS TAX) OR XV (MUTUAL THRIFT INSTITUTIONS TAX) OF THE REFORM CODE OF 1971, AND PRIVATE BANKS.**

Except as otherwise provided, a taxpayer's net income after adjustments and allocation shall be apportioned to Philadelphia in accordance with a formula composed of a property factor, a payroll factor and a receipts factor.

(1) Property Factor.

- (a) General. The property factor of the apportionment formula shall include all real and tangible personal property owned and rented by the taxpayer and used during the income year or period in the regular course of the taxpayer's trade or business. The term "real and tangible personal property" includes land, buildings, machinery, stocks of goods, equipment, and other real and tangible personal property but does not include coin or currency. The property factor shall include the average value of property includible in the factor.

Property shall be included in the property factor if it is actually used or is available for or capable of being used during the income period. Property held as reserves or standby facilities or property held as a reserve source of materials shall be included in the factor. For example, a plant temporarily idle or raw material reserves not currently being processed are includible in the factor. Property or equipment under construction during the tax period (except inventorable goods in process) shall be excluded from the factor until such property is actually used for the production of income. If the property is partially used for the production of income while under construction, the value of the property to the extent used shall be included in the property factor. Property held for the production of income shall remain in the property factor until its permanent withdrawal is established by an identifiable event such as its sale or the lapse of an extended period of time (normally, five years) during which the property is held for sale.

Property used in connection with the production of nonbusiness income shall be excluded from the property factor. Property used both in the regular course of taxpayer's trade or business and in the production of nonbusiness income shall be included in the factor only to the extent the property is used in the regular course of taxpayer's trade or business.

Property used in connection with the production of receipts, net income, gains or losses taken as an adjustment to net income (or loss) shall be excluded from the property factor to the extent the property is so used. The method of determining that portion of the value to be included in the factor will depend upon the facts of each case.

- (b) Numerator. The numerator of the property factor shall include the average value of the real and tangible personal property owned or rented by the taxpayer and used within Philadelphia during the income period. This amount will be tangible personal property owned plus the value of real and tangible personal property rented (as determined pursuant to subsection (1)(d)(ii)). Taxpayer's property in transit between locations of the taxpayer shall be considered to be at the destination for purposes of the property factor. Property in transit between a buyer and seller which is included by a taxpayer in the

denominator of its property factor in accordance with its regular accounting practices shall be included in the numerator according to the location of destination. The value of mobile or movable property such as construction equipment, trucks or leased electronic equipment which are located within and without Philadelphia during the income period shall be determined for the purposes of the numerator of the factor on the basis of total time within Philadelphia during the income period. An automobile assigned to a traveling employee shall be included in the numerator if the employee's compensation is included in the numerator of the payroll factor.

(c) Denominator. The denominator of the property factor shall include the average value of the real and tangible personal property owned or rented by the taxpayer everywhere. This amount shall be determined pursuant to the same procedures used to calculate the numerator.

(d) Valuation of Property.

(i) Valuation of Owned Property. Property owned by the taxpayer shall be valued at its original cost. As a general rule, "original cost" is deemed to be the basis of the property for federal income tax purposes (prior to any federal adjustments) at the time of acquisition by the taxpayer and adjusted by subsequent capital additions or improvements thereto and partial disposition thereof, by reason of sale, exchange or abandonment, etc., provided that any taxpayer subject to the jurisdiction of a regulatory agency shall determine the original cost of its property in accordance with the system of accounts prescribed by the regulatory agency for such taxpayer.

If the original cost of property is unascertainable, the property is included in the factor at its fair market value as of the date of acquisition by the taxpayer.

Inventory of stock of goods shall be included in the factor in accordance with the valuation method used for federal income tax purposes.

Example (1): The taxpayer acquired a factory building in Philadelphia at a cost of \$500,000 and 18 months later expended \$100,000 for major remodeling of the building. Taxpayer files its return for the current taxable year on the calendar year basis. Depreciation deduction in the amount of \$22,000 was claimed on the building for its return for the current taxable year. The value of the building includible in the numerator and denominator of the property factor is \$600,000, as the depreciation deduction is not taken into account in determining the value of the building for purposes of the factor.

Example (2): During the current taxable year, X Corporation merges into Y Corporation in a tax-free reorganization under the Internal Revenue Code. At the time of this merger, X Corporation owns a factory which X built five years earlier at a cost of \$1,000,000. X has been depreciating the factor at the rate of two percent per year, and its basis in X's hands at the time of the merger is \$900,000. Since the property is acquired by Y in a transaction in which, under the Internal Revenue Code, its basis in Y's hands is the same

as its basis in X's, Y includes the property in Y's property factor at X's original cost, without adjustment for depreciation, i.e., \$1,000,000.

