I. PENNSLYVANIA LEGISLATION – ACT 13 of 2019 (06/28/2019)

A. Corporate Net Income Tax (“CNIT”) - Change to Manufacturing Innovation and Reinvestment Deduction

Act 13 expands the existing CNIT deduction for “qualified manufacturing innovation and reinvestment” expenses by creating two tiers of minimum investment needed to qualify for benefits and by increasing the allowable deduction. Under prior law, taxpayers who obtained pre-approval from the Department of Revenue (“DOR”) and agreed to make at least $100 million of qualified investments within an initial three years could deduct 25% of the investment in each year.

Effective for tax years beginning after December 31, 2019, taxpayers can qualify for the deduction with a minimum investment of $60 million. Additionally, for the portion of investments in excess of $60 million and less than $100 million, the allowable deduction is increased to 37.5% of the qualifying investment. The 25% cap on the deduction remains in place for any investment above $100 million.

B. Sales and Use Tax (“SUT”)  

1. Wayfair Implementation and Marketplace Sellers

Act 13 updates SUT collection rules in light of the United States Supreme Court’s decision in South Dakota v. Wayfair, Inc., in which the Supreme Court held that physical presence in a state by a vendor is not required for the state to impose SUT collection requirements.

In 2017, before Wayfair expanded the rights of states to enforce collection by out-of-state vendors, Pennsylvania enacted a regime that imposed a variety of collection and information reporting obligations on persons who sell or who facilitate sales in Pennsylvania through the web. After Wayfair was decided, the DOR issued SUT Bulletin 2019-01 that provided
that any person with $100,000 or more of sales in Pennsylvania was immediately required to collect SUT following *Wayfair*.

Act 13 largely codifies the DOR’s position in SUT Bulletin 2019-01 by providing that all direct vendors and “marketplace facilitators” - *i.e.*, persons who facilitate sales on behalf of “marketplace sellers” - who had $100,000 or more of sales in Pennsylvania during 2018 are required to collect and remit SUT for the period from July 1, 2019 through March 31, 2020. All such persons who have $100,000 or more of sales in Pennsylvania during 2019 or any subsequent calendar year must collect and remit SUT beginning in the second quarter (April 1) of the following calendar year through the end of the first quarter (March 31) of the subsequent calendar year.

Act 13 also eliminates the reporting-only option from SUT Bulletin 2019-01 that was available to marketplace facilitators. Thus, when a marketplace facilitator facilitates sales in Pennsylvania on behalf of an out-of-state marketplace seller, the SUT collection responsibility falls on the marketplace facilitator, not the marketplace seller unless the marketplace seller fails to provide the marketplace facilitator with sufficient information to allow the marketplace facilitator to collect the tax (*e.g.*, the marketplace facilitator cannot determine that a sale is to a customer in Pennsylvania or the sale of property that is subject to SUT). This is the case even if the marketplace seller makes sales of $100,000 or more in Pennsylvania through the marketplace facilitator. As long as a marketplace seller receives a statement from the marketplace facilitator indicating that the marketplace facilitator will collect and remit the SUT with respect to Pennsylvania sales made by the marketplace seller through the marketplace seller, the marketplace seller is relieved of SUT collection obligations (provided that the information the marketplace seller provides to the marketplace facilitator is sufficient to allow the marketplace facilitator to collect the SUT).

2. **Vendor Absorption of SUT**

Act 13 changes the long-standing prohibition against vendors advertising that the SUT imposed on certain sales will be absorbed in the vendor’s stated price. Effective June 28, 2019, vendors can advertise that the SUT will be absorbed by the vendor but must (i) state on any receipt provided to the customer that the vendor will pay the tax and not imply that the transaction is exempt from SUT, (ii) separately state the amount of the SUT on any receipt provided to the customer, and (iii) keep books and records documenting the purchase price and the SUT absorbed and remitted to the state.

Once the vendor satisfies the foregoing, the law provides that the vendor “shall be solely responsible and liable for any [SUT] . . . and shall not be
entitled to a refund of such [SUT].” It is not clear to what extent the prohibition on refunds will apply (e.g., whether a vendor would be prohibited from claiming a refund if it makes an erroneous overpayment during a tax period) or whether a blanket prohibition on refunds of overpaid tax would withstand constitutional scrutiny.

3. **Malt Beverage Tax – Brew Pubs**

The SUT treatment of malt beverages has traditionally differed from that of other tangible personal property in that the tax typically is collected from the retailer by the manufacturer or the distributor of the beverages and is not collected upon retail sales to consumers. Consequently, the SUT tax base typically is wholesale price of the beer rather than the full retail price.

Following changes to the liquor laws that expanded the ability of brew pubs to sell directly to consumers for on or off-premises consumption, SUT Bulletin 2018-02 provided that, effective July 1, 2019, brew pubs would be required to collect SUT on the retail price paid for its own products.

Act 13 supersedes SUT Bulletin 2018-02 and provides some relief to brew pubs by (i) delaying the implementation date to sales made after September 30, 2019, and (ii) providing that the deemed retail price of sales directly to the ultimate consumer for consumption on or off premises is 25% of the retail price of the product sold to the ultimate consumer for consumption on or off premises. Therefore, while brew pubs soon will have SUT collection obligations, the tax base should be closer to the wholesale price.

Act 13 also clarifies that Philadelphia County and Allegheny County may continue to impose their own local taxes on sales by malt beverage manufacturers within those counties.

4. **Other SUT Changes**

Act 13 also provides for three new SUT exemptions, all of which are effective for sales occurring after December 31, 2019:

a. **Food and Beverage Sales by Youth Development Organizations**

The existing exemption for food and beverage sales by nonprofit organizations supporting youth sports is expanded to encompass nonprofit organizations supporting youth development programs;
b. **Sales by Volunteer Fire Organizations**

There is a new exemption for sales by volunteer fire organizations that raise funds for use by such organizations; and

c. **Materials and Supplies for Animal Housing Facilities**

There is a new exemption for the sale of building materials and supplies used for the construction or repair of an animal housing facility.

**C. Personal Income Tax (“PIT”) Changes**

1. **Qualified Opportunity Zone (“QOZ”) Conformity**

Unlike many states, Pennsylvania’s PIT base does not start with federal taxable income. Instead, PIT is imposed on seven categories of income. Consequently, absent a change to Pennsylvania law, PIT taxpayers would have been subject to PIT on their gains that are deferred and excluded for federal income tax purposes under the QOZ program.

Effective for tax years beginning after December 31, 2019, pursuant to Act 13, taxpayers subject to PIT will not include gain or income that are excluded from federal taxation under the QOZ rules in PIT income. Income from QOZ investments will be included in PIT income only to the extent it is included in federal taxable income under the QOZ rules.

2. **Other PIT Changes.** Act 13 also changes the PIT rules to provide:

a. **Election to Treat Estate as Taxpayer in the Case of Revocable Trust**

Effective for tax years beginning after December 31, 2019, executors of estates that are subject to PIT will be able to make a PIT election to correspond with the election allowed under Section 645 of the Internal Revenue Code (“IRC”) that, in certain circumstances, permits the executor of an estate and the trustee of a revocable trust to treat the income of the trust as the income of the estate and to therefore file a single return (for the estate) rather than separate returns for the trust and estate;
b. **Tax Preparer Signatures**

Effective for tax years beginning after December 31, 2019, all PIT returns prepared by a paid tax preparer must be signed by, and include the preparer tax identification number of, the paid tax preparer;

c. **Olympic Medals and Prize Money**

Effective June 28, 2019, Olympic medals and prize money are excluded from the PIT base; and

d. **Veterans’ Trust Fund**

For tax years beginning after December 31, 2019, the PIT return will provide a check-off box for voluntary contributions to the Veterans’ Trust Fund.

D. **Realty Transfer Tax (“RTT”) Changes**

Act 13 adds, effective June 28, 2019, a new RTT exemption for a transfer of property that is subject to an agricultural conservation easement to a “qualified beginning farmer,” defined as a person who:

1. Demonstrates experience in the agriculture industry or related field or has transferable skills as determined by the Department of Agriculture;

2. Has not received federal gross income from agricultural production for more than the 10 most recent taxable years;

3. Intends to engage in agricultural production in Pennsylvania and to provide the majority of the labor and management involved in that agricultural production; and

4. Obtains written certification from the Department of Agriculture confirming qualified beginner farmer status.

E. **Changes to Economic Development Programs**

1. Act 13 allows the Department of Community and Economic Development (“DCED”) to designate additional Keystone Opportunity Zones in Cambria County, Clearfield County and Lancaster County. The counties must submit an application to DCED by October 1, 2021, and DCED is required to act on any applications by December 31, 2021.

