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Independent Regulatory Review Commission

PA Chamber® of Business and Industry

June 24, 2024

Independent Regulatory Review Commission
333 Market Street
14th Floor
Harrisburg, PA 17101

By email: irrc@irrc.state.pa.us

Re: Department of Revenue Proposed Regulations 61 Pa. Code § 153.24a (Corporate Net Income Tax (CNIT) - Business Income and Nonbusiness Income)

Dear Commissioners:

The Pennsylvania Chamber of Business and Industry (Chamber) applauds the Department of Revenue (DOR) for undertaking this important and complex project to provide certainty in an area has been the subject of tremendous uncertainty and controversy. That said, the Chamber finds the timing of the Proposed Reg curious. DOR claims the Proposed Reg "is mandated by 72 P.S. § 7401(3)2.(a)(1)(A) and 72 P.S. § 7401(3)2.(a)(1)(D)"[1] (Subparagraphs), which – over two decades ago – the legislature found and declared "to clarify existing law."[2]

This curiosity aside, the Chamber respectfully asserts the Proposed Reg most saliently:

Exceeds DOR's statutory authority and contradicts the intent of the legislature by attempting to provide DOR with authority to force combined reporting. The legislature has repeatedly considered - and repeatedly rejected - mandatory combined reporting. Therefore, subsections 153.24a.(e) and (f) should be deleted in their entirety. Alternatively, these subsections should be revised to reaffirm DOR lacks authority to force combined reporting.

Contradicts, mischaracterizes and ignores pertinent legal precedent by incorrectly finding the 'multiformity' and 'unrelated assets' principles to be 'inapplicable.' The Pennsylvania Commonwealth and Supreme Courts have affirmed these principles remain good law. Therefore, the discussion of *ACF* and *Glatfelter* should be deleted.

Is not in the public interest because it incorrectly states that it will not increase reporting and will have no fiscal impact. Subsections (h)(1) and (2) impose additional and irrelevant reporting requirements and, therefore, these subsections should be deleted. The Proposed Reg will necessarily have a fiscal impact to the extent it exceeds DOR's statutory authority and usurps the role of the judiciary.

[1] Regulatory Analysis Form at ¶9 (emphasis added).
[2] Section 25, Act 23 of 2001.

That said, the Chamber invites DOR to engage in constructive dialogue for the purpose of achieving our mutual goal of providing clear and accurate guidance on this important topic.

As set forth in detail below, the Chamber respectfully asserts the Proposed Reg:

1. Exceeds DOR's authority by attempting to establish policy that the legislature has consistently chosen to reject.
2. Directly contradicts, mischaracterizes and ignores pertinent legal precedents;
3. Misapplies the plain language of the applicable statute in a way that creates additional taxpayer burden;
4. Misstates the economic impact of the Proposed Reg; and
5. Lacks clarity by providing ambiguous statements and examples.

1. The Proposed Reg exceeds DOR's authority by attempting to establish policy that the legislature has consistently chosen to reject.

Subsections 153.24a.(e) and (f) should be stricken. These subsections directly contradict the plain language of the Tax Reform Code by attempting to provide DOR with authority to impose mandatory combined reporting.[3] Moreover, the legislature has repeatedly considered – and always rejected – mandatory combined reporting. Therefore, subsections (e) and (f) should be deleted or modified to make clear that DOR possesses no authority to mandate combined reporting.

Subsections (e) and (f) mistakenly conflate the unitary business principle (UBP) with mandatory combined reporting and, in so doing, contradict the plain language of the Tax Reform Code, which imposes Corporate Net Income Tax (CNIT) on a separate company basis. The UBP is only relevant in a separate company reporting context in the case of dispositions (which the Proposed Reg already addresses in subsections (c) and (d)) and partnerships (which a final draft of the Proposed Regs may choose to include). Moreover, the Proposed Reg does not offer any reason to explain why (e) and (f) are relevant.

More specifically, particular language in subsection (e) is ambiguous and, therefore, does not achieve the purpose of the Proposed Reg to provide clarity. For instance, that subsection states:

> The unitary business that is conducted in this Commonwealth includes both a unitary business that the taxpayer alone may be conducting and a unitary business the taxpayer may conduct with any other person or persons. Proposed Reg 153.24a.(e).

[3] "Taxable income" is unambiguously defined to be "taxable income [of a corporation] which would have been returned to and ascertained by the Federal Government if separate returns had been made to the Federal Government[.]" 72 P.S. § 7401(3)(1)a.

By describing the unitary business as one that may be "conduct[ed] with other persons" contradicts the plain language of 7401[4], which imposes tax on a 'corporation' – not a combined group or corporations, which is the clear implication of Proposed Reg language.

The last sentence of (e) is at best ambiguous and at worst an attempt to give DOR authority to force combination where the legislature has expressly refused to give it such authority. Here is the sentence:

> Determination of the scope of the unitary business being conducted in this Commonwealth is without regard to the extent to which this Commonwealth requires or permits combined reporting. Proposed Reg 153.24a.(e).

That sentence is ambiguous because it does not define for what purpose it discusses "the scope of a unitary business." This is particularly confusing given the previously cited sentence, which implies DOR has authority to force combination.

