TAX MANAGEMENT
# MULTISTATE TAX REPORT

VOL. 15, NO. 2 71-74 FEBRUARY 22, 2008

Business Privilege and License Taxes

In a recent decision, the Pennsylvania Supreme Court reversed its previous position that a municipality cannot tax an entity that lacks a permanent base of operations within its borders. In this analysis, author Dan A. Schulder provides an overview of the litigation leading up to the court's decision in *Rendina v. Harrisburg* and analyzes the holding's impact on businesses throughout the state.

# Pennsylvania Supreme Court Again Muddles Treatment Of Business Privilege Tax; General Assembly Action Is Needed

BY DAN A. SCHULDER

## PROBLEM OVERVIEW

Under the Local Tax Enabling Act (LTEA),[1] the Pennsylvania General Assembly granted authority for local municipalities to tax various classes of taxpayers and transactions. The LTEA empowers these municipalities to "levy, assess and collect . . . taxes as they shall determine on persons, transactions, occupations, privileges, subjects and personal property within the limits of such political subdivisions."[2] The problem has been, and still is, the interpretation of this provision—specifically, how can local municipalities impose a business privilege tax (BPT) on a business exercising the privilege of "doing business" within their borders when that business does not maintain a permanent office there? Generally, this question affects construction contractors, but it can and will affect all types of taxpayers with a decision just rendered by the Pennsylvania Supreme Court.

For purposes of this article "*Rendina* I" refers to the Pennsylvania Commonwealth Court decision, and "*Rendina* II" refers to the decision by which the Pennsylvania Supreme Court reversed the commonwealth court's holding.

In *V. L. Rendina v. Harrisburg*[3] (*Rendina* II), the court reversed the finding of the Pennsylvania Commonwealth Court that a contractor was not subject to a city's BPT because it did not maintain a permanent office within the city limits.

With this decision, the Pennsylvania Supreme Court has muddied the waters by eviscerating the distinction it had consistently recognized before *Rendina* II. Namely, that for a municipality to tax an entity, that entity needed a permanent base of operations within the municipality's borders. Moreover, the inconsistent interpretation and often aggressive approach taken by lo-

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[1] 53 Pa. Stat. §6901, *et seq*. The exception is Philadelphia, which is not subject to the LTEA, as its taxing authority comes from the Sterling Act, 53 Pa. Stat. §§15971-15973.

[2] 53 Pa. Stat. §6902.

[3] *V.L. Rendina Inc. v. Harrisburg and the Harrisburg School District*, 130 MAP 2005, 2007 Pa. LEXIS 2872 (Pa. Dec. 27, 2007) (*Rendina* II).

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cal municipalities is compounded by often conflicting county court rulings on BPT issues.[4] The only solution to put all taxpayers on a level playing field in the BPT area is for the General Assembly to clarify §6902 of the LTEA to provide that:

- a BPT may be imposed only if the "privilege" of doing business is exercised through a "base of operations" in the local taxing jurisdiction, and
- engaging in transactions within the taxing jurisdiction does not constitute the "privilege of doing business."

The General Assembly should also codify the rulings in *Northwood*,[5] and *QED*[6] requiring either apportionment of gross receipts of a taxpayer subject to LTEA taxes measured by gross receipts in other local taxing jurisdictions (*Northwood*) or a credit for LTEA gross receipts taxes paid to another jurisdiction on the same receipts taxed in the "base of operations" jurisdiction (*QED*).

## PROBLEM BACKGROUND

In late 2004, two decisions involving almost identical facts and interpreting similar local ordinances were rendered by the commonwealth court. Both common pleas courts interpreted the same provisions of the LTEA.

In *V.L. Rendina Inc. v. Harrisburg* (*Rendina* I), the commonwealth court reversed the lower court's decision holding a taxpayer subject to the city BPT. In that case, Rendina was the general contractor for a construction of an office building in Harrisburg, Pa., from 1999 through 2001. Rendina maintained its permanent place of business in Lancaster, Pa., and during the three years of construction, the company maintained a job trailer to use as an office at the construction site in Harrisburg. Other than construction during the course of the project, Rendina argued that it had no permanent office in Harrisburg, did not conduct business in Harrisburg, and did not solicit work through its presence in Harrisburg. This was generally the same fact pattern that was involved in *Northwood*,[7] However, in *Rendina* I, the Dauphin County Court of Common Pleas had determined that Rendina *did* have a place of business within Harrisburg and, therefore, was subject to BPT there.

