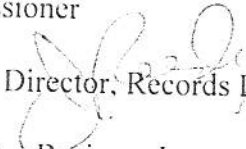Memorandum   City of Philadelelphia

Date: 12/18/15

To: Clarena I.W. Tolson, Revenue Commissioner

From: Jeanne Reedy, Administrative Services Director, Records Dept.

Subject: Advertisement of Proposed Regulations – Business Income and Receipts
           Tax Regulations - Sections 301, 408 and 507 – Single Sales/Receipts
           Factor Apportionment

The above Regulations promulgated by the Department of Revenue were received in the
Department of Records on 12/17/15 for filing and advertising.

If there are no requests for hearings these Regulations will become effective 1/19/16.

Cc: Joseph F. Procopio Jr., CPA Manager – Technical Staff

Articles III, IV and V of the Department of Revenue's Business Income and Receipts Tax Regulations are being amended to provide for a Single Sales/ Receipts Factor Apportionment Methodology for Tax Years 2015 and thereafter. For Tax Year 2015 and thereafter, the use of the Property and Payroll Factors in the calculation of the apportionment percentage to determine taxable income is discontinued and the Department will adopt the use of a Single Sales/Receipts Factor. In light of the Department's adoption of the Single Sales/Receipts Factor Apportionment Methodology (and in accordance with Bill No. 110554), the use of the Single Sales Factor Apportionment Tax Credit of Section 507 is discontinued for Tax Years 2015 and thereafter. In accordance with Bill No. 121037-A, the sourcing of receipts of a *Software Company* (as defined by Section 101 of the regulations) for calculation of the tax on receipts as well as the Single Sales/Receipts Apportionment Factor shall be in accordance with Market Based Sourcing. All other taxpayers will continue to source receipts in accordance with the definition of *Taxable Receipts* as defined by Philadelphia Code § 19-2601 and as currently promulgated under Article III of the regulations.

CITY OF PHILADELPHIA
BUSINESS INCOME AND RECEIPTS TAX REGULATIONS

ARTICLE III

TAX ON RECEIPTS

SECTION 301. DEFINITION OF RECEIPTS.

"Receipts." Cash, credits, property of any kind or nature, received from conducting any business or by reason of any sale made, including re-sales of goods, wares or merchandise taken by a dealer as a trade-in or as part payment for other goods, wares or merchandise or services rendered, or commercial or business transactions without deduction therefrom an account of the cost of property sold, materials used, labor, service or other cost, interest or discount paid or any other expense. For the purpose of determining receipts from the business of insurance, such receipts shall mean those from premiums received from risks within Philadelphia, whether by mutual or stock companies, domestic or foreign, without any deductions there from for any cost or expenses whatsoever; except, premiums shall not include return premiums, dividends paid or credited to policyholders, if such dividends are in the nature of an adjustment of the premiums charged, and premiums received for reinsurance. Receipts of a person engaged in the business of insurance shall also include receipts from rental real estate situated in Philadelphia but shall not include interest, dividend and capital gain receipts. Nothing in this definition shall preclude the taxation of other non-premium business receipts of persons engaged in the business of insurance. For purposes of determining the source of receipts of a Software Company the Market Based Sourcing Rule shall apply in accordance with Section 408 [(H)(1)] (G.1) of these regulations so that the source of receipts from the sale of products and services shall be deemed to be the location where the recipient receives the benefit of the products and services.

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ARTICLE IV

TAX ON NET INCOME

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

Except as otherwise provided in other sections of this regulation and in subsection [(H)] (I) of this section, for all Tax Years prior to Tax Year 2015, a taxpayer's net income after adjustments and allocation shall be apportioned to Philadelphia in accordance with a formula composed of a property factor, a payroll factor and a receipts factor. **For Tax Year 2015 and thereafter, the Property Factor of subsection (A) and the Payroll Factor of subsection (B) will no longer be used to calculate the apportionment of net income. The apportionment of net income after adjustments (made pursuant to Sections 403 or 404 of these regulations) and allocation (pursuant to Section 406 of these regulations) will be made in accordance with a Single Sales Factor as detailed in subsection (G) of this section.**

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(C) Receipts Factor **for Tax Year 2014 and Prior Years** .