2. Act 13 made clarifying changes to the City Revitalization and Improvement Zone (“CRIZ”) law by (i) allowing the use of funds to finance revolving loans and (ii) amending the definition of "infrastructure"
to make clear that facilities that are ancillary to the primary facilities in the
CRIZ qualify.

3. Act 13 also made clear that the SUT exemption applicable in certain
strategic development areas (“SDAs”) applies to the use of computers,
laptops, software, and cell phones by employees assigned to a facility
located within a SDA when such items are used by those employees at a
location outside the SDA.

F. Extensions and Expansions of Existing Programs

Act 13 made the following changes, all effective as of July 1, 2019, to various tax
credit programs in the Commonwealth:

1. Film Production Credit. Act 13:
   a. Defines "postproduction expenses" to include the purchase of
      music rights if (i) (a) the purchase is from a resident of the
      Commonwealth, (b) the purchase is from an entity subject to
taxation in the Commonwealth, and (ii) the transaction is subject
to PIT or CNIT;
   b. Extends the period for investing at least $400 million within a tax
      credit investment district from four years to eight years and the
      number of required soundstages located in the district is reduced
      from six to two;
   c. Permits the sale or assignment of tax credits to an entity filing on
      the same federal consolidated return as the seller or assignor
      without any reduction of the credit amount; and
   d. Increases the annual cap on total credits from $65 million to $70
      million.

2. Concert and Rehearsal Tax Credit. Act 13:
   a. Allows for the use, sale, or assignment of unused tax credits
      generated from rehearsals held after January 1, 2017 and before
      October 1, 2018.
   b. Increases the annual cap from $4 million to $8 million and
      updates the individual limitations per tour as follows:
      (1) purchases between $3 million and $4 million - $800,000
          per tour;
      (2) purchases between $4 million and $8 million - $1.25
          million per tour; and
(3) purchases of at least $8 million - $2 million per tour.

3. **Resource Enhancement and Protection Tax Credit.** Act 13:
   a. Raises the existing cap per eligible applicant from $150,000 to $250,000; and
   b. Increases the annual cap from $10 million to $13 million.

4. **Historic Preservation Incentive Tax Credit.** Act 13:
   a. Extends the sunset date from 2020 to 2031;
   b. Allows non-commercial buildings to qualify for the program;
   c. Establishes an application fee of $2,000; and
   d. Increases the annual cap from $3 million to $5 million.

5. **Coal Refuse Energy and Reclamation Tax Credit.** Act 13:
   a. Extends the sunset date of from 2026 to 2036;
   b. Provides for netting of federal tax credits; and
   c. Increases the annual cap from $10 million to $20 million.

6. **Rural Jobs and Investment Tax Credit.** Act 13:
   a. Allows businesses with fewer than 150 employees to apply (decreased from fewer than 250 employees); and
   b. Increases the annual cap from $1 million to $6 million and increases the total amount that may be awarded over the life of the program from $6 million to $30 million;

7. **Neighborhood Assistance Tax Credit.** Act 13:
   a. Adds investments in Youth and Adolescent Development Services as allowable policy goals of the program but provides that no more than $2 million shall be used for such purposes.

G. **Other Miscellaneous Tax Changes**

1. The transfer of property to a child aged 21 or younger from a natural parent, adoptive parent or stepparent will be exempt from Inheritance Tax effective for dates of death on or after January 1, 2020.

2. The 2% Table Games Tax is extended through December 31, 2021.
II. PENNSYLVANIA – CASE LAW, ADMINISTRATIVE DECISIONS AND OTHER CHANGES

A. Corporate Tax Cases, Legislation and Administration


The DOR announced that, effective for tax years beginning on or after January 1, 2020, a corporate taxpayer with $500,000 or more of direct or indirect gross receipts from certain Pennsylvania sources will have nexus for CNIT purposes even if the corporate taxpayer has no physical presence in Pennsylvania.

The Department determined that the Supreme Court’s decision in Wayfair means that CNIT nexus does not require physical presence and that, beginning with tax years starting on or after January 1, 2020, there will be a rebuttable presumption that a corporate taxpayer has nexus with Pennsylvania for CNIT purposes if it has $500,000 or more of, direct or indirect, sales that would be apportioned to Pennsylvania from (i) the sale, rental, lease, or licensing of tangible personal property, (ii) the sale of services; and/or (iii) the sale or licensing of intangibles, including franchise agreements.

When setting forth the $500,000 threshold, the Bulletin expressly references the CNIT apportionment rules used to determine a corporate taxpayer’s Pennsylvania sales factor. Therefore, corporate taxpayers with no physical presence in Pennsylvania but with Pennsylvania sales must calculate what the numerator of their Pennsylvania sales factor would be to determine whether the rebuttable presumption applies. This will require such a taxpayer to apply Pennsylvania’s market-sourcing rules for the sales of tangible property and sales of services and the ambiguous “cost of performance” rules for other sales. Only if, after applying those rules, the Pennsylvania sales (i.e., the numerator of the Pennsylvania sales factor) are $500,000 or more does the presumption apply. Thus, for taxpayers who derive revenue from intangibles in Pennsylvania, the cost of performance rules (currently the subject of ongoing litigation) could determine whether a taxpayer has a CNIT filing obligation.

The DOR also acknowledged the continued applicability of Public Law 86-272. Public Law 86-272 prevents states from imposing net income taxes on taxpayers that are engaged in selling tangible personal property in the state if the taxpayer’s only activity in the state is soliciting such sales. In the past, many corporations who were protected from CNIT by Public Law 86-272 did not file returns because they did not have any physical presence in Pennsylvania. However, notwithstanding that these taxpayers still will pay no CNIT because they have Public Law 86-272 protection, if they have Pennsylvania sales of $500,000 for tax years beginning on or
after January 1, 2020, these taxpayers will be required to file CNIT returns.


The DOR announced that, effective for tax years beginning after December 31, 2018, receipts from hedging and foreign currency transactions are excluded from both the numerator and denominator of a taxpayer’s CNIT apportionment factor. The CNIT law says that sales, for purposes of the sales factor, do not include “gross receipts heretofore or hereafter received from the sale, redemption, maturity or exchange of securities.” The DOR determined that this exclusion applies to (i) gross receipts related to gain or loss from a transaction identified as a hedge under IRC Section 1221(b)(2)(A)(i) or 475(c)(3)(ii), (ii) receipts attributed to accrued interest income or expense, gain or loss on a debt instrument, a payable, a receivable or a forward contract payable in a foreign currency for foreign currency gain or loss that is computed under IRC Section 988, and (iii) gross receipts related to IRC Section 986(c)(1) foreign exchange gain or loss on distributions of previously taxed income.


The DOR announced its position regarding the Pennsylvania treatment of global intangible low-taxed income (“GILTI”) and foreign-derived intangible income (“FDII”), both of which were added to the federal tax law by the act known as the “Tax Cuts and Jobs Act” (“TCJA”).

a. **GILTI**

For tax years beginning after December 31, 2017, the TCJA provides that a U.S. shareholder who owns 10% of a controlled foreign corporation (“CFC”) is subject to tax on certain income of the CFC (“GILTI income”). The U.S. shareholder must include the GILTI income in its current income. U.S. C corporation shareholders are allowed a federal deduction of up to 50% of GILTI income, reducing the federal effective tax rate to 10.5% on the GILTI inclusion.

The DOR announced that, because GILTI is treated in a manner similar to Subpart F income for federal income tax purposes, and because Pennsylvania treats Subpart F income as dividend income for purposes of CNIT, Pennsylvania will treat GILTI income as dividend income. CNIT taxpayers should therefore include GILTI in their CNIT base for the year in which the GILTI is recognized for federal income tax purposes (or would be recognized on a
separate company basis if the CNIT taxpayer were required to file a separate federal income tax return). When the GILTI actually is distributed, Pennsylvania will follow the federal treatment and treat the distribution as previously taxed income that is not subject to CNIT.

