STATE AND LOCAL TAXATION: WHAT'S IN A NAME? THAT WHICH WE CALL A PRIVILEGE CAN BE TAXED

Posted on **December 29, 2015** by **Jim Malone**

Just before Christmas 2015, the Supreme Court of Pennsylvania addressed the scope of a business privilege tax imposed by Lower Merion Township; the case was brought by a group of landlords, who contended that the township could not tax revenue generated from leasing property, and a divided Court sustained the tax. *Fish v. Township of Lower Merion*, No. 29 MAP 2015, 2015 Pa. LEXIS 2979 (Pa. Dec. 21, 2015).

Under the Local Tax Enabling Act, various municipalities are entitled to impose a tax "on persons, transactions, occupations, privileges, subjects and personal property within the limits of such political subdivisions, and upon the transfer of real property, or of any interest in real property, situate within the political subdivision levying and assessing the tax . . . ." 53 P.S. § 6924.301.1(a). The township imposed a business privilege tax upon individuals doing business in Lower Merion that was calculated on the basis of gross receipts. *Fish*, 2015 Pa. LEXIS 2979 at *1.

While the Local Tax Enabling Act provides a very broad grant of authority, it does contain exclusions, including an exclusion that prohibits a tax upon leases. 53 P.S. § 6924.301.1(f)(1). Previously, the Supreme Court had ruled that the lease exclusion in the enabling act barred a municipality from imposing a tax upon lease transactions. See Lynnebrook & Woodbrook Assoc. v. Borough of Millersville, 600 Pa. 108, 120-21, 963 A.2d 1261, 1268 (2008).

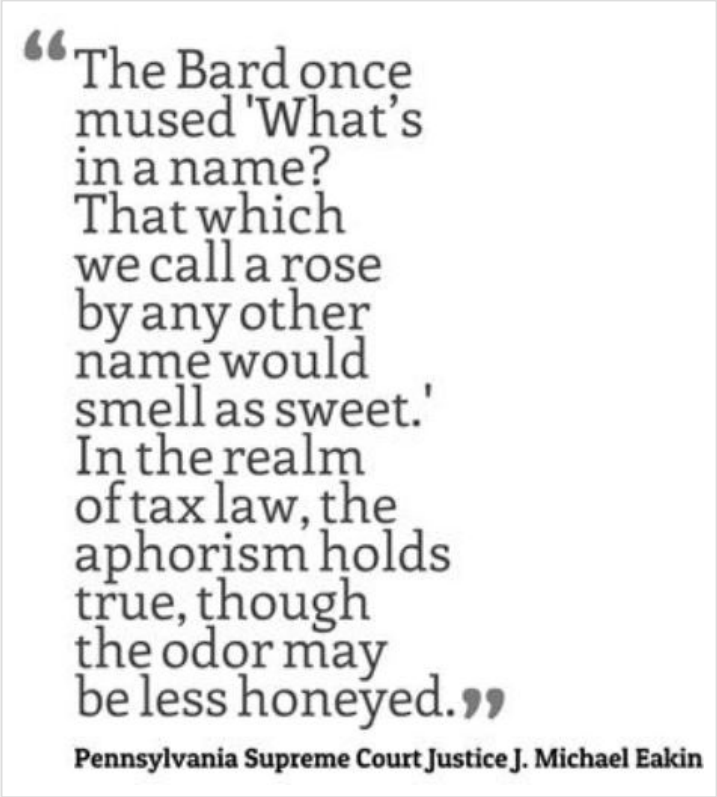
Lynnebrook paved the way for *Fish*, serving as the principal authority for the taxpayers' challenge to Lower Merion's business privilege tax. The taxpayers owned real estate in the township that they leased to tenants. 2015 Pa. LEXIS 2979 at *2. The township advised the taxpayers that their

leasing business fell within the scope of its business privilege tax, and that each of their properties was a discrete business that was required to register separately for the tax. *Id.* The taxpayers argued that Lower Merion's business privilege tax was indistinguishable from the tax on leases that was struck down in *Lynnebrook*. *Fish*, 2015 Pa. LEXIS 2979 at *8-*9. They also argued that while the tax was denominated as a business privilege tax, in substance it operated as a direct tax on leases in violation of the exclusion contained in the enabling act. *Id.* at *10.