1) Numerator. The numerator of the receipts factor shall be receipts as defined and limited by the provisions dealing with "Tax on Receipts" adjusted as follows:

   (a) The following shall not be included in the numerator:

   (.1) Receipts, or the net income, gain or losses attributable thereto, which are taken as an adjustment to net income (or loss) pursuant to Section 404;

   (.2) Receipts that contribute to net income, gain or loss which constitutes nonbusiness income allocated within or without Philadelphia pursuant to Section 406.

   (b) The following receipts shall be included in the numerator:

   (.1) Those receipts referred to in subsection 302(G)(4).

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1. Denominator. The denominator of the receipts factor shall be receipts as defined and limited by the provisions dealing with "Tax on Receipts", adjusted as follows:

(a) The following shall not be included in the denominator:

(.1) Receipts, or the net income, gain or losses attributable thereto, which are taken as an adjustment to net income (or loss) pursuant to Section 404:

(.2) Receipts that contribute to net income, gain or loss which constitutes nonbusiness income allocated within or without Philadelphia pursuant to Section 406.

(b) The following receipts shall be included in the denominator:

(.1) Those receipts referred to in subsections 302(F), 302(G)(3) and (4) and 302(M).

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(G) Single Sales Factor Apportionment. For Tax Year 2015 and the years thereafter, a taxpayer's net income after adjustments **(made pursuant to Sections 403 or 404 of these regulations)** and allocation **(pursuant to Section 406 of these regulations)** shall be apportioned based solely on the ratio of [t] Taxable [r] Receipts of the business from within the City of Philadelphia to the total [r]Receipts of the business **everywhere.** [as determined in accordance to Subsection (C) of this Section]. **The sourcing of business activity will be in accordance with the definition of Taxable Receipts as defined by Philadelphia Code § 19-2601 and as promulgated under Article III of these regulations. Receipts are as defined by Philadelphia Code § 19-2601 and as promulgated under Article III of these regulations. Only sales/ receipts that generate business income are includible in the numerator and denominator of the factor. Therefore the factor includes business income from the sale of inventory or the performance of services as well as interest, dividends, rentals, royalties, capital gains, or any other income that given the taxpayer's business activity would be classified as business income.** For purposes of determining the taxable receipts of the business from within the City of Philadelphia, the source of receipts from the sale by a Software Company (as defined by Section 101DD of these Regulations) of products or services shall be deemed to be the location where the recipient receives the benefit of the products and services, also known as market based sourcing.

(G.1) Market-Based Sourcing of Service /Sales Revenue Using the Single Sale Factor for Software Companies for Tax Years 2015 and thereafter.

(a) A Software Company (defined by Section 101DD of these regulations) is any entity whose business is categorized under the North American Industry Classification System as computer systems design and related services (NAICS 5415, 54151, 541512), computer software publishing (NAICS 51121), internet publishing and broadcasting (NAICS 51611), internet web service provider (NAICS 51811), data processing, hosting and related services (NAICS 518210), and financial transaction processing and clearing (NAICS 52232).

(b) Under market-based sourcing, the gross receipts of a Software Company from the performance of services are included in the numerator of the Single Sales Apportionment Factor if the recipient of the service receives all of the benefits of the service in Philadelphia. If the recipient of the service receives some of the benefits of the service in Philadelphia, the gross receipts are included in the numerator of the Single Sales Apportionment Factor in proportion and to the extent the recipient receives benefit of the service in Philadelphia.

(c) The gross receipts of a Software Company from the sales of prepackaged or canned software are included in the numerator of the Single Sales Apportionment Factor if the recipient of the product receives all of the benefits of the product in Philadelphia. If the recipient of the product receives some of the benefits in Philadelphia, the gross receipts are included in the numerator of the Single Sales Apportionment Factor in proportion and to the extent the recipient receives benefits in Philadelphia.

Example 1- A corporation located in Philadelphia, engaged in writing and testing software, contracts with a company located in Dallas, Texas, engaged in publishing packaged software, to write software that meets the needs of the Dallas based company's software publishing business. The Philadelphia corporation writes and tests the software in its Philadelphia office. The Dallas company uses all the software at its office in Dallas. None of the gross receipts from writing and testing the software are included in the numerator of the Philadelphia corporation's Single Sales Apportionment Factor because none of the benefits of the service is received by the recipient of the service in Philadelphia.