Pennsylvania law allows a deduction for corporations that receive dividends from foreign corporations, and because Pennsylvania treats GILTI income as dividend income for CNIT purposes, Pennsylvania will allow a dividends received deduction with respect to GILTI, but will not allow the federal deduction under IRC Section 250(a)(1). The dividends received deduction also will apply to any CNIT taxpayer that would have been entitled to such deduction on a separate company basis if it were required to file a separate federal income tax return. The dividends received deduction may be less than 100%, depending on the CNIT taxpayer's ownership interest in the entity generating the GILTI income.

b. FDII

FDII is certain income earned in the U.S. related to foreign sales and services. Effective for tax years beginning after December 31, 2017, new IRC Section 250 allows a deduction of 37.5% of the FDII of a domestic corporation. The deduction results in a reduced federal effective tax rate of 13.125%, subject to a taxable income limitation on the amount of the deduction allowed. The FDII deduction is reported as a special deduction.

Because the FDII deduction is a special deduction under federal law and the CNIT law does not allow special deductions, the FDII deduction is not available for CNIT purposes.


The DOR announced its position regarding new IRC Section 163(j), added by the TJCA. Under new IRC Section 163(j), a taxpayer's business interest expense deduction for tax years beginning after December 31, 2017 is limited to the sum of (i) the taxpayer's business interest income, plus (ii) 30% of the taxpayer's adjusted taxable income, plus, (iii) the taxpayer's floor plan interest. The Section 163(j) limitation is determined at the filer level (e.g., at the consolidated group or partnership level). Taxpayers with average annual gross receipts of less than $25 million generally are excluded from the application of IRC Section 163(j), subject to detailed attribution rules, and other taxpayers may elect out in exchange for reducing allowable depreciation. Any interest expense disallowed by
IRC Section 163(j) in one taxable year may be carried forward indefinitely.

Because the starting point for computing CNIT income is federal taxable income before a net operating loss deduction and special deductions, the DOR announced that Pennsylvania automatically adopted the changes made by the 2017 TCJA.

However, because Pennsylvania requires every CNIT entity to file separately and to start with federal taxable income as if the entity had filed a separate federal return, CNIT taxpayers will need to calculate a Section 163(j) limitation on a separate entity basis. Likewise, the federal exceptions to the limitation, including the $25 million gross receipts threshold, will be applied on a separate entity basis. Bulletin 2019-03 also makes clear that, contrary to guidance provided in federal regulations, intercompany transactions between separately filing entities must be taken into account when applying the IRC Section 163(j) rules for CNIT purposes.


The BF&R denied relief and rejected a taxpayer’s argument that it could exclude an investment in a joint venture when calculating its apportionment factor for the, now phased-out, foreign franchise tax.

A subsidiary of the taxpayer (Appalachia) was audited and the DOR concluded that Appalachia should not have reported its interest in “Atlas JV” in its franchise tax calculation. Therefore, Appalachia amended its return and claimed a franchise tax refund based on the removal of Atlas JV from its return. The DOR concluded that Atlas JV should have been included instead in the taxpayer’s franchise tax calculations.

The taxpayer argued that it should have been able to use a single-factor apportionment factor for franchise tax purposes and that its interest in Atlas JV should have been excluded when calculating its franchise tax apportionment because Atlas JV was not a separate legal entity (it was a tax partnership only). The taxpayer argued that, by including the value of its interest in Atlas JV as an asset, the DOR was effectively double-counting that investment. The taxpayer’s position was that its franchise tax factor should be based solely on the proportion of taxable assets in Pennsylvania, after excluding all entities with no presence in Pennsylvania and after eliminating intercompany items.

The BF&R rejected the taxpayer’s argument, finding that it did not produce sufficient evidence about its corporate structure or to demonstrate the value if its taxable assets within and outside of Pennsylvania.

The BF&R rejected several arguments by the taxpayer that would have reduced its sales that were allocated and apportioned to Pennsylvania. The taxpayer manages pharmaceutical benefits from its offices in Missouri. Additionally, the taxpayer owned an interest in “RxHub,” an entity that provides communication services among the parties in the prescription chain. The taxpayer argued that it was entitled to exclude its management income from its Pennsylvania sales factor because such income must be sourced using the cost of performance method and a greater proportion of its costs to provide the management services (i.e., its income-producing activity) were incurred outside of Pennsylvania than in Pennsylvania. Additionally, the taxpayer argued that its share of income from RxHub was nonbusiness income, none of which was applicable to Pennsylvania.

The BF&R rejected both arguments. The Board stated that until a customer purchases the taxpayer’s services there has not been an income-producing activity. Thus, the Board stated that the fact that the taxpayer had substantial facilities and employees outside of Pennsylvania was not dispositive. Instead, it said that, to show that a greater proportion of its costs of performance were incurred outside of Pennsylvania than inside Pennsylvania, the taxpayer needed to isolate the costs that were directly attributable to the purchase of its services by customers in Pennsylvania. The Board ruled that the taxpayer did not present sufficient evidence as to the direct costs of performance.

Additionally, the BF&R concluded that the taxpayer did not provide sufficient evidence to support its nonbusiness income claim with respect to RxHub.


The BF&R rejected an argument that the taxpayer’s receipts from on-line education should be excluded from its sales factor numerator. The taxpayer argued that it was eligible to use the “cost of performance” method to apportion its receipts and that, under those rules, no receipts were sourced to Pennsylvania because substantially all of the taxpayer’s costs were incurred outside of Pennsylvania. The BF&R rejected the argument, however, finding that the taxpayer failed to demonstrate (i) what its income-producing activity is, and (ii) that a greater proportion of its costs in such activity were incurred outside of Pennsylvania than inside Pennsylvania.

   The BF&R denied the taxpayer’s claim for relief and ruled that receipts from credit card processing transactions were receipts from the sale of services and therefore sourced to the location of the customer. The BF&R also rejected an argument that the taxpayer could exclude transactions with affiliates, finding that the taxpayer did not produce sufficient evidence regarding such transactions.

9. **In re: SBA Communications Corporation,** BF&R Docket No. 1717843 (04/02/2019).

   The BF&R granted relief and allowed a taxpayer to claim CNIT losses from entities that were corporate subsidiaries of the taxpayer but that converted into single-member limited liability companies that were disregarded for federal tax and CNIT purposes after the conversion. Under IRC Section 381, the net operating losses of the subsidiaries became net operating losses of the parent after the reorganizations. Although the taxpayer did not produce sufficient evidence regarding all of the entities that were involved, to the extent it could show that the converted entities had losses and converted into entities that were disregarded entities owned by the taxpayer, the BF&R allowed the taxpayer to use the losses.


    The BF&R granted relief to an S corporation that inadvertently filed a corporate tax report indicating the S corporation had CNIT liability and then filed a late appeal challenging the assessment of tax reported on the return. The taxpayer’s preparer mistakenly prepared a corporate tax report (RCT-101) even though the taxpayer was an S corporation for CNIT and PIT purposes. When the DOR assessed tax as reported on the return, it mailed the assessment to an old address, no longer used by the taxpayer. Consequently, the BF&R determined that the taxpayer was entitled to *nunc pro tunc* relief and treated the taxpayer’s appeal as valid. Because the taxpayer was an S corporation (with a valid Pennsylvania election), the BF&R struck the assessment of CNIT against the corporation.


    The BF&R denied relief and upheld the DOR’s denial of deductions for royalties paid to an affiliate during a tax year that predated the CNIT statute that disallows such payments in certain circumstances. To shield its intellectual property from liability in civil claims, the taxpayer created an intellectual property holding company and paid the holding company
an annual fee based on a percentage of taxpayer’s sales. The holding
company is located in Delaware, has regular board meetings and, in
connection with its ownership of intellectual property, negotiates and
enforces confidentiality agreements and files suits to defend its rights.
The taxpayer deducted its royalty payments to the holding company and
the DOR added the deductions back to the taxpayer’s CNIT income.

The BF&R upheld the denial of the deductions, holding that the taxpayer
did not demonstrate that the holding company “had any economic
substance as a separate business entity or that the type of transaction [the
taxpayer] engaged in served an economic purpose.” It found that the
stated purpose of liability protection and evidence of actual royalty
payments was insufficient evidence that the holding company had separate
substance.

1830125 (06/11/2019).