Ultimately, *Fish* turned on the fact that Lower Merion's tax was a business privilege tax and not a transactional tax. Under Pennsylvania law, transactional taxes and business privilege taxes are distinct types of taxes, and a business privilege tax permits a municipality to impose a tax on gross receipts earned outside of its territory, even though it could not tax the relevant transactions directly. See *Gilberti v. City of Pittsburgh*, 511 Pa. 100, 511 A.2d 1321 (1986).

The taxpayer in *Gilberti* was an architect who maintained an office in Pittsburgh, but he frequently traveled outside the city to supervise work on various projects. 511 Pa. at 102, 511 A.2d at 1322. Mr. Gilberti sought to exclude all of his receipts from on-site supervision of projects outside of Pittsburgh from the city's business privilege tax, but the city did not accept that exclusion. *Id.* Because Mr. Gilberti did not maintain a formal place of business outside of Pittsburgh, all of his revenues fell within the ordinance. *Id*. at 104, 511 A.2d at 1323. The Supreme Court sustained the tax, even though it recognized that Pittsburgh lacked the authority to impose a tax upon transactions that did not involve significant activity within the city's limits. *Id.* at 104-06, 511 A.2d at 1324. In sustaining the tax, the Supreme Court reasoned that Mr. Gilberti's Pittsburgh office gave him "a base of operations from which to manage, direct and control business activities occurring both inside and outside the City limits." *Id.* at 109, 511 A.2d 1326. Given the contribution that the office in Pittsburgh made to his business, the Court concluded that it was appropriate to tax revenues earned elsewhere. *Id.*

In a similar vein, the Supreme Court previously held that a business privilege tax could reach receipts a contractor earned from construction of new homes despite a provision in the Local Tax Enabling Act that barred municipalities from imposing a tax on the construction of new homes or the issuance of building permits. *School District of the City of Scranton v. Dale & Dale Design & Dev., Inc.*, 559 Pa. 398, 403-04, 741 A.2d 186, 189 (1999).



In light of *Gilberti* and *Dale & Dale*, the majority readily sustained Lower Merion's position and upheld the application of its business privilege tax to the leasing business conducted by the taxpayers. *Fish*, 2015 Pa. LEXIS 2979 at *15-*17. In reaching this conclusion, the majority stressed that a tax that was denominated as a business privilege tax but that only applied to leasing would be treated differently. *Id.* at *15. Consequently, while the township's decision to call its tax a business privilege tax was significant, its structure also played a role, as it was "a general business privilege tax which encompasses all for-profit businesses that offer services to the public within the Township's borders." *Id.* at *16.

There is a forceful dissent. While acknowledging that existing case law distinguished between taxes on transactions and taxes on privileges, Justice Eakin found that rationale unsatisfactory on the facts:

[W]here the amount of a privilege tax is a fixed percentage of transactional income, it becomes a titular distinction with no actual difference. Where the tax on the "privilege" is determined to the penny by the amount on non-taxable income, one is not paying tax on privilege at all–one is paying tax on lease income, which defeats the statutory prohibition.

Id. at *20 (Eakin, J., dissenting). The dissent criticizes the majority for excessive formalism: "substance trumps labels in the realm of tax law; what counts is what you do, not what you call it." *Id.* at *20-*21 (Eakin, J., dissenting). For good measure, the dissent turned to Shakespeare:

The Bard once mused "What's in a name? That which we call a rose by any other name would smell as sweet." In the realm of tax law, the aphorism holds true, though the odor may be less honeyed. Irrespective of labels, taxation of lease income under the LTEA is prohibited; that tax smells the same, whether levied directly as in Lynnebrook, or repackaged as an indirect privilege

tax, as here.

Id. at *25 (Eakin, J., dissenting) (quoting WILLIAM SHAKESPEARE, ROMEO AND JULIET, act 2, sc. 2).

Certain factors made this case difficult. The fact that all of the rental income was apparently generated in Lower Merion eliminated the extra-territorial reach of the business privilege tax from the case, making it harder to distinguish the permitted tax on a privilege from the prohibited transactional tax. From my perspective, the township's insistence that each rental property be registered as a separate business also made the tax appear more transactional, although neither the majority nor the dissent gave this factor weight. The case is a close one, and the dissent's position is not without appeal. In light of existing precedent, however, the majority's position appears to be sound.

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