The commonwealth court reversed, concluding that the job-site trailer was not a base of operations from which the company could manage and direct all business activities occurring both inside and outside the city limits within the meaning of *Gilberti*.[8] The court also cited *Northwood* and concluded that the proper place of taxation was where the taxpayer maintained its principal place of business—within Lancaster County. The court reasoned that because the contractor had its principal place of business within a particular jurisdiction which could be used to solicit business, conduct meetings, accept accommodations, store supplies, perform office work, manage, direct and control business activities occurring both inside and outside Lancaster, that was the proper place where the BPT was to be assessed.[9] The court further indicated that the privilege of doing business in the locality implies that a potential taxpayer has portrayed itself in the community as an entity conducting business within the taxing municipality on a regular, and permanent, basis.[10] The court went on to indicate that even though Lancaster County did not assess a BPT where Rendina's principal place of business was located, that fact was not relevant to the analysis and did not compel Rendina to pay BPT somewhere else.[11]

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[4] In particular, common pleas courts' rulings reviewed in *Rendina* I and *School District and City of Scranton v. R.V. Valvano Construction Co.*, 863 A.2d 48 (Pa. Commw. Ct. 2004) (*Valvano*) should be noted. While in both cases the common pleas courts had very similar facts and interpreted the same provisions of the LTEA, they came to opposite conclusions regarding whether the taxpayer was subject to the BPT. These different rulings provide another reason as to why the General Assembly needs to step in and clarify the LTEA in this regard.

[5] *Northwood Construction Co. v. Upper Marion Twp.*, 856 A.2d 789 (Pa. 2004).

[6] *Lower Marion Twp. v. QED Inc.*, 738 A.2d 1066 (Pa. Commw. Ct. 1999).

[7] In *Northwood*, the taxpayer was headquartered in the township and operated as a construction manager/general contractor throughout Pennsylvania and in various other states. When performing its manager/construction activities at the various job sites, the taxpayer maintained trailer offices at each such site. These offices were essential for the taxpayer's construction activities at each site, and the taxpayer maintained job records, drawings, specifications, schedules, and employee records related to the job at each of these job-site offices. Each office was equipped with telephone, fax, and copier services and contained offices and a meeting room. Additionally, at each job site the taxpayer employed full-time, on-site personnel to conduct the day-to-day operations required to manage the construction activities and employees at the site.

In rendering its decision, the court utilized the rationale of *Gilberti v. Pittsburgh*, 511 A.2d 1321 (Pa. 1986) (*Gilberti*) and reasoned that the *Gilberti* decision was grounded on the understanding that the company's central office provided "a base of operations" from which it exercised control over its operations. Moreover, in citing *G.A. and F.C. Wagman Inc. v. Manchester Twp.*, 535 A.2d 702 (Pa. Commw. Ct. 1988), the court observed that supervision of projects from temporary on-site offices did not negate the fact that the route of all of the company's business is at its sole permanent business headquarters. As a result, the court rejected the taxpayer's assertion that its out-of-township receipts were excluded from the township's BPT.

[8] In *Gilberti*, the Pennsylvania Supreme Court first considered the extent of a municipalities' taxing power under §6902 of the LTEA. In that case, a Pittsburgh company was taxed pursuant to a Pittsburgh BPT based on the gross receipts it received from business conducted both inside and outside the city limits. The taxpayer maintained its permanent place of business within Pittsburgh as well as temporary office locations at various job sites outside of the city. The court made two important conclusions in that case:

- the LTEA authorized a municipality to tax a business whose *principal office* was within its borders for the privilege of maintaining that office within the municipality; and
- the measure of that tax could include receipts from work outside the municipality, based on the recognition that the company's maintenance of "a base of operations" within the municipality contributed to the business' ability to conduct activities and exercise control over its operations outside the municipality.