The BF&R granted relief to the taxpayer because it found that DOR
records supported the contention that it was entitled to a net operating loss
carryforward. When it filed a CNIT return for its tax year ended July 31,
2017, taxpayer claimed a net operating loss from its tax year ended July
31, 2010 but could not locate a copy of the amended return on which the
loss was initially claimed. However, the BF&R ruled in favor of the
taxpayer because it found that the DOR had paid a refund in accordance
with the amended return and therefore must have received and processed
the return.

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


The Supreme Court upheld in part and overruled in part a Commonwealth
Court decision regarding the taxability of electronic poker machines at
taxpayer’s casino. The taxpayer operates a harness racing track, off-track
betting locations and a casino resort with 250 slot machines. The taxpayer
contracted with a vendor install the machines at the taxpayer’s business
location.

The Supreme Court agreed with the Commonwealth Court’s holding that
the entire contract price for the machines was subject to SUT. The court
rejected the taxpayer’s argument that the “true object” of the payments
was to secure simulcasting services, not the slot machines. In doing so, it
effectively rejected the “true object” test altogether and held that each item
purchased must be viewed separately to determine the taxability. Because
there was only one stated purchase price (i.e., the simulcasting charges
were not broken out) and the transaction involved the purchase of tangible
personal property – the slot machines – the court determined that the entire purchase price paid under the contract was subject to SUT.

However, the Supreme Court overruled the Commonwealth Court’s holding that a license agreement under which the vendor licensed intellectual property necessary to operate the machines to the taxpayer was also taxable as software because it found evidence to support separately stated charges for the software component (taxable) and the intellectual property license (nontaxable).


The Commonwealth Court held that a taxpayer who powder-coated race car chassis was not engaged in the business of manufacturing but was instead engaged in the taxable service of repairing or altering tangible personal property. The taxpayer could not produce any evidence supporting its contention that the fundamental composition of the chassis was changed by the powder-coating process.

The court also held that the taxpayer’s purchase of natural gas was subject to tax. Although the court agreed that the taxpayer was engaged in some activity that constituted manufacturing, the taxpayer did not produce any evidence allocating the taxable use and the nontaxable use of simply heating its building.


The Commonwealth Court reversed the trial court and held that it erred when ordering the Pennsylvania Liquor Control Board (“PLCB”) to reinstate a pizzeria’s liquor license after the non-payment of SUT. The PLCB revoked the pizzeria’s license because it did not have confirmation from the DOR that the licensee had filed a required SUT returns and paid SUT. The pizzeria owner filed a late challenge to the revocation of its license and argued (among other things) that it was making provisions to pay the sales taxes. The trial court agreed to grant *nunc pro tunc* relief with respect to the taxpayer’s challenge because it found several defects in the process that led to the revocation and it ordered the PLCB to reinstate the license. The Commonwealth Court held that the *nunc pro tunc* relief was within the trial court’s discretion but that the trial court improperly ordered the license reinstated because the taxes had not been paid and there was no formal payment plan in place. The court held that tax clearance was a necessary condition of the license and the trial court could not order reinstatement absent full clearance by the DOR.
4. **SUT Ruling SUT-18-004 (11/05/2018).**

The DOR ruled that, for local SUT purposes, the retailer’s business location is the situs of the sale, even when the retailer is selling services. The taxpayer was a cleaning service provider based in Allegheny County, which has a 1% local SUT imposed in addition to the Commonwealth’s 6% SUT. The DOR ruled that the taxpayer was required to collect the Allegheny County tax from all sales, even when the services are provided to customers outside of Allegheny County, reasoning that the SUT (unlike CNIT, which is apportioned using market-sourcing) is a point-of-sale tax. This ruling is consistent with the plain language of the Regulations governing the situs of sales in 61 Pa. Code § 60.16(c).

C. **Property Tax Cases**


The Commonwealth Court upheld the trial court and held that a shed erected on the taxpayer’s land was not an improvement and could not be taken into account when assessing the land. The shed was placed on a bed of limestone, was readily removable and was not connected to municipal services such as water, gas, electric or sewer. Likewise, it lacked plumbing and was not wired for electricity. However, the shed was serviced by a portable heater fueled by a 20-pound capacity propane tank.

The Consolidated County Assessment Law includes as real property – “buildings permanently attached to land or connected with water, gas, electric or sewage facilities.” Thus, the county primarily argued that, because the shed was connected to the propane tank, it was real property and could be taken into account when increasing the assessment.

The court rejected this argument finding that (i) the shed was readily movable, and (ii) could be quickly and easily disconnected from the propane tank. Therefore, the court reasoned that there was no permanency to the shed’s attachment to the property.

The court also rejected an argument that the shed was a taxable improvement to the real property for similar reasons. It determined that, to be an improvement under the Consolidated County Assessment Act, there must be a degree of permanency that is not present in a shed that could easily be moved.

The Commonwealth Court held that a church center with business offices and meeting rooms as well as an "adoration chapel" was entitled to an exemption for 50% of the property. The Parish claimed that because the adoration chapel was open for anyone to worship 24 hours a day and the offices and meeting rooms were all used for church business or church meetings, the center should be fully exempt even though no regular worship services were conducted there. Oddly, the trial court granted the exemption for 50% of the property even though it concluded that the chapel was not regularly used for religious worship. The Commonwealth Court rejected the church’s argument that the entire property was entitled to the exemption because of the chapel and indicated that – had the county appealed – it may have struck down the exemption in its entirety because of the trial court’s finding that there was no regular worship.


The Commonwealth Court denied claims by the taxpayer under the Uniformity Clause of the Constitution and the real property tax refund statute. After the taxpayer’s appeal rights lapsed, it tried to seek relief through constitutional claims and based on the general real estate tax refund statute. However, the court held that, because the taxpayer had the right to seek its desired remedies by appealing the prior ruling of the trial court, it could not use the new claims to get around its failure to appeal.


The Commonwealth Court reversed the trial court and held that an outpatient surgical center was not entitled to a real estate tax exemption as a hospital. The surgical center is owned by an organization that is exempt from federal income tax under IRC Section 501(c)(3) and that owns a hospital facility that is exempt from property taxes. The Board initially denied an exemption application because it found that the surgical center was not licensed as a hospital (it was licensed as an ambulatory surgical center) and because it was in direct competition with similar for-profit facilities. The trial court ruled in favor of the surgical center but the Commonwealth Court reversed. It held that whether something is a “hospital” entitled to an exemption is a question of fact and that the center did not qualify because (among other reasons) it did not offer care 24 hours per day and did not have multiple departments. The court also agreed with the Board that the facility competed with for-profit surgical centers. Finally, the court held that the surgical facility was not entitled to an exemption as part of the larger hospital facilities because it was not a
necessary component of the hospital’s functions. The court remanded the case for further proceedings to determine whether, alternatively, the property is exempt as property owned and used by an institution of purely public charity.

D. PIT Cases and Administration


   In addition to the CNIT issues (discussed above), the Bulletin makes clear that the IRC Section 163(j) limitation does not apply for PIT purposes and that all interest is deductible for PIT purposes if the interest is an ordinary and necessary business expense.


   In addition to the CNIT issues (discussed above), the DOR announced that the TJCA concepts of GILTI and FDII do not apply for PIT purposes.


   The Commonwealth Court held that the statute of limitations barred a refund claim that was based on a stipulated settlement with the Commonwealth. The taxpayers owned stock in an S corporation and membership interests in two limited liability companies engaged in the aviation business. On March 26, 2013, the DOR issued assessments related to the aviation entities’ 2009 and 2010 tax years. The issue was the allocation of the entities’ income and losses between the PIT categories of net trade or business income and net rental income. When the 2009 and 2010 assessments were mailed, an appeal was pending at the Commonwealth Court relating to the 2006, 2007 and 2008. The taxpayers paid the 2009 assessment on October 15, 2013 and paid the 2010 assessment on November 1, 2013.

   On March 17, 2014, the taxpayers agreed to a settlement with the Commonwealth whereby the income would be allocated 75% to the trade or business category and 25% to the rental category. An e-mail from the Deputy Attorney General provided “I will recommend the same 75/25 split for future years unless and until there would be a change in the applicable laws or caselaw [sic] and provided that there are no jurisdictional defects in any appeal at any state [sic] of the proceedings.”

