RECENT DEVELOPMENTS IN PENNSYLVANIA AND PHILADELPHIA TAXATION

By
Wendi L. Kotzen
Ballard Spahr LLP
Kotzenw@ballardspahr.com

Christopher A. Jones
Ballard Spahr LLP
Jonesc@ballardspahr.com

October 2018

I. PENNSYLVANIA LEGISLATION – ACT 43 of 2017 (10/30/2017)

A. Personal Income Tax (PIT) – New Withholding Rules

Effective January 1, 2018, a Pennsylvania business that makes payments for which a federal Form 1099-MISC must be filed (i.e., payments in connection with a trade or business) totaling $5,000 or more during a calendar year to a nonresident individual or to a disregarded entity owned by a nonresident individual is required to withhold PIT from such payments at a rate of 3.07%.

Likewise, a Pennsylvania business that makes rent or royalty payments with regard to Pennsylvania property totaling $5,000 or more during a calendar year to a nonresident individual, estate or trust or to an agent, designee or other entity that collects rents on behalf of a nonresident individual, estate or trust is required to withhold PIT.

If a payor that is required to withhold fails to withhold and remit the required PIT, the Department of Revenue (DOR) can collect the PIT from the payor. If the payee pays the tax, the DOR cannot collect the PIT from the payor, but it can collect interest and penalties attributable to any late payment of PIT by the payee from the payor.

The DOR announced in early 2018 that, notwithstanding the effective date of the new rules, it would not assess PIT against any payor required to withhold PIT with respect to any payments made before July 1, 2018. Shortly before July 1, 2018, the DOR published additional materials for payors on its website (https://www.revenue.pa.gov/GeneralTaxInformation/Tax%20Types%20and%20Information/NonresidentWithholding/Pages/default.aspx ) including a new PIT form that payees can use to represent that withholding is not required.
B. Sales and Use Tax (SUT)


The law includes "Marketplace Sales" provisions that impose SUT collection or information reporting obligations on persons who sell or who facilitate sales through web platforms. The Marketplace Sales rules apply to all sales of products and services other than digital products and related services after March 31, 2018, and will apply to sales of digital products and related services after March 31, 2019.

"Marketplace facilitators," "remote sellers," and "referrers" (collectively referred to as Marketplace Sellers) are required to elect annually either to (i) collect sales tax, or (ii) comply with notification and reporting requirements designed to allow the DOR to collect use tax from purchasers.

Marketplace Sellers that elect to comply with the notice requirements in lieu of collecting tax must: (1) post a conspicuous notice that informs purchasers that Pennsylvania SUT may be due; (2) provide a written notice to each purchaser that includes a statement that sales tax is not being collected and that the purchaser may be required to remit use tax to the DOR; (3) provide an annual notice to purchasers stating that sales tax was not collected, providing detail about the purchaser's purchases, and including instructions as to how use tax can be paid; and (4) file an annual report with the DOR, including each purchaser's name, billing address, delivery address, and the aggregate amount of the purchases made.

2. Software Support Services - SUT

Act 43 clarified that help center and call center services that are separately stated from charges for canned computer software are not subject to SUT.

C. Corporate Net Income Tax (CNIT)

1. Net Operating Losses – Nextel Follow-Up

The United States Supreme Court denied certiorari and declined to hear an appeal of the Pennsylvania Supreme Court's 2017 decision in Nextel Communications of the Mid-Atlantic, Inc. v. Commonwealth striking down the dollar-based cap on net operating loss (NOL) carryforwards. U.S. S.Ct., Dkt. No. 17-1506 (06/11/2018). In Nextel, both the Commonwealth Court and Pennsylvania Supreme Court held that the NOL cap was unconstitutional. However, whereas the Commonwealth Court found that the proper remedy was to strike down the NOL cap in its entirety, the Pennsylvania Supreme Court reversed the Commonwealth Court’s opinion requiring the payment of a refund to Nextel, struck only the dollar-based cap, and held that Nextel’s use of NOLs was capped at 12.5% of its CNIT
income. Although Nextel argued only that the NOL cap was unconstitutional as applied to it and is not facially unconstitutional, the Pennsylvania Supreme Court noted that – because its decision would have precedential value in other tax years – that was a distinction without a difference. Therefore, the Pennsylvania Supreme Court’s decision effectively rendered the dollar-based NOL caps unconstitutional for all tax years.

The issues in the certiorari petition were the appropriate remedy for the unconstitutional application of the NOL cap to Nextel in years otherwise closed by the statute of limitations and whether Nextel was entitled to a refund of CNIT for 2007. The denial of certiorari means that no refund is available to Nextel and that the dollar-based cap is invalid for all tax years. See the discussion of Chester Downs and Marina LLC v. Pennsylvania Department of Revenue (at II, E, 4, a, below) regarding refund claims filed after a statute is found unconstitutional.

Act 43 amended the CNIT law in light of Nextel to cap NOL carryforwards going forward using only on a percentage of a corporate taxpayer's CNIT taxable income: 35% of a taxpayer’s CNIT taxable income for tax years beginning after December 31, 2017, and 40% of a taxpayer’s CNIT taxable income for all tax years beginning after December 31, 2018. Act 43 provides that this provision would become effective only following the publication in the Pennsylvania Bulletin of a "notice of decision" by the DOR, which notice was published on January 27, 2018.