Example 2- A New Jersey corporation contracts with a Delaware computer software company to develop and install custom computer software for a business office of the New Jersey Corporation located in Philadelphia. The Delaware company has business nexus in Philadelphia with sufficient exposure to the net income portion of the Business Income and Receipts Tax. The software will only be used by the business office in Philadelphia. The software development occurs in Delaware. All of the gross receipts from the

software development and installation are attributable to Philadelphia and are included in the numerator of the Single Sales Apportionment Factor because the recipient of the service received all of the benefit of the service in Philadelphia.

Example 3- A corporation from New York contracts with a computer software company from Virginia to develop and install custom computer software for its own use. The Virginia company has business nexus in Philadelphia with sufficient exposure to the net income portion of the Business Income and Receipts Tax. The software will be used by the New York corporation in its business office located in Philadelphia and in its business office located in New York. The software development occurs in Virginia. The gross receipts from the software development and installation are included in the numerator of the Single Sales Apportionment factor in proportion to the extent the software is used in Philadelphia.

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(I) Pilot Programs: For Tax Year beginning on January 1, 2010 **and ending on December 31, 2014**, the following two pilot programs [are] **were** initiated to test the feasibility and effectiveness of implementing apportionment methods different from the regularly applicable apportionment method provided in this section:

1) Single Receipts Factor apportionment method for businesses engaged in Research and Development in the Physical, Engineering, and Life Sciences classified in Industry 54171 of NAICS. Single Receipts Factor apportionment means that the apportionment percentage will be determined solely based on business receipts without considering property and payroll as factors.

(a) This industry comprises establishments primarily engaged in conducting research and experimental development in the physical, engineering, and life sciences, such as agriculture, electronics, environmental, biology, botany, biotechnology, computers, chemistry, food, fisheries, forests, geology, health., mathematics, medicine, oceanography, pharmacy, physics, veterinary, and other allied subjects.

(b) For this purpose, the numerator and the denominator of the Single Receipts Factor shall be determined in accordance with the rules provided in subsection [(3)] (C) of this section.

(c) For Tax Years beginning January 1, 2015 and thereafter, the Pilot Program of subsection (I) 1) is discontinued and apportionment of net income will be calculated in accordance with subsection (G) of this section.

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2) Market-Based Sourcing of service revenue for businesses engaged in Computer Systems Design and Related Services classified in Industry 54151 of NAICS **for Tax Year 2010 through Tax Year 2014.**

   (a) This industry comprises establishments primarily engaged in providing expertise in the field of information technologies through one or more of the following: (1) writing, modifying, testing, and supporting software to meet the needs of a particular customer; (2) planning and designing computer systems that integrate computer hardware, software, and communication technologies; (3) on-site management and operation of clients computer systems and/or data processing facilities; and (4) other professional and technical computer related advice and services.

   (b) Under Market-Based Sourcing rule, the receipts factor is designed to measure the marketplace for the taxpayer's services. For the purpose of this paragraph, the gross receipts from the performance of services are included in the numerator of the apportionment factor if the recipient of the service receives all of the benefit of the service in Philadelphia. If the recipient of the service receives some of the benefit of the service in Philadelphia, the gross receipts are included in the numerator of the apportionment factor in proportion to the extent the recipient receives benefit of the service in Philadelphia. The adjustments to the numerator and the denominator of the receipts factor provided in paragraph (a) and (b) of subsection (3) of this section shall also apply for this paragraph. The following examples illustrate the application of the Market - Based Sourcing rule provided in this subparagraph:

      (.1) A corporation located in Philadelphia, engaged in writing and testing software, contracts with a company located in Dallas, Texas, engaged in publishing packaged software, to write software that meets the needs of the Dallas based company's software publishing business. The Philadelphia corporation writes and tests the software in its Philadelphia office. The Dallas company uses all the software at its office in Dallas. None of the gross receipts from writing and testing the software are included in the numerator of the Philadelphia corporation's apportionment factor because none of the benefits of the service is received by the recipient of the service in Philadelphia.

      (.2) A New Jersey corporation contracts with a Delaware computer software company to develop and install custom computer software for a business office of the New Jersey Corporation located in Philadelphia. The Delaware company has business nexus in Philadelphia with sufficient exposure to the net income portion of the Business Income and Receipts Tax. The software will only be used by the business office in Philadelphia. The software development occurs in Delaware. All of the gross receipts from the software development and installation are attributable to Philadelphia and are included in the numerator of the apportionment factor

because the recipient of the service received all of the benefit of the service in Philadelphia.