Example (3): Corporation Y acquires the assets of Corporation X in a liquidation by which Y is entitled to use its stock cost as the basis of the X assets under section 334 (b)(2) of the 1954 Internal Revenue Code (i.e., stock possessing 80 percent control is purchased and liquidated within two years). Under these circumstances, Y's cost of the assets is the purchase price of the X stocks prorated over the X assets.

- (ii) Valuation of Rented Property. Property rented by the taxpayer is valued at eight times its net annual rental rate. The net annual rental rate for any item of rented property is the annual rate paid by the taxpayer for such property, less the aggregate annual subrental rates paid by subtenants of the taxpayer. Subrents are not deducted when the subrents constitute business income because the property which produces the subrents is used in the regular course of a trade or business of the taxpayer when it is producing such income. Accordingly, there is no reduction in its value. If the subrents taken into account in determining the net annual rental rate produce a negative or clearly inaccurate value for any item of property, another method which will properly reflect the value of rental property may be required by the Department or requested by the taxpayer. In no case, however, shall such value be less than an amount which bears the same ratio to the annual rental paid by the taxpayer for such property as the fair market value of that portion of the property used by the taxpayer bears to the total fair market value of the rented property. If property owned by others is used by the taxpayer at no charge or rented by the taxpayer for a nominal rate, the net annual rental rate for such property shall be determined on the basis of a reasonable market rental rate for such property.

Leasehold improvements shall, for the purposes of the property factor, be treated as property owned by the taxpayer regardless of whether the taxpayer is entitled to remove the improvements or the improvements revert to the lessor upon expiration of the lease. Hence, the original cost of leasehold improvements shall be included in the factor.

Example (1): The taxpayer rents a 20 story office building and uses the lower two stories for its general corporation headquarters. The remaining 18 floors are subleased to others. The rental of the eighteen floors is not incidental to but rather is separate from the operation of the taxpayer's trade or business. The subrents are to be deducted from the rent paid by the taxpayer.

Example (2): The taxpayer rents a 10-story building at an annual rental rate of \$1,000,000. Taxpayer occupies two stories and sublets eight stories for \$1,000,000 a year. The net annual rental rate of the taxpayer must not be less than two-tenths of the taxpayer's annual rental rate for the entire years or \$20,000.

"Annual rental rate" is the amount paid as rental for property for a 12-month period (i.e., the amount of the annual rent). Where property is rented for less than a 12-month period, the rent paid for the actual period of rental shall constitute the "annual rental rate" for the tax period. However, where a taxpayer has rented property for a term of 12 or more months and the income period covers a period of less than 12 months (due, for example, to a reorganization or change of accounting period), the rent paid for the short income period shall be annualized. If the rental term is for less than 12 months, the rent shall not be annualized beyond its term. Rent shall not be annualized because of the uncertain duration when the rental term is on a month to month basis.

Example (1): Taxpayer A, which ordinarily files its returns based on a calendar year, is merged into Taxpayer B on April 30. The net rent paid under a lease with 5 years remaining is \$2,500 a month. The rent for the period January 1 to April 30 is \$10,000. After the rent is annualized, the net rent is \$30,000 ( $\$2,500 \times 12$ ).

Example (2): Same facts as in Example (1) except that the lease would have terminated on August 31. In this case the annualized net rent is \$20,000 ( $\$2,500 \times 8$ ).

"Annual rent" is the actual sum of money or other consideration payable, directly or indirectly, by the taxpayer or for its benefit for the use of the property and includes (A) any amount payable for the use of real or tangible personal property or any part thereof, whether designated as a fixed sum of money or as a percentage of sales, profits, or otherwise; and (B) any amount payable as additional rent or in lieu of rents, such as interest, taxes, insurance, repairs or any other items which are required to be paid by the terms of the lease or other arrangement, not including amounts paid as service charges, such as utilities, janitor services, etc. If a payment includes rent and other charges unsegregated, the amount of rent shall be determined by consideration of the relative values of the rent and the other items.

Example (1): A taxpayer, pursuant to the terms of a lease, pays the lessor \$12,000 a year rent plus taxes in the amount of \$2,000 and interest on a mortgage in the amount of \$1,000. The annual rent is \$15,000.