These subsections are unnecessary, confusing[5] and improper because they are outside of DOR's authority. It is the exclusive role of the courts to interpret the constitution. DOR may not attempt to utilize the regulatory review process as a back door way of garnering deference for its interpretation of the constitution.

The Proposed Reg also goes beyond DOR's authority when it states:

> Satisfaction of either the transactional test or the functional test complies with the unitary business principle because each test requires that the transaction or activity, in the case of the transactional test or the property, in the case of the functional test, be tied to the same trade or business. Proposed Reg 153.24a.(e).

If satisfaction of either the transactional or functional test does indeed *per se* comply with the unitary business principle, DOR should provide the authority for such statement.

Subsection (f) also interchanges terms in a way that at best is confusing and at worst contrary to Section 7401 mandate of imposing CNIT on a separate 'corporation' – as opposed to a combined group of corporations. For instance, the Proposed Reg uses the following inconsistent terminology:

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[4] *See* note 3.

[5] Other references in the Proposed Reg to the UPB similarly conflate the UPB with combined reporting in an inaccurate, misleading and confusing manner (*see e.g.*, "[U]nderstanding when a unitary relationship exists between the Commonwealth filer and the other affiliated entity may be important in reaching a determination as to the proper treatment of the income or loss which is recognized as a result of these transactions." Proposed Reg Preamble at 12 (emphasis added)).

> "single economic enterprise,"
>
> "separate parts of a single entity,"
>
> "The income of the unitary business is then apportioned to this Commonwealth."
>
> "Those businesses are part of the unitary business"
>
> "A single entity may have more than one unitary business."
>
> "A unitary business may exist within a single entity or among a commonly controlled group of entities."

These statements fly in the face of the statute which imposes tax on a "corporation" – not a business, not a group of entities.

Finally, the Proposed Reg states that the reason for their promulgation is "to affirm that the definition of 'business income' includes all income of the taxpayer's unitary business." The Proposed Reg defines 'unitary business' to include 'controlled corporations,' among other entities that are not within the definition of 'corporation' contained in Section 7401. This statement underscores why subsections (e) and (f) should be deleted to eliminate the flagrant error of attempting to establish policy beyond the authority of DOR.

2. **The Proposed Reg directly contradicts, mischaracterizes and ignores pertinent legal precedents.**

Another error is that the Proposed Reg mischaracterizes the controlling precedent of *Commonwealth v. ACF Industries*, Inc, 441 Pa. 129; 271 A.2d 273 (1970) and fails to recognize the controlling precedent of *RB Alden Corp. v. Comm'w.*, 142 A.3d 169 (2016) and *Glatfelter Pulpwood Co. v. Commonwealth*, 619 Pa. 243, 61 A.3d 993 (2013). *See* Proposed Reg Preamble at 7 - 8.

DOR incorrectly concludes that "the application of older Pennsylvania-court-designed concepts such as 'unrelated income' or 'multiformity' do not limit the State's authority to tax under the unitary business principle" and that "*ACF* is not applicable." (Proposed Reg Preamble at 7 - 8 (emphasis added). This is the identical argument DOR made in *RB Alden* eight years ago and which the Commonwealth Court flatly rejected:

> The Commonwealth argues that the multiformity or unrelated assets doctrines are antiquated and no longer apply as they were developed out of 1930-40s era Pennsylvania case law attempting to apply the Due Process and Commerce Clauses of the United States Constitution to the Pennsylvania foreign franchise tax. The Commonwealth maintains that ACF Industries' holding as it relates to the multiformity or unrelated assets doctrines is inapplicable in this case because ACF Industries was decided before the Code was enacted and, instead, it interpreted a 1965 amendment to a 1935 statute, which has long been repealed. The Commonwealth argues

> that although some of the ACF Industries' era analysis may be similar, it does not control the interpretation of the current Pennsylvania definition of business and nonbusiness income adopted by our legislature. Although the Commonwealth is correct in that ACF Industries analyzed a statute that is not relevant to this case and that it was decided before the Code was even enacted, this Court . . . used *ACF Industries* in determining whether the multiformity or unrelated assets doctrines apply, even after the definition of "business income" was amended in 2001. *RB Alden* at footnote 9.

This recitation of controlling and pertinent precedent demonstrates that *ACF* is indeed applicable and, therefore, the Proposed Reg is absolutely wrong in saying that "*ACF* is not applicable." The Proposed Reg also ignores the pertinent Commonwealth Court precedent of *RB Alden*, which unequivocally rejected the same argument the Proposed Reg posits.

Citing *Glatfelter* (Proposed Reg Preamble at 8), the Proposed Reg implies that the unitary business principle overrides or supplants the 'multiformity' or 'unrelated assets' analysis. Such an implication, regardless of whether intentional, is misguided because in *Glatfelter* the Pennsylvania Supreme Court applied the multiformity and the unrelated asset principles as enunciated in *ACF* and expressly noted that Glatfelter had merely "misconstrued *ACF*" and "incorrectly apply[ied] that precedent to the factual circumstances of this case[.] 61 A.3d at 1006. If the Pennsylvania Supreme Court had believed that the multiformity and unrelated assets principles were not longer applicable, it would have said so and not have engaged in several pages of discussing why Glatfelter did not qualify for multiform or unrelated assets treatment. *See Glatfelter*, 61 A.3d 993, 1005 – 1008.