Following that announcement, on May 10, 2018, the DOR published Corporate Tax Bulletin 2018-02 to clarify that – notwithstanding the Pennsylvania Supreme Court’s language implying that the Nextel decision would have precedential value for other taxpayers in other tax years – it will treat the Nextel decision as effective only prospectively and will not apply it to tax years beginning prior to January 1, 2017. Thus, for tax years beginning after December 31, 2006 through December 31, 2016, the DOR will allow CNIT taxpayers to use the greater of the flat dollar cap or the percentage cap and the DOR will not attempt to collect tax from taxpayers who benefitted from the – now invalid – dollar-based NOL cap. Consequently, for those tax years, it certainly seems that the uniformity violation identified by both the Commonwealth Court and the Pennsylvania Supreme Court will remain because some taxpayers during those years were able to use NOLs to completely eliminate CNIT taxable income while other similarly-situated taxpayers were subject to CNIT solely because of the NOL cap.

The Pennsylvania Supreme Court also remanded RB Alden Corp. v. Commonwealth to the Commonwealth Court. Nos. 60 and 66 MAP 2017 (09/21/2018). In RB Alden, the Commonwealth Court followed its
decision in Nextel (before reversal by the Pennsylvania Supreme Court) and allowed the taxpayer to use its NOLs without a cap to reduce its CNIT income for its tax year ending June 30, 2007 to zero because it found the NOL cap to be unconstitutional on its face.

2. **Qualified Manufacturing Deduction**

There is a new CNIT deduction for "qualified manufacturing innovation and reinvestment" expenses equal to 5% of the amount invested in the creation or renovation of a Pennsylvania manufacturing facility for each tax year in a five-year period. Taxpayers seeking to take advantage of this new program must obtain pre-approval from the DOR and must agree to make at least $100 million of qualified investments within the initial three years (although the period in which a taxpayer makes qualifying investments may extend to five years).

D. **Change to Tax Appeal Time Limitations**

Two important tax appeal time limitations—the time that a taxpayer has to appeal assessments to the Board of Appeals and the time that a taxpayer has to appeal an adverse Board of Appeals decision to the Board of Finance and Revenue (BF&R) — were shorted from 90 days to 60 days, effective December 29, 2017.

E. **Fireworks Tax**

In connection with the legalization of consumer fireworks, effective December 29, 2017, a new fireworks tax is imposed at a rate of 12% on the sale of fireworks that are suitable for use by individual users; it is not applicable to display fireworks used by professionals. The new tax is imposed in addition to SUT.

A group of fireworks sellers filed a complaint in Commonwealth Court seeking to invalidate the fireworks tax. *Phantom Fireworks Showrooms, LLC et al. v. Tom W. Wolf Governor of the Commonwealth of Pennsylvania, et al.*, Docket No. 21 MD 2018. Among the plaintiff’s arguments are that the General Assembly did not follow constitutional requirements for enacting Act 43 because (i) the bill did not have a single subject, and (ii) the bill did not properly repeal prior law regulating the sale of fireworks. Although the primary target of the suit is the fireworks tax, if the plaintiffs’ suit succeeds, depending on which argument a court finds persuasive, the result could be invalidating all of Act 43.

F. **Carsharing Fee**

Effective December 29, 2017, there is a new fee on "carsharing," defined as a membership program that (i) does not require a written agreement for each use, (ii) does not require an attendant to be present at vehicle sites, (iii) offers members the opportunity to use vehicles at any time, and (iv) allows a vehicle to be rented on per minute, per hour, per day or per trip rates, which rates typically
include fuel, insurance, and maintenance. The fee is collected by the person who makes the vehicle available for use in addition to SUT at the following rates:

1. $0.25 for uses of less than two hours;
2. $0.50 for uses of two to three hours;
3. $1.25 for uses of three to four hours; and
4. $2 for uses of four hours or more.

**G. Increased Benefits for ABLE Program**

Effective October 30, 2017, taxpayers may deduct contributions to a Pennsylvania Achieving a Better Life Experience (ABLE) account for PIT purposes and distributions from an ABLE account are exempt from PIT.

**H. Changes to Credit/Incentive Programs**

1. To obtain approval for many Pennsylvania tax credits by the Department of Community and Economic Development (DCED), a taxpayer must have filed all required returns and paid all required taxes (unless a tax is under appeal).

2. DCED is authorized to designate two "Film Production Tax Credit Districts" located on deteriorated property, each containing one qualified production facility and six soundstages. Specific credits for activities within the new districts will be authorized in the 2019-20 fiscal year and will be in addition to the currently-available Film Production Tax Credits.

3. The deadline by which applications by political subdivisions for the designation of new Keystone Opportunity Zones (KOZs) must be made was extended from October 31, 2016 to October 31, 2018, and the time for DCED to act on such applications was extended from December 31, 2016 to December 31, 2018, thereby reopening the opportunity for municipalities to apply for KOZ designation.