   After the settlement for 2006, 2007 and 2008 was finalized with the Commonwealth Court, on September 29, 2014, the taxpayers filed a Petition for Refund with the Board of Appeals based on the allocation agreed to as part of the settlement. The Board of Appeals denied the
The Commonwealth Court upheld the denial of the refund claim. First, it rejected the argument that the Commonwealth was equitably estopped from denying the claim because the taxpayers could not show that they relied on the settlement when paying the 2009 and 2010 assessments because they made the payment before finalizing the agreement. Second, the court pointed out that the e-mail confirming the arrangement for future years was contingent upon a claim without jurisdictional defects. Finally, the court rejected an argument that the general statute of limitations, which allows a refund claim to be filed within three years of the actual payment of tax, should apply because the taxpayers filed the Petitions for Refund in an effort to enforce the settlement, not to challenge the audit assessments. The court reasoned that (i) the six-month statute as applied to payments made in response to an assessment is an absolute bar, and (ii) because the taxpayers made the payments before the settlement was finalized, they could not show any reliance on the settlement when making the payments.


The Commonwealth Court upheld the BF&R’s calculation of PIT in a long-disputed case in which nonresident individual limited partners in a partnership that owned Pennsylvania real estate were found to be taxable upon the foreclosure of the partnership's property.

Effective for tax years after December 31, 2000, a PIT taxpayer is required to reduce its basis for property based on minimum depreciation. The DOR argued that this effective date meant that the requirement was applicable for all years, even years before 2001. The court, however, rejected this argument and agreed with the BF&R that the taxpayers were required to reduce their basis for property by minimum depreciation only starting with their 2001 tax years.


The BF&R rejected a claim by the taxpayer that his compensation for services should be excluded from PIT because he performed the services outside of Pennsylvania. The taxpayer, a resident of Florida, performed services for an S corporation that was located in Coraopolis, Pennsylvania from his Florida home. He therefore argued that all compensation should be sourced to where he provided the services. The BF&R, however, rejected this argument, finding that services performed outside of Pennsylvania are excludable only if performed outside of the Commonwealth for the “convenience of the employer.” Because the services performed by the taxpayer could have been performed in
Coraopolis, the BF&R held that the compensation for such services was properly sourced to Pennsylvania.


In *RP Polo Run Investors and Bucks Holding*, the BF&R rejected a taxpayer’s attempt to defer gain upon the exchange of property under IRC Section 1031. The PIT law does not have a provision analogous to IRC Section 1031 but the taxpayers kept their books and records using the “federal income tax method” and therefore argued that an express provision in the PIT law was not required. Until December 31, 2017, the PIT Bulletin 2006-07 provided that, even in the absence of such a provision, taxpayers could defer gain if it was deferred under the method of accounting regularly used. PIT Bulletin 2006-07 was revised and now provides that the DOR will not allow a taxpayer to use any method that results in the deferral of gain under IRC Section 1031. Although the transactions at issue in *RP Polo Run Investors and Bucks Holding* predated the change to the PIT Guide, the BF&R held that the taxpayers could not use the federal income tax method of accounting for PIT purposes as a means to incorporate federal provisions not otherwise in the PIT law.

However, in the *Jones* decisions, which also involved transactions before the revision to PIT Bulletin 2006-07, the petitioners produced evidence that they kept books and records using GAAP and that the gain was deferred under GAAP. Thus, the BF&R allowed the deferrals of gain.


The BF&R granted refunds to a trust because it determined that the trust demonstrated it was a nonresident trust and was not subject to tax under the principles of *McNeil v. Commonwealth*, 67 A.3d 185 (Commw. Ct. 2013). In *McNeil*, the Commonwealth Court held that, although Pennsylvania law provides that a trust is a resident trust if its settlor or grantor was a Pennsylvania resident at the time of creation, Pennsylvania cannot impose PIT on trusts that do not otherwise have requisite contacts with Pennsylvania.

The trust at issue was created by a Pennsylvania resident. It had multiple Pennsylvania trustees (a majority during at least some tax years), a Pennsylvania beneficiary during some tax years and kept its books and records in Pennsylvania. It also retained legal and accounting services in
Pennsylvania. However, the trust asserted that it had no Pennsylvania property or income from Pennsylvania sources during any of the years at issue. The BF&R agreed with the taxpayer that, because the trust had no assets in Pennsylvania, it did not have nexus with Pennsylvania and could not be subject to PIT.

8. **In re: Fox Caleb Decd for Decedent’s Trust**, BF&R Docket No. 1713438 (12/05/2018).

The BF&R agreed that a trust was entitled to a refund in light of the principles of *McNeil*, discussed above. The trust at issue was created by a Pennsylvania resident and did not have any Pennsylvania trustees during the years at issue. It had several Pennsylvania beneficiaries and retained legal and accounting services in Pennsylvania. The books and records were kept outside of Pennsylvania and the trust asserted that it had no Pennsylvania property or income from Pennsylvania sources during any of the years at issue. The BF&R agreed with the taxpayer that, because the trust had no assets in Pennsylvania, it did not have nexus with Pennsylvania and could not be subject to PIT.


Owing to what it called the “breakdown of the administrative process,” the BF&R granted relief from penalties and one-half of the interest assessed against the taxpayer. The taxpayer sought PIT amnesty and filed an amnesty return for the tax years 2006, 2007, 2008, 2009, 2013 and 2015 but did not – as was required by the amnesty process – make a cash payment of the tax, plus one half of the interest. When his amnesty request was denied, the taxpayer filed an appeal with the Board of Appeals. The Board of Appeals denied his appeal but – in its order – did not provide a time for an appeal to the BF&R. When the taxpayer filed his petition with the BF&R, it was after the statutory period but the taxpayer argued (i) he was unaware, and (ii) the period does not apply to the denial of an amnesty request because it is not a specific tax type.

The BF&R determined that the Board of Appeals should have given proper notice of appeal rights to the taxpayer and therefore treated his petition as valid. Additionally, the BF&R used its “equitable powers” to relieve the petitioner from penalties and one-half of the interest, thereby putting him in the position he would have been had his amnesty submission been accepted.


The BF&R denied relief to taxpayers who argued that the DOR miscalculated their share of gain from the disposition of a limited liability
company membership interest by an S corporation in which the taxpayers owned an interest. The S corporation, an accrual method taxpayer, disposed of its interest in the limited liability company in 2015 and received payments in 2015 and 2016. The S corporation reported the transaction as an installment sale and consequently, passed out only some of the gain to the taxpayers during 2015. The taxpayers argued that—under the “all events” test for the accrual method—the 2016 payment was not required to be taken into account because it was subject to material contingencies and could be substantially reduced. The BF&R, however, rejected this argument and stated that the installment method only is available to cash method taxpayers for PIT purposes when the installment sale is the disposition of tangible personal property. Because the transaction at issue involved the disposition of goodwill, the BF&R held that the installment method was not available and that the entire gain was recognized for PIT purposes in 2015.

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

1. Tax Credits

   a. Restricted Tax Credit Bulletins 2018-02 and 2019-01
      (12/12/2018 and 01/03/2019).

      The DOR announced its position regarding the tax treatment of Educational Improvement Tax Credits (“EITCs;” Bulletin 2018-02) and other credits (Bulletin 2019-01) following federal changes to the deductibility of payments for donation-based tax credits.

      Following TJCA changes that limited the deductibility of state and local taxes, several states enacted provisions that would have allowed taxpayers to make charitable contributions in lieu of paying state and local taxes. The Internal Revenue Service (“IRS”) advised, in regulations that were proposed in May 2018 and finalized in June 2019, that—except in the case of tax credit programs where the credit is 15% or less of the contributed amount—a charitable deduction only will be allowed to the extent a contribution to a charity exceeds the amount of state tax credit generated by the contribution. However, the IRS also indicated that the new rules will not necessarily prohibit businesses from deducting payments made in exchange for state and local tax credits as ordinary and necessary business deductions.

      The DOR announced that Pennsylvania law does not prohibit businesses that make contributions to EITC organizations or other credit programs from claiming the applicable tax credits, even if it deducts the contributions as business expenses for federal income tax purposes.
However, the DOR clarified that pass-through entities with members who are subject to PIT must add-back amounts that are deducted as business expenses and cannot claim a deduction for any amount for which it receives a Pennsylvania tax credit. This is because the DOR views such credits as charitable in nature for PIT purposes.

Although the DOR stated that its guidance could change following finalization of the federal regulations, no update has been published since those regulations were finalized.