Example (2): A taxpayer stores part of its inventory in a public warehouse. The total charge for the year was \$1,000 of which \$700 was for the use of storage space and \$300 for inventory insurance handling and shipping charges, and C.O.D. collections. The annual rent is \$700.

Example (3): A taxpayer, pursuant to the terms of a lease, pays a lessor \$1,000 per month as a base rental and at the end of the year pays the lessor one percent of its gross sales of \$400,000. The annual rent is \$16,000 ( $\$12,000$  plus one percent of \$400,000 or \$4,000).

- (e) **Averaging Property Values.** As a general rule, the average value of property owned by the taxpayer shall be determined by averaging the value at the beginning and ending of the income period. However, the Department may require or allow averaging by monthly

values if such method of averaging is required to properly reflect the average value of the taxpayer's property for the income period. Averaging by monthly values will generally be applied if there is substantial fluctuation in the value of the property during the income period or where property is acquired after the beginning of the income period or disposed of before the end of the income period.

Example: The monthly value of the taxpayer's property was as follows:

January	\$ 2,000
February	2,000
March	3,000
April	3,500
May	4,500
June	10,000
July	15,000
August	17,000
September	23,000
October	25,000
November	13,000
December	<u>2,000</u>
Total	\$120,000

The average value of the taxpayer's property includible in the property factor for the income year is determined as follows:

$$\$120,000/12 = \$10,000$$

Averaging with respect to rented property is achieved automatically by the method of determining the net annual rental rate of such property as set forth in subsection (1) (d) (ii).

(2) Payroll Factor.

- (a) General. The payroll factor of the apportionment formula shall include the total amount paid by the taxpayer in the regular course of its trade or business for compensation during the tax period except that to the extent that compensation is paid to employees in connection with the production of receipts, net income, gains or losses taken as an adjustment to net income (or loss), such compensation shall be excluded from the payroll factor. The payroll factor shall not include compensation paid to employees in connection with the production of nonbusiness income. Compensation paid to employees working both in the regular course of taxpayer's trade or business and in the production of nonbusiness income shall be included in the factor only to the extent the compensation is paid for work performed in the regular course of taxpayer's trade or business.

Example (1): The taxpayer uses some of its employees in the construction of a storage building which, upon completion, is used in the regular course of

taxpayer's trade or business. The wages paid to those employees are treated as a capital expenditure by the taxpayer. The amount of such wages is included in the payroll factor.

Example (2): The taxpayer owns various securities as an investment separate and apart from its trade or business. The management of the taxpayer's investment portfolio is the only duty of Mr. X, an employee. The salary paid to Mr. X is excluded from the payroll factor.

The total amount "paid" to employees is determined upon the basis of the taxpayer's accounting method. If the taxpayer has adopted the accrual method of accounting, all compensation properly accrued shall be deemed to have been paid.

The term "compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services. Payments made to an independent contractor or any other person not properly classifiable as an employee are excluded. Only amounts paid directly to employees are included in the payroll factor. Amounts considered paid directly include the value of board, rent, housing, lodging and other benefits or services furnished to employees by the taxpayer in return for personal services provided that such amounts constitute income to the recipient under the Federal Internal Revenue Code.

In the case of employees not subject to the Internal Revenue Code, e.g., those employees in foreign countries, the determination of whether such benefits or services would constitute income to the employees shall be made as though such employees were subject to the Federal Internal Revenue Code.

In filing returns with Philadelphia, if the taxpayer departs from or modifies the treatment of compensation paid used in returns for prior years, the taxpayers shall disclose in the return for the current year the nature and extent of the modification.

- (b) Numerator. The numerator of the payroll factor is the total amount paid in Philadelphia during the period by the taxpayer for compensation.
- (c) Denominator. The denominator of the payroll factor is the total amount paid everywhere during the tax period by the taxpayer for compensation. This amount shall be determined pursuant to the same procedures used to calculate the numerator.
- (d) Compensation Paid in Philadelphia. Compensation is paid in Philadelphia if:
  - (i) The employee's service is performed entirely within the City; or
  - (ii) The employee's services are performed both within and without the City, and
    - (.1) the service performed without the City is incidental to the employee's service within the City. The word "incidental" means any service which is temporary or transitory in nature, or which is rendered in connection with an isolated transaction; or
    - (.2) the employee's base of operations is in this City; or
    - (.3) There is no base of operations in any political subdivision in which some part of the service is performed but the place from which the service is directed or controlled is in this City; or

- (.4) The base of operations or the place from which the service is directed or controlled is not in any political subdivision in which some part of the service is performed, but the employee's residence is in the City.