4. Effective October 30, 2018, Neighborhood Improvement Zones (NIZs) may be altered by transferring unused parcels out of the NIZ and replacing them with parcels of the same or lesser acreage.
II. PENNSYLVANIA – CASE LAW, ADMINISTRATIVE DECISIONS AND OTHER CHANGES

A. Corporate Tax Cases, Legislation and Administration


The Pennsylvania Supreme Court held that, if a CNIT return is filed late, a refund claim is timely only if it is filed within three years from the due date of the tax return.

The taxpayer made estimated payments of Pennsylvania corporate taxes (CNIT and capital stock franchise tax (CSFT)) of $430,000 for its tax year ending December 31, 2007, and also had an overpayment of $32,297 carried forward from the prior tax year. The due date for the taxpayer's 2007 annual report—without extensions—was April 15, 2008, and all tax owed by the taxpayer was due on April 15, 2008 (even if the taxpayer had a valid extension on file).

The taxpayer failed to seek an extension to file its annual corporate tax report for 2007 and filed its corporate tax report late, on September 19, 2008, reporting CSFT liability of $66,344 and CNIT liability of $314,175. The Pennsylvania Department of Revenue accepted the taxpayer's annual report as filed, applied the taxpayer's estimated tax payments and overpayment against the reported 2007 liability, and imposed a $913 late-filing penalty. On September 16, 2011, just short of three years after the taxpayer filed its return, the taxpayer filed a petition claiming a CSFT refund of $66,344.

Pennsylvania law requires a taxpayer to file a petition for a refund of tax "within three years of actual payment of the tax, interest or penalty.” The issue, therefore, was whether the "actual payment of the tax" occurred when the taxpayer filed its late return or at some prior date.

The Commonwealth Court sided with the taxpayer, finding that the "actual payment of tax" occurred on September 19, 2008, when the taxpayer filed its 2007 annual report and the taxpayer's 2007 CSFT liability was established, allowing the credits on the taxpayer's account to be applied.

The Pennsylvania Supreme Court, however, reversed the Commonwealth Court's decision, holding that the "actual payment of tax" occurred on April 15, 2008, when the taxpayer's payments of CSFT and CNIT were due. It agreed with the Commonwealth Court that the actual payment occurs when the credits on the account can be applied against a taxpayer's liability. However, the Court determined that actual payment could happen without the filing of a return by the taxpayer, and that the payment of tax and the filing of a return are two separate acts—even though in many cases, they occur at the same time.
In holding that the actual payment of tax occurred when the CSFT and CNIT were due, the Court relied on the fact that, under Pennsylvania law, the taxpayer’s estimated tax payments and credits were treated as payments of 2007 CSFT and CNIT on the due date of the annual report (April 15, 2008). The court stated: "[w]e further hold the filing of the annual report—when it takes place after the due date as happened here—is not the triggering event for determining whether a refund petition is timely filed." The majority cautioned that its opinion is "based on the facts before us here," leaving unanswered the question of whether the result would have been different if the taxpayer had timely sought an extension of its annual report making its report a timely filed return.

2. **Bonus Depreciation**

Act 72 of 2018 (6/28/2018) amended the CNIT law to allow CNIT taxpayers to use the federal Modified Accelerated Cost Recovery System (MACRS), but not federal bonus depreciation.

Under the new federal law known as the Tax Cuts and Jobs Act, effective for eligible property placed in service after September 27, 2017, taxpayers will be able to claim bonus depreciation equal to 100% of the cost of eligible property, phasing down beginning in 2023. In late 2017, the DOR had announced that (i) all bonus depreciation must be added back to income for CNIT purposes, and (ii) CNIT taxpayers could not claim any depreciation with respect to assets for which bonus depreciation was claimed for federal tax purposes during the period the taxpayer owns the property, thereby disallowing all cost recovery.

Act 72 fixes this by adopting the federal depreciation rules, other than bonus depreciation, for CNIT purposes. Thus, Pennsylvania taxpayers will be able to use MACRS to calculate depreciation allowances for CNIT purposes for eligible property placed in service after September 27, 2017.

3. **Corporation Tax and Personal Income Tax Information Notice 2018-01 (04/20/18).**

The DOR announced its position as to how the repatriation income and deduction under Section 965 of the Internal Revenue Code (IRC) (the Repatriation Tax) should be treated for CNIT and PIT purposes.

The Repatriation Tax is imposed on previously untaxed earnings and profits (E&P) of certain foreign corporations owned by US taxpayers accumulated after 1986 and prior to 2018. The provision requires most corporate taxpayers to include in taxable income for the last taxable year that began before January 1, 2018, an amount equal to the untaxed E&P of foreign corporations that they own (the Repatriation Amount).
The Repatriation Tax also includes a deduction (the Repatriation Deduction) designed to reduce the effective federal tax rate on the Repatriation Amount to (i) 15.5% in the case of cash or cash equivalents and (ii) 8% in the case of illiquid assets. Taxpayers must recognize the Repatriation Amount, less the Repatriation Deduction (the Net Repatriation Amount) as income in the year of the deemed repatriation. Taxpayers other than real estate investment trusts (REITs) may elect to defer their payments of the Repatriation Tax over an eight-year period to mitigate the one-time tax hit. Unlike other corporations, for federal income tax purposes, REITs are not required to recognize the entire Net Repatriation Amount as income in the first year, but instead recognize it over eight years.