*Gilberti*, 511 A.2d. at 1326 (emphasis added).

[9] *Id.* at 892.

[10] *Id.* fn. 5.

[11] *Id.* fn. 6.

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## Valvano Decision

Shortly after issuing its decision in *Rendina* I reversing the lower court, the commonwealth court issued its decision in *School District and City of Scranton v. R.V. Valvano Construction Co. (Valvano)*, upholding the lower court's finding that a school district within the city of Scranton and the city itself could not tax a construction company for BPT if the company did not maintain an office within Scranton city limits. In this case, the taxpayer operated a construction business and performed substantial amounts construction work within the city of Scranton, but maintained its sole permanent place of business and base of operations in an adjacent municipality, Dickson City. The taxpayer did not keep a temporary job trailer within the city of Scranton, but each day brought in a temporary office with its trucks, and each evening, returned the office to Dickson City. The Lackawanna County Court of Common Pleas ruled in favor of the taxpayer on the basis of *Gilberti* and *QED*.[12] It concluded that because Valvano was obligated to pay a BPT in Dickson City for all construction revenues, the assessment of additional BPT on the revenues from the city of Scranton required Valvano to pay the same tax twice, which was prohibited by Pennsylvania law.

On appeal to the commonwealth court, the city and the school district argued that *Gilberti* should be overruled and that BPT should be defined, instead, as a tax on the privilege of generating gross receipts, which they argued was what the General Assembly intended when it enacted the LTEA. The city argued that this very language and concept was embodied within the city's ordinance. In response, the court held that the city's attempt to collect a BPT from an out-of city business that performed work within the city "commingle[d] a business privilege tax and transaction tax into a single levy and ignore[d] the conceptual and practical distinction between those two items of taxation."[13]

The common pleas court observed that the city's ordinance clearly and unambiguously spells out the subject and the measure of the tax as a BPT on the annual gross receipts from any person engaging in any business in Scranton. Moreover, the lower court stated that there was no mention of transaction or any indication that Scranton intended to tax individual transactions performed within the city by out-of-city businesses.

The commonwealth court held contrary to the city's arguments, and concluded that the city ordinance was a tax on the privilege of engaging in a business within the city and imposed a tax on gross annual receipts thereof.

In affirming the decision of the lower court, the commonwealth court noted that the city's line of analysis was clearly rejected in *Gilberti*:

> The "privilege" of engaging in business within the City which the [Enabling Act] establishes as a subject that may be taxed, *must be regarded as being separate and apart from "transactions" within the City that may be taxed. To regard otherwise would be to ignore the significance of the two subjects for taxation having been separately stated in the [Enabling Act]*.[14]

The court concluded that the city was not entitled to tax Valvano for the privilege of performing work inside the city if Valvano did not maintain a place of business there.

Based upon the prior case law, it was clear that the LTEA allowed municipalities to impose a tax on any business exercising the privilege of "doing business within their jurisdiction." Case law interpreting the LTEA concluded, however, that in order for a municipality to tax an entity, the taxpayer must have a base of operations located within that municipality—a permanent place of business within that taxing jurisdiction. Temporary office trailers or construction trailers on particular job sites within a municipality were not considered to be permanent places of business because the companies were not conducting activities or exercising control over operations *outside* the municipality, so they were not exercising the privilege of doing business both within and outside that jurisdiction on a regular and continuous basis. In other words, the LTEA, as interpreted by the courts prior to the Pennsylvania Supreme Court's reversal of *Rendina* I required a bright-line test of a permanent place of business constituting a base of operations within the taxing jurisdiction in order to impose BPT. That has now changed with the supreme court's decision in *Rendina* II.