2. **Realty Transfer Tax**


      The BF&R denied a petition for reassessment and upheld the assessment of RTT where the petitioner argued that the transfer was a deed in lieu of foreclosure to the holder of a bona fide mortgage.

      The deed in lieu of foreclosure was signed on December 13, 2013 with a stated effective date of December 30, 2014 and placed into escrow. Likewise, the mortgage was assigned to the intended grantee effective December 30, 2014. The DOR argued that there was insufficient evidence that the grantee was the bona fide holder of the mortgage when the property was conveyed.

      The petitioner argued that escrow agreement meant that the deed was not delivered to the grantee until December 30, 2014. Although the DOR agreed that the signature date was not necessarily dispositive, it argued that the grantor’s obligations with respect to the transaction were completed when it placed the deed in escrow and that the grantee therefore constructively received the deed at that time.

      The BF&R agreed with the DOR because it also found that no material conditions remained when the deed was placed in escrow and that placing the deed in escrow on December 13, 2013 therefore constituted constructive delivery to the grantee, at which time the grantee was not the holder of the mortgage. Therefore, it upheld the assessment of RTT.

   b. **In re: Michael R. Bradley and Daniel S. Doyle**, BF&R Docket Nos. 1806981 and 1807061 (05/14/2019).

      The BF&R struck an assessment of RTT in its entirety because it agreed with the petitioners and found that the deed at issue was a
confirmatory deed. The petitioners purchased property at a sheriff’s sale with the intent of taking title through an entity known as “Homestead Development, LLC.” However, because the petitioners used personal checks with their own names to pay for the property, the sheriff’s office inadvertently listed the petitioners as the grantees on the deed it prepared. Because the petitioners were told that the sheriff’s office could not reverse the action by undoing a deed, they instead prepared and delivered a deed to Homestead Development, LLC and claimed that such deed was exempt as a correctional deed.

The DOR assessed RTT based on the computed value of the real property and the Board of Appeals denied relief because it found that the petitioners did not present sufficient evidence that they intended for the LLC to take title. At the BF&R, petitioners provided organizational documents for the LLC and a letter to the sheriff’s office indicating that, before the sale, petitioners expected to take title in the LLC. Even when presented with that information, the DOR continued to insist that RTT was due. It pointed to a Pennsylvania Rule of Civil Procedure that (contrary to what petitioners were told) allows a sheriff’s office to correct a deed in this situation.

The BF&R, however, agreed with the petitioners that the deed met the requirements for a correctional deed because (i) the property interest in the correctional deed was identical to the property intended to pass with the original deed, (ii) the parties treated the property interest described in the correctional deed as that of the grantee from the time of the original transaction, and (iii) the parties never treated the property interest as belonging to the individuals. Thus, the BF&R stuck the assessment in its entirety.

3. Local Taxes


The Pennsylvania Supreme Court overturned a decision of the Commonwealth Court and held that the York business privilege tax (“BPT”) cannot be imposed on shipping charges collected by a freight broker from its customers and passed on to freight carriers. The issue was whether such charges were paid or advanced by the freight broker on behalf of its customers.

The taxpayer is a freight broker that does not itself ship products; its business consists of receiving a freight order from a customer and locating/negotiating with a common carrier to transport the
cargo. The taxpayer pays the common carrier for the service and bills the customer for the common carrier’s price, plus a commission.

The Local Tax Enabling Act (“LTEA”) prohibits municipalities from taxing “charges advanced by a seller for freight, delivery or other transportation for the purchaser…” The taxpayer argued that this language required York to allow it to deduct the amounts paid to the common carriers when calculating its gross receipts for business privilege tax purposes. The Commonwealth Court held that the LTEA restriction applies only in the case of sales of tangible personal property if the seller of such property advances shipping charges for reimbursement by the purchaser.

The Supreme Court reversed the Commonwealth Court relying on the language in York’s BPT regulations, which excludes from the BPT base “gross receipts which constitute ... [f]reight delivery or transportation charges paid by the seller for the purchaser.” (Emphasis added). The court determined that this was a broader exclusion than is required by the LTEA in that the regulation does not require charges to be “advanced” by the seller. The court then found that the term “seller,” as used in the regulations, was broad enough to encompass the taxpayer’s activities. Because it uses amounts collected from its customers to pay the freight carriers, the court held that the taxpayer can exclude such amounts from its BPT base; therefore, it should be subject to BPT only on the commissions collected from its customers.


The Commonwealth Court held that neither the Pennsylvania Home Improvement Consumer Protection Act (“HICPA”), nor the LTEA preempts the imposition of BPT on home improvement contractors.


The Commonwealth Court remanded a case for further proceedings to determine how much Allegheny County Hotel Tax was owed by the operator of a motel. The court characterized the motel’s accounting methods as “at best, haphazard” leading to difficulty in ascertaining the facts. The operator argued that a material amount of tax at issue related to 13 rooms that were held for use by a regular costumer (Equipment Transport (“ET”)) and
therefore were permanent residences, not transient lodging. There was no written contract with ET but the trial court found evidence that the relationship existed and struck the assessment. The Commonwealth Court agreed that an oral contract could be sufficient and agreed that the hotel tax ordinance treats as a permanent residence a room that an occupant “has the right to occupy” for 30 uninterrupted days or more even if the occupant does not actually occupy the room. However, the Commonwealth Court determined that the requisite relationship only exists if the occupant (or potential occupant) pays for the rooms and thereby truly has the right to occupy. It believed that the actual relationship between the parties was that ET used rooms occasionally and, in practice, only paid for the rooms it used. Thus, it remanded the case to the trial court to determine whether any rooms were actually and continuously occupied (under the ordinance) for 30 uninterrupted days.

4. Miscellaneous Taxes


The Pennsylvania Supreme Court struck down a tax imposed by the Gaming Act and ordered the commonwealth to refund taxes to the plaintiff casinos.

The case involved a constitutional challenge to the 0.5% tax that is paid into the Casino Marketing and Capital Development Account (“CMCD Account”). While all casinos pay into the CMCD Account (which also is funded by transfers from the Gaming Fund), amounts are distributed from the CMCD Account to casinos in the Commonwealth. The distributions from the CMCD Account are disproportionate and are based on (i) the types of gaming a casino offers, and (ii) the casino’s annual revenues. The effect is that casinos with higher revenue partially subsidize the operations of smaller casinos.

The plaintiff (joined by another casino that intervened) argued that the manner in which the tax was imposed violated the Due Process and Equal Protection Clauses of the U.S. Constitution as well as the Uniformity Clause of the Pennsylvania Constitution. Although there was a split in the court and it could not agree on which clause of the U.S. Constitution applied, there was a majority that agreed that the tax violated the U.S. Constitution. The court determined that there was no rational basis for the disproportionate benefits that the CMCD Account conferred on casinos if different sizes.
After determining that the CMCD Account provisions could be severed from the remainder of the Gaming Act, the court turned to the remedy to which the plaintiffs were entitled. In many situations, Pennsylvania courts have held that – when taxing provisions are struck down – the tax is invalidated prospectively and refunds are not available. However, in this situation, the plaintiffs had obtained injunctive relief preventing the funds from being distributed from the CMCD Account while the case was pending. Because, based on its holding, the court determined that the funds could not constitutionally be distributed, it held that refunds must be paid from the CMCD Account to the plaintiffs.


The Commonwealth Court struck down the Fireworks Tax enacted by the General Assembly in 2018 but rejected constitutional arguments that would have invalidated all of Act 43 of 2018, in which the tax was enacted. Among the plaintiff’s arguments were that the General Assembly did not follow constitutional requirements for enacting the tax because (i) Act 43 did not have a single subject, and (ii) Act 43 did not properly repeal prior law regulating the sale of fireworks. The court ultimately agreed with the taxpayers on a narrower argument – *i.e.*, that the General Assembly improperly delegated authority by relying on National Fire Protection Association standards – leaving the remainder of Act 43 in place.


The Commonwealth Court upheld the denial of credits by the BF&R because the taxpayer did not file a refund claim within the requisite three-year 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). In June 2018, the Commonwealth Court upheld a decision of the BF&R denying the refund claim.
The taxpayer then filed a petition with the Board of Appeals seeking a credit for the taxes against future gaming tax liabilities. In rejecting an argument by the taxpayer that credits should be treated differently, the court noted that the statutory provision with the three-year period expressly applies to both refunds and credits. Additionally, the court held that the three-year period was a statute of repose, rather than a statute of limitations, and therefore extinguished the taxpayer’s claim when it lapses and precluded a revival.