The term "base of operations" is the place of more or less permanent nature from which the employee starts his work and to which he customarily returns in order to receive instructions from the taxpayer or communications from his customers or other persons or to replenish stock or other materials, repair equipment or perform any other function necessary to the exercise of his trade or profession at some other point or points. The term "place from which the service is directed or controlled" refers to the place from which the power to direct or control is exercised by the taxpayer.

(3) Receipts Factor.

- (a) Numerator. The numerator of the receipts factor shall be receipts as defined and limited by the provisions dealing with "Tax on Receipts" adjusted as follows:
  - (i) The following shall not be included in the numerator:
    - (.1) Receipts, or the net income, gain or losses attributable thereto, which are taken as an adjustment to net income (or loss) pursuant to Section 404;
    - (.2) Receipts that contribute to net income, gain or loss which constitutes nonbusiness income allocated within or without Philadelphia pursuant to Section 406.
  - (ii) The following receipts shall be included in the numerator:
    - (.1) Those receipts referred to in subsection 302(7)(d).
- (b) Denominator. The denominator of the receipts factor shall be receipts as defined and limited by the provisions dealing with "Tax on Receipts", adjusted as follows:
  - (i) The following shall not be included in the denominator:
    - (.1) Receipts, or the net income, gain or losses attributable thereto, which are taken as an adjustment to net income (or loss) pursuant to Section 404;
    - (.2) Receipts that contribute to net income, gain or loss which constitutes nonbusiness income allocated within or without Philadelphia pursuant to Section 406.
  - (ii) The following receipts shall be included in the denominator:
    - (.1) Those receipts referred to in subsections 302(6), 302(7)(c) and (d) and 302(13).

(4) Excludable Factors (Zero in Numerator or Denominator).

In the event any of the factors has a denominator which is zero or an insignificant amount, that factor shall be omitted from the computation. For this purpose, an insignificant amount shall mean an amount so small that inclusion of the factor would result in an apportionment that does not fairly represent the taxpayer's business activity in Philadelphia. If, however, the numerator is zero and the denominator is represented by an amount which is not insignificant, the resultant percentage is zero, and is includible in the computation.

(5) Weighted Averaging. A weighted average of factors shall be obtained by adding the property factor plus the payroll factor plus twice the sales factor and dividing that total by four. If any factor is excludable as provided in subsection 408 (4), then the weighted average shall be computed as the sum of includible factors (with the sales factor multiplied by two, if it is one of the includible factors) divided by the number of includible factors (with the sales factor, if includible, counted as two includible factors)

Example 1: Corporation W had no property in Philadelphia but the average value of its property everywhere in 19X1 amounted to \$275,000. W's payroll in Philadelphia in 19X1 amounted to zero and the total payroll everywhere was \$125,000. W reported receipts in Philadelphia in 19X1 of \$5,000,000 and receipts everywhere of \$8,000,000. The apportionment fraction is computed as follows:

$$\begin{array}{l} \text{Property} \quad \$ \quad \frac{0}{275,000} = 0 \\ \text{Payroll} \quad \$ \quad \frac{0}{125,000} = 0 \\ \text{Sales} \quad \$5,000,000 \quad = .625 \times 2 = 1.25 \\ \quad \quad \quad 8,000,000 \\ \text{Total Percentages} \quad = 1.25 \\ \text{Average of Percentages} \\ (1.25 \div 4) = .3125 \end{array}$$

Example 2: Corporation Y had **no** property and **no** payroll assignable **outside** of Philadelphia. Y's average value of property in 19X2 amounted to \$275,000 and its total payroll in 19X2 was \$125,000. Y reported receipts in Philadelphia in 1994 of \$5,000,000 and receipts everywhere of \$8,000,000. The apportionment fraction is computed as follows:

$$\begin{array}{l} \text{Property} \quad \frac{\$275,000}{275,000} = 1.00 \\ \text{Payroll} \quad \frac{\$125,000}{125,000} = 1.00 \end{array}$$

$$\begin{array}{rcl} \text{Sales} & \frac{\$5,000,000}{8,000,000} \times 2 = & 1.25 \\ \text{Total Percentages} & = & 3.25 \\ \text{Average of Percentages} & = & \\ (3.25 \div 4) & = & .8125 \end{array}$$

- (6) Application of Fraction. The amount of apportioned net income (or loss) to be included in the measure of the tax is determined by multiplying the weighted average of factors computed pursuant to subsection 408 (5) by the net income (or loss) after adjustments and allocation of nonbusiness income.
- (7) Other Methods of Apportionment. If the regularly applicable apportionment method does not fairly represent the taxpayer's business activity in Philadelphia, the taxpayer may petition for, or the Department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
- (a) Separate Accounting;
  - (b) The exclusion of one or more additional factors;
  - (c) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this City; or
  - (d) The employment of any other method to effectuate an equitable apportionment of the taxpayer's income.