The DOR concluded that the Repatriation Amount is included in a taxpayer's CNIT income but that a taxpayer may reduce its CNIT income by the amount of its Repatriation Deduction. Thus, a CNIT taxpayer must include the Net Repatriation Amount in CNIT income.

The DOR also concluded that the Net Repatriation Amount, as opposed to the Repatriation Amount, is treated as a deemed dividend from the foreign corporations from which the Repatriation Amount is derived. Thus, the Net Repatriation Amount, not the Repatriation Amount, is eligible for the Pennsylvania Dividends Received Deduction. Finally, because the Pennsylvania apportionment rules provide that dividends are not taken into account when calculating the sales factor, the Net Repatriation Amount is not included in either the numerator or the denominator of a corporation’s sales factor.

The DOR also explained that: (1) no election will be available to spread the Repatriation Tax liability out over time, as is available for federal tax; and (2) REITs will recognize the Net Repatriation Amount at the same time as it is recognized for federal tax purposes (i.e., over an eight-year period).

Because the Net Repatriation Amount is not paid in cash or property, the Department explained that the Net Repatriation Amount is not required to be included in the PIT base.


The BF&R rejected the taxpayer’s contention that gross proceeds from foreign exchange contracts must be included in the denominator of the sales factor because the taxpayer failed to produce evidence supporting the amount of the gross receipts or that such gross receipts were included on the taxpayer’s federal return. The BF&R also held that the taxpayer could not deduct interest paid to affiliates because the taxpayer did not produce
any evidence that the interest expenses were legitimate, had economic significance served an economic purpose and were not for the sole purpose of evading tax.


The BF&R held that a New Jersey corporation could not exclude royalties from the numerator of its sales factor because it did not produce evidence that a greater portion of its costs of performance were incurred outside of Pennsylvania than inside of Pennsylvania. The taxpayer argued that, because its headquarters were in New Jersey, when franchisees make royalty payments, those fees are attributable to activities conducted in New Jersey. The BF&R agreed that the relevant inquiry is where the costs of performance giving rise to the royalties occurred but found that the taxpayer failed to present any evidence that the costs of performance were incurred outside of Pennsylvania.

**B. SUT Cases, Administrative Notices and Decisions, and Letter Rulings**


The Supreme Court, without an opinion, affirmed the Commonwealth Court’s holding that a taxpayer that provided infrastructure, including the local dial network, telephone numbers, and modems, for internet service providers was providing Internet access, not telecommunications service, and therefore was not required to collect SUT.

Under the SUT law, SUT is imposed on charges for certain telecommunications services, including telecommunication services purchased by an Internet service provider to deliver access to the Internet to its customers. Under the federal Internet Tax Freedom Act, however, Pennsylvania cannot impose SUT on charges for “Internet access.”

The product offered by Level 3 was a Point of Presence (PoP) facility: “an access point, location or facility that connects to and helps other devices establish a connection with the Internet.” Analog calls traveled through the tunnels provided by Level 3 and Level 3 provided the connection to an internet service provider.

The Commonwealth Court twice held that the service offered by Level 3 constituted Internet access and, therefore, charges for Level 3’s services could not be subject to SUT. The court held that it was sufficient for Level 3 to provide the tunnels through which end users accessed the AOL homepage, a site on the Internet, to constitute Internet access. The Supreme Court affirmed this holding.
2. **Pennsylvania Sales and Use Tax Ruling No. SUT-17-002** (05/17/2017, republished with an enforcement date of 08/03/2017).

The DOR ruled that information retrieval products, sold in the form of subscriptions to specialized Internet-based research services constitute tangible personal property and are subject to Pennsylvania sales and use tax. The ruling notes that “[t]he information retrieval products constitute tangible personal property in that the transactions are comprised of both (i) a license to electronically access and use canned computer software and (ii) the right to electronically access tangible personal property.” Under this ruling, payments by tax professional to access subscription services like Westlaw and LexisNexis are subject to SUT.


The DOR ruled that neither (i) a computer software and services company nor (ii) an online search and display advertising qualify as "referrers" under the new Marketplace Sales provisions described above and are not required to comply with the new requirements.

Under the new law, a referrer is defined as a person who (1) agrees to list or advertise for sale at retail one or more products of the marketplace seller or remote seller in a physical or electronic medium; (2) receives consideration from the marketplace seller or remote seller from the sale offered in the listing or advertisement; (3) transfers by telecommunications, Internet link or other means, a purchaser to a marketplace seller, remote seller or affiliated person to complete a sale; and; and (4) does not collect a receipt from the purchaser for the sale. However, the term does not include a person that provides Internet advertising services; and (i) does not provide the marketplace seller's or remote seller's shipping terms or (ii) advertise whether a marketplace seller or remote seller collects a sales or use tax.

Because, in the facts of the ruling, neither taxpayer provides the sellers’ terms or indicate whether the sellers collect sales tax, the DOR ruled that neither taxpayer fully satisfies the definition of “referrer.”