The Commonwealth Court held that the doctrine of sovereign immunity barred a claim against the Commonwealth to collect funds that were escheated to the Treasury Department. In 2010, US Bancorp turned over $10,500 of uncashed checks in the names of plaintiff’s parents for the benefit of the plaintiff’s deceased brother. Plaintiff asserted that he was the rightful owner of the funds, but the Treasury Department denied his claim because he could not prove he was a trustee or beneficiary of the funds. The plaintiff then sued his parents and US Bancorp, received a verdict in his favor for $9,000 and then filed a claim in equity seeking an order that the Treasury Department release the checks to him. The court held that sovereign immunity prevented the plaintiff from suing the state to release the funds and that there was no applicable exception. The plaintiff obtained a monetary judgment against his parents and US Bancorp but could not sue the Commonwealth to collect on that debt; instead, the funds could only be released to him if he obtained a judgment stating that he was the rightful owner of the specific funds held by the Treasury Department.

e. **In re: Bryan E. McCracken Trucking**, BF&R Docket No. 1810431 (06/18/2019).

The BF&R used equitable powers to strike an assessment of Motor Carrier Road Tax when it concluded that the audit was not properly conducted. The auditor reviewed odometer readings for a sample of trucks and found discrepancies. The auditor concluded that the company must have used map distances (rather than odometer readings) to calculate its tax. The auditor also found discrepancies in the fuel records kept by the taxpayer. As a result of these findings, it increased the taxpayer’s total liability based on estimates related to the discrepancies. The taxpayer, however, argued that the discrepancies were easily explainable and that it kept the required documentation to support its tax.
The BF&R, reviewing these facts, determined that the auditor must have assessed tax without specific substantiation and decided to strike the audit assessment in its entirety.

III. PHILADELPHIA DEVELOPMENTS

A. Legislative and Administrative Developments

1. Philadelphia Ordinance No. 190135 – Changes to Realty Transfer Tax Base

Effective July 1, 2017, Philadelphia transfer tax is imposed when a real estate company experiences a 75 percent or more change in ownership in a six-year period and the tax base is presumed to be the “actual consideration” paid for the interests in the real estate company.

Effective May 15, 2019, Ordinance No. 190135 provides that the term “actual consideration” for these purposes includes any liens or encumbrances on the real estate existing before the transfer and not removed by it. The change clearly is an effort by the City to cause mortgage debt owed by a real estate company to be included in the transfer tax base in the case of a bona fide arm’s length sale of the company's interests.

2. Philadelphia Ordinance No. 180077-A; Business Income and Receipts Tax (“BIRT”) Regulations § 202(B)

The BIRT estimated tax requirements are now phased in for new businesses. For taxpayers commencing business in the City in the 2019 calendar year or later, no estimated tax payments will be required with a business’ first BIRT return. Following the filing of such a business’ second BIRT return, the business is required to make quarterly estimated BIRT payments. 25% of the BIRT due with the second BIRT return must be paid on each of April 15, June 15, September 15 and January 15 following the filing of the second BIRT return. Beginning with the third return, all taxpayers must make an estimated tax payment equal to 100% of the BIRT due for the period for which the return is being filed.


Effective July 1, 2020, as part of the application for a BIRT account, all businesses that are not natural persons or publicly-traded companies must disclose information regarding natural persons who are the ultimate owners of the applicant. Specifically, the BIRT account application will require the name and preferred mailing address of each natural person who has an equity interest in the applicant, whether held directly or through one or more tiers of a corporate structure of at least (a) 49% of the value of
the applicant, or (b) 49% of the value of the owner of such applicant. If no natural person has a requisite ownership interest, the application shall identify the name and address of the two natural persons who have the largest equity interest in the applicant. For these purposes, an equity interest means “[a] legal or equitable ownership interest in a property or business, however designated, including, but not limited to, capital stock, partnership interests, or membership interests.” Businesses will have an ongoing obligation to provide updated information and must report any changes within 10 business days of a change. Knowingly providing false or misleading information will be a Class III criminal offense while negligently providing false or misleading information shall be a Class II offense.

4. **BIRT Regulations § 103 – “Doing Business” After Wayfair**

The Revenue Department updated the BIRT regulations in light of the U.S. Supreme Court decision in *South Dakota v. Wayfair*. For tax years starting on or after January 1, 2019, a business with no physical presence in Philadelphia will be subject to BIRT if the business has generated at least $100,000 in Philadelphia gross receipts during any 12-month period ending in the current year and has sufficient nexus with Philadelphia to establish nexus under the U.S. Constitution.

5. **Philadelphia Ordinance No. 180909 – Potential Extension of BIRT Net Operating Loss Carryforwards**

City Council amended the BIRT law to allow an increase in the allowable net operating loss carryforwards from 3 years to 20 years. However, the change is effective only upon the passage of enabling legislation by the Commonwealth General Assembly, which has not yet happened. If and when the change is effective, it applies only to losses generated after the effective date; all losses generated before the effective date still will be subject to the 3-year carryforward.

6. **Philadelphia Ordinance No. 190155 – Wage and Net Profits Tax Rate Reductions**

Effective July 1, 2019, the Wage Tax and Net Profits Tax (“NPT”) rates were reduced to 3.8712% for residents and 3.4481% for nonresidents from the old rates of 3.8809% for residents and 3.4567% for nonresidents.

7. **Advisory Notice — Net Interest Expense Limitation [IRC Sec. 163(j)] Tax Policy Update (05/29/2019) – City 163(j) Rules**

The Philadelphia Revenue Department announced its policy regarding the implementation of new IRC Section 163(j) for BIRT purposes.
The Revenue Department announced that, absent Pennsylvania legislation decoupling a taxpayer's federal interest expense deduction amount for BIRT purposes, taxpayers are obligated to use the federal interest expense deduction calculated on a separate entity basis. To the extent practicable, federal regulations are to be followed in determining a taxpayer's pro-forma interest expense deduction under IRC Section 163(j) for purposes of calculating BIRT Method II net income. If a BIRT Method II taxpayer has a Section 163(j) limitation and also reports nonbusiness income, the taxpayer should determine the amount of overall interest expense associated with nonbusiness income, if any, and allocate an interest limitation to that amount on a pro-rata basis.

For BIRT purposes, the interest expense limitation is calculated for partnerships at the partnership level.

Because the IRC Section 163(j) limitation is not reflected on a taxpayer's books and records, it is not applicable to BIRT Method I taxpayers.

8. **The IRC Section 199A Deduction: Frequently Asked Questions**
   (01/17/2019).

   The Philadelphia Revenue Department published answers to frequently asked questions regarding the new federal deduction for certain income earned by pass-through entities. The Revenue Department announced that there is no corresponding deduction for Philadelphia tax purposes.

   Because pass-through entities pay BIRT at the entity level, the federal deduction does not apply.

   With respect to NPT, partnerships with nexus in Philadelphia are instructed to pay NPT based on the partnership income, without any deduction under IRC Section 199A. For partnerships without nexus in Philadelphia, a resident partner should file a NPT return reporting the distributive share of the partnership income without the federal deduction.

9. **Employee Business Deductions – BIRT**

   On January 16, 2019, the Philadelphia Revenue Department announced that, in accordance with Section 204 of the BIRT Regulations, Philadelphia will continue to allow deductions for employment expenses that are ordinary, necessary, and reasonable and will continue to allow deductions for expenses associated with moving to a new home in the City from outside the City, or from one home in the City to another home in the City notwithstanding that such deductions were suspended for federal income tax purposes by the TJCA.

The Philadelphia Revenue Department announced its position regarding the BIRT treatment of GILTI and FDII (both of which were added by the TJCA and are described above).

a. The Revenue Department announced that, for BIRT purposes, GILTI income is treated as dividend income and will be included in the BIRT Income Tax base of Method II taxpayers. Philadelphia announced that it will not conform to the federal GILTI deduction.

   For most BIRT Method II taxpayers, GILTI income will be eligible for a deduction for dividends received from another corporation of the same affiliated group or from a corporation of which the receiving corporation or partnership owns at least 20% of the voting power of all classes of stock and at least 20% of each class of nonvoting stock. In calculating the BIRT Gross Receipts Tax, GILTI income is excluded from taxable receipts as dividends received from another corporation of the same affiliated group or from a corporation of which the receiving corporation or partnership owns at least 20% of the voting power of all classes of stock and at least 20% of each class of nonvoting stock.