## SUPREME COURT REVERSES *RENDINA* I

At the end of December, the Pennsylvania Supreme Court eliminated the bright-line test and reversed the commonwealth court, holding that BPT was properly imposed on Rendina's receipts attributable to its office building construction activities within the city of Harrisburg.[15] The Pennsylvania Supreme Court rejected the commonwealth court's reading of *Gilberti* and specifically concluded that the LTEA did not require a perma-

[12] In *QED* the taxpayer maintained its principal place of business in one township and performed certain remodeling work within Lower Marion Township, but did not maintain even a temporary on-site office within Lower Marion Township. The court concluded that merely conducting business within the township absent a permanent place of business there could not subject the taxpayer to BPT. *QED*, 738 A.2d. at 1069. The court held that under the LTEA, the taxpayer was only responsible for the payment of BPT on gross receipts from one municipality for the privilege of having a base of operations there. *Id.* at 1071.

[13] *Valvano*, 863 A.2d at 51, citing the common pleas opinion, Dec. 24, 2002 at 7. In an earlier decision, the Pennsylvania Supreme Court had noted that there is a difference between a business privilege tax and a transaction tax. "A business privilege tax is a tax imposed on all gross receipts from all of the businesses' activities everywhere, so long as the base of operations within the political subdivision contributes to those activities because the privilege of doing business is far more than the sum of the transactions . . . performed within the territorial limits of the taxing entity." *Airpark Internatl. v. Interboro School District*, 735 A.2d 646, 647 (Pa. 1999). However, a transaction tax "is imposed on the receipts from the designated transactions that are actually performed within the taxing entity, because its subject is only the transaction and not the privilege of engaging in a business that allows the transaction to be consummated. *Airpark Internatl.*, 735 A.2d at 647.

[14] *Valvano*, 863 A.2d at 53, citing *Gilberti*, 511 A.2d at 1234. (Emphasis added).

[15] *V.L. Rendina Inc. v. Harrisburg*, 130 MAP 2005 (Pa. Dec. 27, 2007).

nent base of operations in the taxing jurisdiction before BPT could be imposed.

According to the supreme court, *Gilberti* did not mandate that a base of operations was necessary to impose BPT.[16] Rather, because the taxpayer in *Gilberti* had its sole base of operations within the city of Pittsburgh, receipts earned outside Pittsburgh could be attributed to Pittsburgh.[17] Such a result was due to the fact that the office within Pittsburgh contributed to the company's earnings. [18] The court distinguished *Gilberti* because Rendina's activities at issue took place only within the city of Harrisburg.[19]

The court indicated that what was necessary for taxation under the LTEA was that the "business activities sought to be taxed are of the type authorized under the LTEA and the BPT."[20] The court noted that the LTEA granted broad overlapping authority to impose tax on various persons, privileges, transactions, and activities within a taxing jurisdiction.[21] The court reasoned that such authority is broad enough to encompass Rendina's construction activities in Harrisburg, regardless of whether it retained an office there.[22] The court concluded that because the Harrisburg ordinance imposed BPT on such activities, the BPT was properly imposed, and Rendina was denied relief[23] In rendering its decision, the court also took pains to distinguish *Gilberti*, and concluded that *Gilberti* harmonized with its present decision in *Rendina II*. The court also noted the city's argument distinguishing the *QED* decision on the basis that *QED* never maintained any office whatsoever within the township and that its activities within the township were limited to an initial visit to the job site.[24]

The court specifically rejected Rendina's argument that the LTEA required an actual, physical, permanent place of business in the taxing municipality as a prerequisite to the imposition of any BPT. Accordingly, although *Gilberti* found the taxpayer's maintenance of an in-city base of operations from which it directed extraterritorial activities was a sufficient condition to permit taxation of such activities (so long as they were attributable to the operational base), the court concluded that it did not follow that the existence of such an office was a necessary condition for the taxation of business activities that are wholly inside of a taxing municipality's boundaries.[25]

Finally, the court sided with the dissent in *Rendina I* indicating that maintaining "the job-site trailer for a major, long-term construction project represented commercial activities relying on the privilege to do business afforded by the municipality."[26] The court went on to indicate that it did not construe the LTEA or the Harrisburg ordinance to impose a base of operations requirement. All that was necessary for BPT taxation was Rendina's work within Harrisburg and that the ordinance taxed it as such regardless of whether the job-site trailer was used as a "base of operations."[27]