The DOR ruled that employees of a Pennsylvania government entity are not exempt from the payment of Philadelphia and Allegheny County hotel tax, regardless of who pays for the room rental, because the only exemptions that apply are those available from the state-level tax. Under a DOR regulation, “[o]ccupancy by employees or representatives of the Commonwealth, its instrumentalities or political subdivisions, is not exempt from [the state-level] hotel occupancy tax, regardless of the nature of the business upon which the employee or representative is engaged, and
regardless of the identity of the person or agency paying for the occupancy.” 61 Pa. Code § 38.2(f)(emphasis added). Consequently, there is no exemption from the Philadelphia or Allegheny County taxes. However, the DOR also stated that such employees (when the cost of a room is borne by the employer) are exempt from hotel occupancy taxes imposed by any other local municipalities because there is no enumerated exemption from sovereign immunity for the local taxes.


The Commonwealth Court upheld the denial of a refund claim by a financial institution for SUT paid in connection with purchases of certain computer hardware, canned software and services. The taxpayer argued that its purchases were exempt under a SUT regulation that provides that a sale of security equipment utilized by financial institutions that is installed by the seller is a construction contract. Therefore, the seller does not charge sales tax on the contract price because the seller is considered the consumer of the property. The Commonwealth did not dispute that the taxpayer met the definition of “financial institution” and that the equipment met the definition of “security equipment” under the regulation. However, when the applicable regulation was promulgated there was no statutory definition of "construction contract" for SUT purposes, so the exemption applied whenever security equipment was “installed.” After the regulation was promulgated, the term “construction contract” was statutorily defined for SUT purposes as “[a] written or oral contract or agreement for the construction, reconstruction, remodeling, renovation or repair of real estate or a real estate structure.” 72 § 7201(mm). The court held that the statutory definition of construction contract trumped the regulation and that, because merely plugging in computer equipment does not rise to the level of a construction contract under the statute, the purchases were subject to SUT.


The Commonwealth Court held that a restaurant owner located in Delaware County was not entitled to a refund of the 2% Philadelphia portion of SUT paid on purchases of malt beverages from a Philadelphia distributor, even though the malt beverages were purchased for resale and were delivered to a location outside Philadelphia (where SUT was collected from the consumer at the point of sale). Although sales for resale are generally exempt, the sale of malt or brewed beverages to a retail dispenser are specifically excluded from the resale exemption. Likewise, for local sales tax purposes, the point of sale (not the point of delivery) determines the rate. Because the beer was delivered to a location in Pennsylvania and the resale exemption did not apply, Philadelphia sales tax was properly collected.
C. Property Tax/Institution of Purely Public Charity Cases

1. In re: Appeal of Springfield Hospital, 179 A.3d 632 (Pa. Commw. 02/13/2018).

The Commonwealth Court upheld a decision finding that the terms of a payment in lieu of a tax (PILOT) agreement required that status of real property be changed from exempt to taxable. The township and school district entered into a PILOT agreement with a nonprofit entity that operated a hospital, sports club and parking garage on real property in the township. The PILOT agreement specified that the hospital and its successors and assigns would not be subject to real property tax so long as the existing hospital building was used solely for hospital purposes by the taxpayer or by another tax-exempt entity. When the entire real property was sold to a for-profit entity, the township and school district sought to impose real property tax effective on the date of transfer. The trial court found, and the Commonwealth Court agreed, that the plain language of the PILOT agreement provided that the property would become taxable immediately upon transfer to a non-exempt entity. The Commonwealth Court further found (among other holdings) that: (1) the assessment of taxes on the date of transfer did not violate the tax assessment day rule because it was not a reassessment of the property; (2) the PILOT agreement itself was specifically authorized by the General Assembly and was therefore valid.


The Commonwealth Court held that the trial court correctly upheld the exempt status of a parcel of real estate owned by a municipal transportation authority that contains passenger waiting areas, a parking garage, several bus bays and a roadway to allow for bus looping and egress onto the public street. The City and School District argued that the parking garage did not have a sufficient connection to the owner’s transportation function and therefore was not exempt use of the property. The court, however, held that the parcel in this case was owned and operated by the municipal authority for its municipal purposes and therefore was exempt.

3. The Commonwealth Court and BF&R denied several applications for property tax and SUT exemptions, finding that the entities at issue did not qualify for charitable exemption under the five-part test articulated in Hospital Utilization Project v. Commonwealth, 487 A2d 1306 (Pa. 1985) (the HUP test).

04/30/2018) (a childcare center failed to prove that it gratuitously donated a substantial portion of its services).

b.  *Foundation for Eldercare v. Dauphin County Board of Tax Assessment Appeals*, Dkt. No. 982 C.D. 2017 (Pa. Commw. 05/08/2018) (a nonprofit foundation that rents homes to senior citizens at below market rent did not benefit a substantial and indefinite class of persons who are legitimate subjects of charity and did not relieve the government of some of its burden).


d.  *In re: Friends Boarding Home*, Pa. BF&R Dkt. No. 1715560 (12/07/2017) (a nonprofit senior living community could not demonstrate that it gratuitously rendered a substantial portion of its services).

### D. Personal Income Tax (PIT) Cases


The Commonwealth Court held that a taxpayer who won the lottery and sold his annual installments (in two separate sales) was subject to PIT on the gain realized from the sales. The taxpayer won the lottery in 1995, at which time lottery winnings themselves were not subject to PIT. Nonetheless, that the lottery proceeds themselves – at that time – were exempt from PIT, gain from the sale of a stream of lottery payments is taxable.