(.3) A corporation from New York contracts with a computer software company from Virginia to develop and install custom computer software for its own use. The Virginia company has business nexus in Philadelphia with sufficient exposure to the net income portion of the Business Income and Receipts Tax. The software will be used by the New York corporation in its business office located in Philadelphia and in its business office located in New York. The software development occurs in Virginia. The gross receipts from the software development and installation are included in the numerator of the apportionment factor in proportion to the extent the software is used in Philadelphia.

(c) For the purpose of this paragraph, in conjunction with the market-based receipts factor provided in subparagraph (b) of this paragraph, the regularly applicable property factor provided under subsection (A) and the payroll factor provided under subsection (B) of this section shall be used. A weighted average of these three factors shall be computed in accordance with the rules provided in subsection (E) of this section.

(d) **For Tax Years beginning January 1, 2015 and thereafter, the Pilot Program of subsection (I) 2) is discontinued and apportionment of net income will be calculated in accordance with subsection (G.1) of this section.**

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ARTICLE V
CREDITS

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Section 507. Single Sales Factor Apportionment Tax Credit.

A. Definitions. In this Section, the following definitions shall apply:

1. Code. The Philadelphia Code

2. Current Business Income and Receipts Tax Liability. A business' liability for the net income portion of the Business Income and Receipts Tax if, pursuant to Revenue Department ("Department") regulations, taxable income is apportioned, in whole or in part, based on factors other than the ratio of taxable receipts of the business from within the City of Philadelphia to the total receipts of the business, and furthermore, for software companies, if market based sourcing is not used for determining the taxable receipts from within the City.

3. Single Sales Factor Apportionment Liability. A business' liability for the net income portion of the Business Income and Receipts Tax if the business' taxable income was apportioned based solely on the ratio of taxable receipts of the business from within the City of Philadelphia to the total receipts of the business. For purposes of determining the taxable receipts of the business from within the City of Philadelphia for purposes of this subsection (A)(3), the source of receipts from the sale by a software company of products or services shall be deemed to be the location where the recipient receives the benefit of the products and services, also known as market based sourcing – see Section 408(H)(2)(b)105 of these regulations.

4. Tax Year. As defined in Section 101 of these regulations.

B. Tax Credit

1. Pursuant to §19-2604(12)(b)(i) of the Code, businesses shall be eligible to receive a nonrefundable Single Sales Factor Apportionment Tax Credit against their Business Income and Receipts Tax liability, starting in tax year 2013. Any unused tax credits may not be carried forward.

2. Pursuant to §19-2604(12)(b)(ii) of the Code.

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a. The Single Sales Factor Apportionment Tax Credit shall be calculated as follows: For the given tax year, a business shall determine its Current Business Income and Receipts Tax Liability minus its Single Sales Factor Apportionment Liability, which resulting number shall be the "single sales factor apportionment tax credit base."

b. The amount of the Single Sales Factor Apportionment Tax Credit shall be calculated as follows: for tax years 2013 and 2014, the Single Sales Factor Apportionment Tax Credit amount shall be whatever percentage of the single sales factor apportionment tax credit base as is determined by the Department by regulation to be fiscally prudent in light of the City's budget needs – see subsection 507(B)(3); and for tax year 2015 and thereafter, the Single Sales Factor Apportionment Tax Credit amount shall be 100% of the single sales factor apportionment tax credit base; provided that there shall be no credit in any year in which, pursuant to Department regulations, taxable income is apportioned exclusively based on the formula set forth in the definition of Single Sales Factor Apportionment Liability.

3. To be fiscally prudent in light of the City's budget needs, the Department has determined for tax year 2013 and tax year 2014 that the Single Sales Factor Apportionment Tax Credit amount shall be zero-percent of the single sales factor apportionment tax credit base.

4. **For Tax Years 2015 and thereafter, the Single Sales Factor Tax Credit provided by this section is discontinued and in its place the Department has adopted a Single Sales Factor Apportionment pursuant to Section 408 (G) of these regulations.**

____ and **bold** denotes new matter
[   ] and **bold** denotes matter deleted

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Commissioner Clarena I.W. Tolson
Chief Revenue Collections Officer

Date: ___12/17/15_____

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