   Only dividends received from less than 20% owned subsidiaries would be included in the BIRT gross receipts and net income tax bases and in the sales factor for apportionment of taxable income.

   Because the includable income and deductions under GILTI are not reflected on a taxpayer's books and records, they are not applicable to BIRT Method I taxpayers.

b. The Revenue Department announced that, for BIRT Method II taxpayers, FDII is included in the BIRT base. When applicable, in addition to dividends, interest, royalties, and distributive share of partnership income, a corporation may deduct all other receipts received from another corporation that is a member of the same affiliated group, includes both domestic and foreign corporations. Philadelphia does not conform to the FDII deduction because it is considered a special deduction for federal income tax purposes.

   Because the deduction under FDII is not reflected in a taxpayer's books and records, the Revenue Department announced that the federal FDII adjustment is not applicable to BIRT Method I taxpayers.
11. **Advisory Notice — Repatriation Transition Tax Policy Update**  
(01/31/2019).

The Philadelphia Revenue Department issued an advisory notice regarding its interpretation of the federal Repatriation Transition Tax, a one-time income inclusion for the undistributed, previously untaxed post-1986 foreign earnings and profits of certain U.S.-owned businesses. For most taxpayers, the deemed income subject to Repatriation Transition Tax (repatriation transition tax income) was taxed in 2017. The Repatriation Transition Tax also included a deduction for a percentage of the deemed repatriation income to achieve a lower federal effective tax rate for this income (repatriation transition tax deduction). Taxpayers had the ability to elect to pay their federal Repatriation Transition Tax liability over 8 years.

The Revenue Department announced that both the repatriation transition tax income and the repatriation transition tax deduction should be reflected in the BIRT income tax base for Method II taxpayers. For most BIRT Method II taxpayers, the net repatriation transition tax income will be eligible for a deduction for dividends received from another corporation of the same affiliated group, or dividends received from a corporation of which the receiving corporation or partnership owns at least 20% of the voting power of all classes of stock and at least 20% of each class of nonvoting stock. For apportionment purposes, only dividends received from less than 20% owned subsidiaries would be included in the sales factor because they are included in the BIRT income tax base. The federal election to pay the repatriation transition tax liability over 8 years will not apply to Philadelphia BIRT. Consistent with the general BIRT rules, the repatriation transition tax income is excludable as dividends received from another corporation of the same affiliated group, or dividends received from a corporation of which the receiving corporation or partnership owns at least 20% of the voting power of all classes of stock and at least 20% of each class of nonvoting stock.

The Revenue Department noted that there may be situations where taxpayers reported the net repatriation transition tax income on their originally-filed BIRT returns. Because this is contrary to the announced policy, such taxpayers may choose to file an amended BIRT return.

Federal repatriation transition tax adjustments are not be applicable to BIRT Method I taxpayers because the repatriation transition tax income is not income that would be reflected in a taxpayer's books and records.
B. Case Law


In a case involving assessment appeals by approximately 700 owners and lessees of commercial and industrial properties in the City, the Court of Common Pleas held that the City of Philadelphia’s reassessments of commercial real property for the 2018 tax year violated the Uniformity Clause of the Pennsylvania Constitution.

The City is required to assess all properties in the City each year at the current fair market value of each property. The City completed the first countywide reassessments in a very long time in 2013, effective for the 2014 tax year. In 2017, the City announced that it had better information to establish the value of commercial properties than it had in 2013 and began reassessing commercial and industrial properties in the City for the 2018 tax year. The City did not reassess residential properties for the 2018 tax year because it argued that studies showed the assessed values of residential properties already reflected the fair market value of those properties.

The court found that, by reassessing only commercial and industrial properties and not residential properties, the City violated the Uniformity Clause. Accordingly, the court ordered the City to reassess the plaintiffs’ properties at their 2017 assessed values and to pay refunds to the plaintiffs based on the difference between the 2018 assessments and the 2017 assessments by July 1, 2021.

The court rejected the City’s contention that the commercial reassessments were constitutional because, based on information that became available after the 2013 countywide reassessment, they were necessary to bring the valuation of commercial properties in line with the valuation of residential properties.

The court reasoned that the “equalization of the quality of the real estate tax assessments” was not a compelling justification for treating the property classes differently. The court also rejected the City’s argument that paying refunds to the plaintiffs would cause a budget shortfall, stating that “[w]here there is a conflict between maximizing revenue and ensuring that the taxing system is implemented in a nondiscriminatory way, the Uniformity Clause requires that the latter be given primacy.” Thus, the court rejected arguments by the City that its lack of funding should be considered when evaluating constitutional challenges.

The court subsequently denied several post-trial motions filed by the City and the School District and reaffirmed its factual conclusions. Of note, the
court reaffirmed its conclusions that the City unconstitutionally targeted commercial properties specifically when reassessing properties for the 2018 tax year. Additionally, the court rejected the City’s argument that it should not have ordered refunds, stating that refunds are the only appropriate remedy for the City’s unconstitutional reassessment.


   The Commonwealth Court remanded a case involving the School District of Philadelphia’s selection process for certain commercial properties for reassessment to the Court of Common Pleas to determine whether such selection violated the Uniformity Clause of the Pennsylvania Constitution.

   In October 2016, the School District appealed the assessment of 140 commercial properties because it felt they were underassessed and because appeals could generate revenue. While the appeals were pending, the Supreme Court (in *Valley Forge Towers Apartments, LP v. Upper Merion Area School District*, 163 A.3d 962 (Pa. 2017)) held that “a taxing authority is not permitted to implement a program of only appealing the assessments of one sub-classification of properties, where that sub-classification is drawn according to property type.” In light of that holding, the Court of Common Pleas quashed the School District’s appeals because it determined that they were impermissibly selected.

   The Commonwealth Court reversed and remanded the case for further findings. It stated that *Valley Forge Towers* prohibits the selection of properties based solely on their classification but the holding does not necessarily prohibit the selection of properties based on other criteria, including potentially monetary values. Therefore, it ordered the Court of Common Pleas to build a record regarding the selection process for the 140 commercial properties so that it could determine whether the selection was proper under the Uniformity Clause.


   The Court of Common Pleas found in favor of a group of taxpayers who challenged the City’s methodology for assessing condominiums. In 2017, the City began allocating a fixed percentage of the total value of the unit to land. In high-rise condominiums, this made the land values artificially high and – for newly-constructed condominium units – shifted the assessment base away from the improvements (which are eligible for tax abatements). Almost 300 homeowners, living in three separate high-rise condo buildings, appealed their assessments.
The Court of Common Pleas found that the City’s approach was not supported in the assessment law and was not a widely-recognized method of valuing the land value for high-rise condominiums.


The Commonwealth Court dismissed a claim by a tax-exempt church to abate City stormwater management charges, finding that the church failed to exhaust administrative remedies. Beginning in 2009, the City began charging all nonresidential property owners fees that were used for a variety of purposes relating to the City’s water drainage facilities. The church argued that the fees were essentially a tax that it was not required to pay because it is an institution of purely public charity. The Commonwealth Court held that, to assert such a claim, the church should have filed a petition with the Tax Review Board (“TRB”) because the TRB has jurisdiction to hear disputes related to “any tax.” Because the church failed to bring its dispute regarding a “tax” to the TRB, it was precluded from doing so by filing suit in court against the City.

5. **In re: Wissahickon Apartments, LLC**, 36RTREFZZ9974, Philadelphia TRB (03/05/2019).

The TRB denied a claim for refund of City realty transfer tax where the taxpayer attempted to allocate the purchase price between the land and a ground lease that was not taxable because it had a term of less than 30 years. Petitioner paid the seller $3.2 million and the agreement specified that $250,000 was consideration for the land deed and $2,970,000 was consideration for the purchase of the ground lease. Petitioner argued that the City impermissibly “collapsed” the non-taxable transaction with a taxable one.

The TRB agreed with the City that the realty transfer tax base was the full amount paid by Petitioner for the interests in real estate he acquired because “[t]he Sales Agreement conveyed both interests to the Wissahickon, with consideration, and terminated the lease at closing.”