The BF&R rejected the claims by two taxpayers that they could defer recognition of gain for PIT purposes on like-kind exchanges that qualified under IRC Section 1031 because they kept their books and records using the federal income tax method of accounting. Although PIT Bulletin
2006-07 allows a taxpayer to defer gain under IRC Section 1031 if permitted by a valid accounting method used by the taxpayer, the BF&R concluded that federal income tax basis is not a valid method of accounting for PIT purposes because the PIT law does not incorporate federal tax principles.

E. Other State and Local Tax Cases, Legislation and Administrative Decisions

1. Realty Transfer Tax


      The DOR ruled that the termination of a condominium under the Pennsylvania Condominium Act was subject to realty transfer tax where taxpayers who previously each owned one condominium unit owned the entire property as tenants in common after the termination. Because, before the termination, the taxpayers separately owned their units, then became co-tenants of the entire property upon termination of the condominium, each taxpayer gained property rights over the other unit and relinquished rights over their previously owned unit. The DOR ruled that exchange of rights was subject to tax.


      The BF&R held that realty transfer tax was properly imposed on a deed because the taxpayer could not demonstrate that the deed was a confirmatory deed following a conversion. The property owner, a Pennsylvania general partnership, converted to a Pennsylvania limited partnership pursuant to a 2006 plan of merger under which the general partnership merged into the new limited partnership (before Pennsylvania corporate law allowed for entity conversions). However, articles of merger were not filed with the Department of State. The BF&R held that, absent evidence that the merger actually occurred and that the existence of the general partnership continued as the limited partnership, the transaction was merely the transfer of property from the general partnership to the limited partnership and therefore was taxable.

2. Local Tax Legislation – Act 18 of 2018 (Effective 07/03/2018).


   Act 32 generally requires employers with (non-Philadelphia) Pennsylvania employees to (i) determine each employee’s home location and work location, and (ii) to withhold local earned income tax at a rate equal to the
higher of (a) the rate imposed on non-residents in the employee's work location, or (b) the rate imposed on residents in the employee's home location.

Effective July 3, 2018:

a. Local tax collectors, except when granted an exception for religious reasons, are required to use only forms developed by DCED beginning on January 1, 2020. Additionally, DCED was given broad authority to develop rules and regulations governing local income taxes and the collection thereof that must be used throughout the Commonwealth.

b. Residency and work location determinations have been clarified:

   (1) An employee who does not meet the Pennsylvania standards for establishing a domicile is deemed to not be domiciled in a local jurisdiction for local tax purposes;

   (2) An employee who works in a temporary work location for less than 90 days is deemed to keep his/her primary work location and is not be deemed to work in the temporary location. Therefore, the temporary work location can be ignored when determining the proper rate of withholding and the employer should use the employee's permanent work location.

   (3) An employee who works in a jurisdiction for 90 days or more is deemed to have a new work location and that jurisdiction must be used as the employee's work location when determining the Act 32 withholding rate; and

   (4) Employees subject to Philadelphia wage tax are exempt from Act 32 rules.

c. The local earned income tax audit procedures have been changed:

   (1) Contingent fee audits are prohibited for earned income tax collection; and

   (2) All audits must be conducted on a calendar year basis.
d. The local tax rules are changed for workers who are not subject to withholding to add estimated tax safe harbors that parallel the federal safe harbors. Taxpayers are deemed to have made sufficient estimated tax payments if they:

1. Make four payments equal to 100% of the prior year’s taxes, less any earned income tax withheld; or

2. Make four payments equal to 90% of the current year’s taxes, less any earned income tax withheld.

3. Local Taxes


In the latest ruling in a case that has been ongoing for several years, a Common Pleas judge denied a motion for summary judgment against the City of Scranton, but ordered the City to produce a list of all tax ordinances it has enacted along with the enabling act pursuant to which each tax was enacted.

Plaintiffs in the case allege that, for 2015, Scranton violated 53 P.S. § 6924.320 (“Act 511”), which limits the taxes that a municipality may collect to the amount calculated by multiplying the assessed value of all real estate in the municipality by 12 mills. Plaintiffs produced evidenced, based on publicly-available records, that the total taxes collected by Scranton in 2015 exceeded the value of all property in Scranton multiplied by 12 mills.

Scranton, however, has argued for more than a year that, because it is a Home Rule Charter municipality, it is not subject to the Act 511 cap. In **City of Pittsburgh v. FOP, Fort Pitt Lodge No. 1**, 18 WAP 2016 (05/22/2017), the Pennsylvania Supreme Court held that – under Section 2962 of the Home Rule Charter Law - only those state laws that are effective in *every* Pennsylvania jurisdiction can preempt a Home Rule Charter. Because Act 511 is not effective in Philadelphia (and therefore is not effective in every Pennsylvania jurisdiction), Scranton has argued that Act 511 does not preempt Scranton’s Home Rule Charter. The judge, however, has consistently ruled against Scranton on this issue and had repeatedly stated that Act 511 applies to Scranton because it is a City of the Second Class.