A departure from the applicable method of apportionment may be permitted only where the method does not accurately and fairly reflect business activity in Philadelphia. An alternative method may not be invoked, either by the Department or the taxpayer, merely because it reaches a different apportionment percentage than the regularly applicable formula. However, if the applicable formula will lead to a grossly distorted result in a particular case, a fair and accurate alternative method is appropriate. The taxpayer seeking to utilize an alternative apportionment method must show by clear and cogent evidence that the regularly applicable formula would result in taxation of net income which is not properly attributable to the doing of business in Philadelphia. This can be shown only, if the regularly applicable formula is demonstrated to operate unreasonably and arbitrarily in attributing to Philadelphia a percentage of income which is out of all proportion to the taxpayer's business activity in Philadelphia. The taxpayer seeking to use an alternative formula must prove that the alternative formula fairly and accurately apportions income to Philadelphia based upon business activity in this City. A departure from the regularly applicable apportionment method will be authorized only in limited and specific cases where unusual fact situations (which ordinarily will be unique and nonrecurring) produce incongruous results under the regularly applicable apportionment provisions.

**SECTION 409. RECOMPUTATION OF TAXABLE NET INCOME OR LOSS BY PERSONS REGISTERED UNDER THE PENNSYLVANIA SECURITIES ACT OF 1972, WHO ELECT TO REPORT TAXABLE NET INCOME UNDER METHOD II (SECTION 404).**

1. In addition to the computation of taxable net income, as adjusted, allocated and apportioned in accordance with Sections 404, 405, 406, 407 and 408, each person registered under the Pennsylvania Securities Act of 1972 who elects to report taxable net income under Method II (Section 404), must recompute taxable net income (or loss) pursuant to the minimum tax provisions in the following manner:
  - (a) Adjusted net income (or loss) as computed pursuant to Section 404, shall be increased or decreased by the amount of the adjustment made pursuant to subsection 404(2)(f) as follows:
    - (i) If the amount of the adjustment made pursuant to subsection 404(2)(f) is less than zero, the taxpayer shall deduct that amount from adjusted net income (decrease net income), or shall add that amount to the adjusted net loss (increase the net loss), as the case may be.
    - (ii) If the amount of the adjustment made pursuant to subsection 404(2)(f) is more than zero, the taxpayer shall add that amount to adjusted net income (increase net income) or add that amount to the adjusted net loss (decrease net loss), as the case may be.
  - (b) The revised adjusted net income as computed in accordance with subsection (a) shall be increased or decreased by the amount of nonbusiness income, as provided in Sections 405, 406 and 407(l).
  - (c) The revised net income after adjustments and allocation shall be apportioned to Philadelphia in accordance with the provisions of Section 408, except that the denominator of the receipts factor shall include those receipts referred to in subsection 302(17).
  - (d) After apportionment of net income to Philadelphia, nonbusiness or losses allocable to Philadelphia shall be added to or subtracted from apportioned net income or losses in accordance with whichever one of the following rules is applicable:
    - (i) Nonbusiness income shall be added to apportioned net income.
    - (ii) Nonbusiness income shall be added to apportioned net losses so as to reduce the net loss.
    - (iii) Nonbusiness losses shall be deducted from apportioned net income.
    - (iv) Nonbusiness losses shall be added to apportioned net losses so as to increase the net loss.