For these reasons, all language discussing *ACF* and *Glatfelter* should be struck as directly contradicting, mischaracterizing and ignoring pertinent precedent.

3. **The Proposed Reg misapplies the plain language of the applicable statute in a way that creates additional taxpayer burden**.

The Proposed Reg provides no statutory support to require, as 153.24a.(h) purports to do, a taxpayer to report consistently year to year (153.24a.(h)(1)) and state to state (153.24a.(h)(2)). Because there is no statutory language to support this purported requirement – and it would impose an additional and unnecessary burden on a taxpayer - these subsections should be stricken.

The (h)(1) requirement ignores that a taxpayer's facts change from year to year. Further, DOR is already in possession of that information and, therefore, requiring the taxpayer to produce it again imposes an unnecessary burden and cost.

The (h)(2) requirement ignores that states have enacted different apportionment laws, which means that the manner in which a taxpayer apportions to another state is not necessarily relevant to how it apportions income to Pennsylvania. In fact, the

Pennsylvania Supreme Court has recognized that states have adopted a wide variety of apportionment formulas:

> As stated in *Allied-Signal*, . . . the High Court's precedent gives States wide latitude to fashion formulae designed to approximate the instate portion of value produced by a corporation's truly multi-state activity. Thus, the High Court has declined to impose a single apportionment formula on the states, while nonetheless recognizing that double taxation will at times occur. *Glatfelter*, 61 A.3d 993, 1010.

Moreover, if the manner in which a taxpayer apportioned income to another state were found to be relevant in a given situation DOR could request such information. Finally, DOR should be able to obtain any relevant information from other states, if appropriate, through information sharing agreements in existence.

In addition to going beyond the plain language of the statute, subsections 153.24a.(h)(1) & (2) impose additional, unnecessary and irrelevant administrative burden on a taxpayer. These subsections, therefore, should be stricken.

4. <u>The Proposed Reg misstates the economic impact of the Proposed Reg.</u>

The Proposed Reg Regulatory Analysis Form claims that the Proposed Reg will have "no financial, economic or social impact on individuals, small businesses, businesses and labor communities, or other public and private organizations." (Regulatory Analysis Form at ¶17) It is simply impossible for this regulation to have no fiscal impact. The Board of Finance & Revenue (BF&R) and Commonwealth Court dockets are replete with business/nonbusiness income issues and no Pennsylvania court has ruled on a business/nonbusiness issue for over a decade since *Glatfelter*. Therefore – and assuming the Proposed Reg will provide "clarification of the CNIT regulations and uniform compliance," (Regulatory Analysis Form ¶15)) - the Proposed Reg will necessarily impact those cases sitting on the dockets at those forums.

5. <u>The Proposed Reg lacks clarity by providing ambiguous statements and examples.</u>

These comments have already pointed to instances in which the Proposed Reg creates ambiguity as opposed to clarity. Example 4 on page 5 provides another example of ambiguity. That example does not contemplate that the 'redundant factory' may have been acquired along with other unwanted assets. So, it may never have been used in the taxpayer's business and, therefore, should not generate business income. Another fact that could be important is how long an asset being sold has been dormant. Based on the examples provided, therefore is no time period over which an asset could become 'old and cold' enough for its sale to produce nonbusiness income.

This is a small sampling of how the examples do not provide meaningfully clear guidance. This lack of clarity is particularly troublesome when one considers the following statement:

> Importantly, this subsection informs taxpayers of the Department's longstanding position that if deductions are taken against a taxpayer's business income in earlier periods, with respect to a piece of property, the Department will presume that income with respect to that property is in fact business income. However, the absence of such deductions against business income in earlier periods will not create a presumption for or against business or nonbusiness income treatment in future periods. Proposed Regs at 11.[6]

This unequal application of a presumption effectively creates a patently unfair 'heads we win, tails you lose' proposition. If a taxpayer were to sell an asset on which it had previously taken deductions, the sale would produce business income. On the other hand, if that same taxpayer were to sell an asset on which it had not previously taken deductions, that same presumption does not apply to treat the gain as nonbusiness income. Therefore, the taxpayer in the latter case would be forced to fight the uphill battle against the Proposed Reg's statement that, "the burden of proof is upon the taxpayer to prove the existence of nonunitary income," Proposed Reg Preamble at 2. This playing field should be level and the presumptions should be applied equally to both sides.

Conclusion

Thank you for the opportunity to review and provide comments on the proposed regulations regarding business and nonbusiness income. The PA Chamber welcomes the opportunity to meet with you to discuss our comments in more detail.

Sincerely,

Neal R. Lesher
Director of Government Affairs

cc: Maria L. Miller, PA DOR (via email)

[6] Subsection §153.24a.(d)(5) proposes another unequal and, therefore, unfair, presumption.