Plaintiffs filed a motion for summary judgment, arguing that the Act 511 calculation was straight-forward and there was no need for a trial because the City’s own records showed that the taxes it
collected in 2015 exceeded the statutory cap. The court, however, disagreed that the issue was entirely clear and held that – even though it continues to believe the Act 511 cap applies - the City should have the right to demonstrate that some of the tax revenue it collected during 2015 was not revenue from “Act 511 taxes” because Scranton enacted the tax ordinances pursuant to other authority. Thus, the court ordered the parties to proceed with discovery and for Scranton to list its Act 511 taxes separately from other taxes.

4. **Gaming Taxes**


   The Pennsylvania Supreme Court denied a claim for refund that was filed after the court held, in *Mount Airy # 1, LLC v. Pennsylvania Dept. of Rev.*, 154 A.3d 268 (2016), that a portion of the gaming tax is unconstitutional. In *Mount Airy*, the court held that the local share tax violated the Uniformity Clause of the Pennsylvania Constitution, but invalidated the tax only prospectively. However, the Court denied Mount Airy’s request for a refund of local share taxes that it paid under the statute that ultimately was found to be unconstitutional. The Pennsylvania Supreme Court held that: “a decision of this Court invalidating a tax statute takes effect as of the date of the decision and is not to be applied retroactively.” *Oz Gas, Ltd. v. Warren Area Sch. Dist.*, 938 A.2d 274, 285 (Pa. 2007). Thus, even the party that successfully brings a claim to invalidate a taxing statute is not entitled to an award of damages for its prior payments. *See Mount Airy #1*, 154 A.3d at 280, fn. 11; *see also Nextel*, discussed at I, C, 1, above).

   In *Chester Downs*, the court stated that, to the extent that the taxpayer’s petition sought refund of taxes paid prior to the *Mount Airy* decision, no relief was available because the decision was effective only as of the date of the decision. The court stated that it did not have any jurisdiction to hear claims for refunds of taxes paid after the Mt. Airy decision and that ordinary refund procedures would be available. Finally, the court rejected the taxpayer’s argument that denying the refunds violated the Equal Protection Clause of the United States Constitution.

The Commonwealth Court affirmed a decision of the Board of Finance and Revenue denying a claim for a refund of gaming tax because the claim for refund was not filed within the three-year limitations period. In 2009, the taxpayer filed a claim for refund of gaming taxes paid in 2007 and 2008 arguing that certain promotional amounts should be excluded from its tax base. In 2014, the Pennsylvania Supreme Court found in favor of the taxpayer and granted a refund of the 2007 and 2008 taxes. After the Supreme Court decision, the taxpayer filed a claim for refund of taxes paid between 2009 and 2011. However, such claim was filed later than three years after the actual payment of the tax (the limitations period for a claim for refund). The court rejected the taxpayer’s contention that it was forced to wait until the Supreme Court’s decision before it could file a claim with respect to the intervening years and held that the claim was barred by the statute of limitations.

5. **Unclaimed Property Legislation – Act 42 of 2018 (Effective June 22, 2018).**

The General Assembly clarified the Pennsylvania Unclaimed Property Law to include language specifying that stock, dividends, and other passive investments are not reportable to the Pennsylvania Treasury until three years after the holder has “lost contact” with the owner. This makes such reporting requirements consistent with the requirements pertaining to retirement accounts.

A holder is considered to have “lost contact” with an owner only when two consecutive communications, sent by the holder to the owner via First Class U.S. mail, are returned to the holder as undeliverable. For owners who do not receive communications via U.S. mail, lost contact may also be established by the holder sending the owner communication via electronic mail no later than two years after the owner last indicated an interest in the property. If the holder receives a notification that the electronic communication was not received, or if no response is received within thirty days, the holder must send the owner communication through First Class U.S. mail. If that communication is returned as undeliverable, the holder is deemed to have lost contact with the owner. The inclusion of a “lost contact” standard is intended to prevent the reporting of securities that are not truly abandoned, but merely held in a passive investment account. Under prior law, the three-year dormancy period began to run without any communications being undeliverable.
III. PHILADELPHIA DEVELOPMENTS

A. Legislative Developments

1. **Ordinance No. 180167 – Realty Transfer Tax Rate Increase**

   Effective July 1, 2018, the Philadelphia realty transfer tax rate was increased from 3.10% to 3.278%. The increased rate will remain in effect through December 31, 2036, and will be reduced to 3.178% effective January 1, 2037 and thereafter.

2. **Ordinance No. 180096 – Realty Transfer Tax Exclusion for Certain Housing Authority Transfers**

   Effective April 18, 2018, there is an exclusion for a transfer between the Philadelphia Housing Authority (PHA) and a Pennsylvania Limited Partnership (PLP) the general partner of which PHA owns and controls. The exclusion applies to both (1) (a) a transfer from PHA to the PLP and (b) any subsequent transfer from the PLP to PHA; and (2) a transfer from PHA or a PLP controlled by PHA to a wholly owned subsidiary of PHA.


   Effective July 1, 2018, the rate of Philadelphia wage, earnings and net profits tax (NPT) was reduced to 3.8809% for residents and 3.4567% for non-residents effective July 1, 2018.

   Effective July 1, 2018, the rate of school district income tax (was decreased to 3.8809% for residents.