**SECTION 410. APPORTIONMENT OF INCOME BY ALL PERSONS WHO ARE SUBJECT TO A TAX PURSUANT TO ARTICLES VII (BANK SHARES TAX), VIII (TITLE INSURANCE AND TRUST COMPANIES SHARES TAX), IX (INSURANCE PREMIUMS TAX) OR XV (MUTUAL THRIFT INSTITUTIONS TAX) OF THE TAX REFORM CODE OF 1971, AND PRIVATE BANKS.**

- (1) The net income after adjustments and allocation of persons described as being subject to a tax imposed pursuant to Articles VII, VIII, IX or XV of the Tax Reform Code of 1971, and of private banks, shall be apportioned to Philadelphia in accordance with a fraction of which the numerator shall be Philadelphia receipts as hereafter described, and of which the denominator shall be total receipts as hereafter described.
- (2) Numerator. The numerator shall be receipts as defined and limited in the provisions dealing with "Tax on Receipts": Provided, however, that those receipts excluded from the definition of "Taxable Receipts" pursuant to Section 2 of the "First Class City Business Tax Reform Act" of 1984, and treated as an exclusion pursuant to subsections 302(6)(a) and 302(6)(b) of these Provisions, shall be included in the numerator.
- (3) Denominator-Businesses Other Than Insurance Companies. The denominator of the fraction shall include the following receipts to the extent that they are included in taxable income (or loss) as properly returned to and ascertained by the Federal Government, but not including receipts, net income, gains or losses taken as an adjustment to net income (or loss) under subsections 404(2)(a), 404(2)(e)(i), and 404(2)(f), and not including receipts or the net income, gains or losses attributable thereto, which are included in the numerator of the fraction used in computing the adjustment under subsection 404(2)(e)(ii):
  - (a) All rents and royalties from real property and tangible personal property.
  - (b) All gains and losses from real property and tangible and intangible personal property sold, exchanged, transferred, paid at maturity or redeemed. If losses are sustained from real property and tangible and intangible personal property sold, exchanged, transferred, paid at maturity or redeemed, such losses may be offset against gains from similar transactions, but may not be deducted from other receipts.
  - (c) All dividends received.
  - (d) All interest received less the interest expense attributable to such interest received.
  - (e) All patent and copyright royalties.
  - (f) All other receipts.
- (4) Denominator-Insurance Companies. The denominator of the fraction shall include the following receipts to the extent that they are included in taxable income (or loss) as properly returned to and ascertained by the Federal Government: All premiums received, all rents from real estate, and all other nonpremium business receipts, but not including return premiums, dividends paid or credited to policyholders if such dividends are in the nature of an adjustment of the premiums charged, and premiums received for reinsurance, not including receipts, net income, gains or losses taken as an adjustment to net income (or loss) under subsections 404(2)(a), 404(2)(e)(i) and 404(2)(f), and not including receipts or the net income, gains or losses attributable thereto, which are included in the numerator of the fraction used in computing the adjustment under

subsection 404(2)(e)(ii), and not including receipts, or the net income, gains or losses attributable thereto which are allocable within or without Philadelphia under Section 406.

- (5) Application of Fraction. The amount of apportioned net income or loss to be included in the measure of the tax is determined by multiplying the percentage equivalent of the fraction by the apportionable net income or loss.

#### **SECTION 411. NET OPERATING LOSSES.**

- (1) Definition.
  - (a) For taxpayers who have elected to report net income under Method I, a net operating loss means a net loss as computed under Section 403.
  - (b) For taxpayers who have elected to report net income under Method II, a net operating loss means any net loss incurred from the operation of a business, as properly returned to and ascertained by the Federal Government prior to giving effect to the exclusion for dividends received and net operating losses from other tax periods, subject to the same adjustments made applicable to net income, and as allocated and apportioned in accordance with the provisions of Sections 406, 407, 408, 409 and 410. The net operating loss must be apportioned by use of the apportionment factors applicable to the period in which the net operating loss was incurred.
- (2) Deduction of Net Operating Losses. Apportioned net operating losses may be deducted from apportioned net income in the tax year to which the apportioned net operating loss is carried forward.
- (3) Carry Forward Period. An apportioned net operating loss may be carried forward for three tax years following the tax year for which it was first reported. The earliest apportioned net operating loss must be carried over to the earliest taxable year in which the taxpayer reports taxable apportioned net income before deducting an apportioned net operating loss carried forward. The amount of any apportioned net operating loss in excess of the apportioned net income for any tax year to which it is carried forward may be carried forward to subsequent tax years but may not be carried forward past the third tax year following the tax year for which it was first reported.
- (4) Effective Dates for Net Operating Loss Carryforwards.
  - (a) The 1986 tax year shall be the first tax year to which a net operating loss reported for a prior tax year may be carried forward and deducted from net income.
  - (b) The first net operating loss which may be carried forward to a succeeding tax year shall be a net operating loss reported on the 1985 Business Privilege Tax Return. No net operating losses for periods prior to the tax period used as the measure of net income or loss for the 1995 Business Privilege Tax Return may be carried forward and deducted from net income on any Business Privilege Tax Returns.

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