## Resulting Problem With *Rendina* II Decision

As a result of the *Rendina* II decision by the supreme court, a number of previously clear lines have been blurred or eliminated completely. First, the long-standing rule of a "base of operations," which was construed as place of business, is no longer needed for BPT taxation under the LTEA. That rule has effectively been eliminated so long as the municipal ordinance is drafted in a similar fashion to the Harrisburg ordinance, so that any activity conducted within the municipality is taxable. Second, if the ordinance is drafted as broadly as possible, carrying on any trade, profession, or other commercial activity within a municipality is enough to subject an entity to BPT there. Third, when a taxpayer without a place of business within a municipality is being taxed, it would appear that the municipality could only tax that income earned within its borders.[28] However, if a taxpayer has specifically located in a municipality which has no local BPT, it will now incur increased costs of BPT potentially wherever it conducts business. Additionally, if the taxpayer's home municipality taxes its residents differently, potential double taxation could occur unless apportionment rules are laid out in a uniform manner. Finally, by eliminating the bright-line rule requiring a base of operations, the BPT in reality becomes a transaction tax, which may otherwise have been unauthorized under the LTEA. In fact, Justice Bear in his concurring opinion raises this very point.[29]

## THE SOLUTION

The only solution to this problem is for the General Assembly to step in and clarify the LTEA. It appears that the supreme court has expanded a municipality's ability to tax any and all taxpayers conducting any business within its borders despite the court's prior distinction between a business "privilege" tax and a business "transaction" tax. There should be a bright-line codified rule for a municipality to tax within its borders, as well as uniform apportionment and credit rules. The bright-line test that has worked best is the maintenance of a permanent place of business (or base of operations)

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[16] *Id.* at 9.
[17] *Id.*
[18] *Id.*
[19] *Id.* at 10.
[20] *Id.* at 9.
[21] *Id.* at 11.
[22] *Id.* at 9-10.
[23] *Id.* at 10.
[24] *Id.* at 7.
[25] *Id.* at 9.
[26] *Id.* at 13.

[27] *Id.*
[28] In the *Rendina* litigation, the Harrisburg ordinance only appeared to tax the revenues earned by the taxpayer within the city and the court did not address any apportionment issues (as in *Northwood*) because the taxpayer did not have a BPT in the home jurisdiction where it maintained its sole base of operations.
[29] "This cautionary note is especially important in light of the General Assembly's post-*Gilberti* enactment of the Local Tax Reform Act [LTEA] . . . which purported to bar local taxing jurisdictions from imposing business privilege taxation schemes not already extant as of the act's effective date . . . . If we are unwilling to recognize a meaningful analytic boundary between transaction, business privilege, and other taxes . . ., then we leave municipalities free to recharacterize their tax ordinances at will to avoid any legislative prohibition . . . ." Concurring Opinion at 3-4, fn. 4. *See also* fn. 15, above, and the *Airpark* decision.

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within a municipality used to conduct business both within and outside the municipality to subject a company to BPT taxation within the municipality.

In effect, this revision would codify the *Gilberti* and *Northwood* rule and their progeny as clearly enunciated in the *Rendina* I and *Valvano* decisions of the Pennsylvania Commonwealth Court. Such a revision in the LTEA would clarify the ambiguity and make absolutely clear when a municipality could tax a company performing work within its borders. This clarification could also deal with the issue raised in footnote 6 of the *Rendina* I decision, as to whether or not the receipts would have to be subject to BPT where the taxpayer maintained its place of business. This could avoid inconsistencies in interpretation of law and afford all taxpayers a level playing field in performing services. The General Assembly should clarify this ambiguity so as to avoid further litigation and permitting municipalities simply assess BPT on all types of companies that conduct discrete activities within a jurisdiction, and thus require all companies to be knowledgeable of and comply with potentially hundreds of local BPT ordinances.

This article was originally published in the BNA Tax Management *Multistate Tax Report*, Vol. 15, No. 2 (Feb. 28, 2008), and is reprinted with permission of Tax Management Inc., a subsidiary of The Bureau of National Affairs, Inc., 1801 S. Bell St., Arlington, Va. 22202. (www.bnatax.com.)