4. **Ordinance No. 180139 – Assessed Value for Business Use & Occupancy Tax (U&O Tax)**

   The U&O Tax ordinance was amended to provide that, starting July 1, 2019, “assessed value” for U&O Tax purposes will be the real estate tax assessment effective for the calendar year during which the U&O Tax is due.

5. **Ordinance 170717 – Zero NPT Rate for New Sustainable Businesses**

   Effective for tax years starting on or after January 1, 2018, a new sustainable business located in the city of Philadelphia will be subject to a NPT rate of zero percent (in addition to the existing zero percent rate of BIRT for new sustainable businesses). A “new sustainable business” is a new business that is certified as a sustainable business by the Philadelphia Office of Sustainability. A new sustainable business must have at least two full-time employees who are not family members, and who work in
the city at least 60% of the time as of the 12-month anniversary of becoming subject to BIRT and continuously through the 18-month anniversary of becoming subject to such tax. Should the required number of employees drop below the required minimum, tax relief will no longer be available and all businesses taxes will be due retroactively as if the business had never been a new sustainable business. However, the Philadelphia Revenue Department (the Department) may waive the recapture provision, or prorate the amount of tax that may otherwise become due if the Department determines that the number of qualifying employees dropped below the required minimum because of circumstances beyond the business' control.

6. **Ordinance No. 180138 – Real Estate Tax Payment Agreements**

Effective April 18, 2018, a taxpayer who is compliant with any payment agreement will be treated as paying property taxes in a timely manner and will be deemed not to be in default on real estate taxes that are subject to the payment agreement.

7. **City Advisory Notice - Bonus Depreciation**

The Department published an advisory notice on July 31, 2018, announcing that it would follow Pennsylvania treatment of depreciation and bonus depreciation for BIRT and NPT. As a result, Philadelphia taxpayers must add back 100% depreciation deducted under IRC Section 168(k) but may use MACRS.

**B. Case Law**


The Supreme Court upheld the constitutionality of the Philadelphia Sugar-Sweetened Beverage Tax (the Soda Tax). The Soda Tax is a 1.5 cent per fluid ounce levy on distributors who transfer sweetened (with sugar, artificial sweeteners or other sweeteners) beverages to dealers in the City for resale within Philadelphia.

The sole issue in front of the court was whether the Soda Tax violates the Sterling Act, which authorizes the City to impose taxes that are not duplicative of state taxes. The plaintiffs argued that the Soda Tax duplicates the SUT because the underlying subject matter – sugar-sweetened beverages – is the same and that, even if the tax is imposed on different parties in name, the burden of both taxes is borne by the consumer.

The court affirmed the decision of the Commonwealth Court and held that, to determine whether a tax is duplicative of a state tax, the inquiry is
whether the tax is imposed on the same transaction. The court stated that the Commonwealth could, but does not, impose tax on transactions between distributors and dealers. Thus, the court determined that those transactions could be taxed by the City.


The Commonwealth Court held that the City could take collection actions against an individual to collect unpaid Parking Taxes under the doctrine of *trustee ex maleficio* but held that the facts did not support treating the person who was the Vice President and Secretary of the parking company as liable for the unpaid Parking Taxes under that doctrine.

During the relevant tax years, Anthony D’Angelo was the Vice President and Secretary of Righter Parking. In his capacity as a corporate officer, the facts showed that Mr. D’Angelo participated in some management activities of the business but (i) was not regularly present at the facility, (ii) did not regularly prepare or sign tax returns, (iii) did not sign payroll checks or other checks, or (iv) otherwise have direct involvement in the day-to-day activities of the business.

Under the City’s Parking Tax ordinance, the tax must be collected from customers and remitted to the City by an “operator” – i.e., “any person conducting or operating a parking facility in the City. Although the Parking Tax ordinance does not have responsible person language similar to the Wage Tax ordinance, it does provide that taxes collected by an operator are held in trust for the City. The City asserted that, under the doctrine of *trustee ex maleficio*, it could collect the taxes directly from Mr. D’Angelo (along with another individual) because the ordinance created a trust, liability could be imposed on any person who held the funds that were to be remitted to the City.

The Commonwealth Court held that the doctrine of *trustee ex maleficio* is implicated by the Parking Tax and that, when the facts show that a person willfully expended funds that are held in trust for the City, the City can collect unpaid taxes directly from that individual. However, the Court found that the facts here did not support collecting the taxes from Mr. D’Angelo because he did not have the requisite involvement in the day-to-day or financial affairs of the company.


The Pennsylvania Commonwealth Court affirmed decisions of the Tax Review Board and Court of Common Pleas upholding the assessment of over $1 million in BIRT and Wage Tax on a construction company. The
taxpayer argued that it was not subject to tax because it had placed its employees on the payroll of various subcontractors. Therefore, it argued that only the subcontractors were doing business in the City for BIRT purposes and that only the subcontractors were required to withhold Wage Tax. However, the invoices and documentation did not support the taxpayer’s contention and the Commonwealth Court agreed that the workers remained employees of the taxpayer.

The Commonwealth Court, however, vacated over $3 million of interest and penalty because it found that the Tax Review Board did not analyze the record to expressly determine that the taxpayer acted in bad faith. Although the Commonwealth Court stated that the facts may support such a conclusion, it remanded the case to the Tax Review Board to consider the facts on record and to expressly determine that those facts support a finding of bad faith.