



City of Philadelphia

City Council
Chief Clerk's Office
402 City Hall
Philadelphia, PA 19107

BILL NO. 040012

Introduced January 22, 2004

Councilmember Nutter

**Re-Referred to the
Committee of the Whole**

AN ORDINANCE

Amending Chapter 19-2600 of The Philadelphia Code, entitled "Business Privilege Taxes," by amending the definition of "Net Income" to determine the net income of unincorporated businesses by allowing deductions of payments to certain proprietors or partners.

THE COUNCIL OF THE CITY OF PHILADELPHIA HEREBY ORDAINS:

SECTION 1. Chapter 19-2600 of the Philadelphia Code is hereby amended to read as follows:

CHAPTER 19-2600. BUSINESS PRIVILEGE TAXES.

§ 19-2601. Definitions.

In addition to the definitions provided in the Act of May 30, 1984, P.L. 345, No. 69, known as the First Class City Business Tax Reform Act, and Chapter 19-500 of this Title, the following definitions shall apply:

	*	*	*
Net Income.	*	*	*

- (a) "Net income" shall, at the option of the taxpayer, which option shall not be revocable by the taxpayer after it has been exercised as provided for by the collector, be either:
 - (1) The net gain from the operation of a business, after provision for all allowable costs and expenses actually incurred in the conduct thereof, either paid or accrued

City of Philadelphia

BILL NO. 040012 continued

in accordance with the accounting system used, without deduction of taxes based on income, *except as provided for by the following:*

- (i) *Commencing with returns the due date of which are on or after January 1, 2005, a deduction of qualified payments to principals of an unincorporated business who materially participate in the operation thereof, subject to the terms and conditions set forth in subsection (2)(vi).*
- (ii) *Phase-in of Deduction: The amount of any deduction claimed under subparagraph (1) shall not exceed the following percentage of total qualified payments:*

<u>Taxable Year</u>	<u>Deduction</u>
2005	50%
2006	60%
2007	70%
2008	80%
2009	90%
2010 and hereafter	100%

(2) The taxable income from any business activity as returned to and ascertained by the Federal Government prior to giving effect to the exclusion for dividends received and net operating loss, subject to the following adjustments:

* * *

- (vi) *A deduction by an unincorporated business of qualified payments to principals who materially participate in the operations of the business, subject to the terms and conditions set forth herein.*
 - (.a) *Unincorporated Business. For purposes of this subsection, an “Unincorporated Business” is an enterprise, activity, profession, trade or undertaking of any nature conducted for profit or ordinarily conducted for profit that is not incorporated, or that is deemed to be a partnership or disregarded entity, and is subject to the Net Profits Tax imposed by Chapter 19-1500.*
 - (.b) *Principal. A sole proprietor or person that has an ownership interest in an association subject to the Net Profits Tax imposed by Chapter 19-1500 of the Code of Philadelphia.*

City of Philadelphia

BILL NO. 040012 continued

(.c) *Qualified Payments:*

- i. *Include payments made to principals that materially participated in the operation of the unincorporated business in the year of distribution, or with respect to payments to inactive principals who materially participated in the operation of the unincorporated business during the three-year period immediately preceding commencement of the distribution.*
- ii. *Include payments for the following items: Guaranteed Payments, Commissions, Bonuses, Fringe Benefits.*
- iii. *Include payments pursuant to a funded or unfunded retirement plan to a retired principal who materially participated in the operation of the unincorporated business for a minimum of three years at anytime prior to commencement of the payments.*
- iv. *Exclude payments to the extent that they represent items excluded from the definition of net income pursuant to any other provision of these regulations.*

(.d) *Material Participation.* A person will be treated as materially participating in the operation of an unincorporated business for purposes of this section only if the person actively engages in the operation of the unincorporated business during each taxable year for which a deduction is claimed.

(.e) *Satisfaction of the Material Participation standard.*

- i. *Proof: The extent and nature of an individual's participation in an activity may be established by any reasonable means. Reasonable means for purposes of this paragraph may include but are not limited to the identification of services performed over a period of time and the approximate number of hours spent performing such services during such period, based on contemporaneous appointment books, calendars, and narrative summaries. Contemporaneous daily time reports, logs, or similar documents are not required if the extent*

City of Philadelphia

BILL NO. 040012 continued

and nature of such participation may be established by other reasonable means.

- ii. *Participation Standards Not Contained In Section 404(A)(3) Not Applicable: The fact that an individual satisfies the requirements of any participation standard (whether or not referred to as “material participation”) under any provision of any other federal, state, or local tax legislation or regulation shall not be taken into account in determining whether such individual materially participates in any activity for any taxable year for purposes of Section 19-2601 of the Philadelphia Code, as amended effective January 1, 2005, and the regulations thereunder.*
- iii. *Where an unincorporated business claims a deduction for a payment to a principal, other than a limited partner in a limited partnership, or similar limited liability principal in a limited liability entity, there is a rebuttable presumption that the principal materially participated in the operation of the unincorporated business and the burden of proof is on the collector to establish that the payment is not deductible.*
- iv. *Where a limited liability unincorporated business claims a deduction for a payment to a limited partner or other limited liability principal, there is a rebuttable presumption that the limited liability principal did not materially participate in the operation of the unincorporated business, and the taxpayer has the burden of proving the validity of the deduction.*

SECTION 2. This ordinance shall become effective commencing with tax returns due on or after January 1, 2005.

Explanation:

[Brackets] indicate matter deleted.
Italics indicate new matter added.