PROPOSED RULEMAKING

PENNSYLVANIA HEALTH INSURANCE EXCHANGE AUTHORITY

[31 PA. CODE CH. 5001]

Health Equity Accreditation

The Pennsylvania Health Insurance Exchange Authority d/b/a Pennie® (Exchange Authority) proposes to add Chapter 5001 to the Exchange Authority's regulations under Part L[1] to read as set forth in Annex A. This rulemaking is proposed under the Exchange Authority's general rulemaking authority under section 506 of The Administrative Code of 1929 (71 P.S. § 186) and the act of July 2, 2019 (P.L. 294, No. 42) (Act 42 of 2019) which added 40 Pa.C.S. §§ 9101—9703 (relating to health insurance markets oversight), also known as the Health Insurance Markets Oversight Act, specifically 40 Pa.C.S. § 9701(a) (relating to regulations).

Background Information

The Exchange Authority is the State-affiliated entity that operates the Commonwealth's State-based health insurance marketplace. The Exchange Authority was created in July of 2019 under Act 42 of 2019. It was a unanimous and bipartisan effort to transition away from the Federal health exchange and to take State control by establishing a State-based health insurance marketplace at a significantly lower cost and using the savings to launch a reinsurance program to lower premiums for families purchasing health and dental insurance through the Exchange Authority. The Exchange Authority's mission is to improve the accessibility and affordability of individual market health coverage for all residents of this Commonwealth.

Purpose

The purpose of this proposed rulemaking is to require insurers selling qualified plans[2] through the Exchange Authority to be accredited in health equity.[3] Through health equity accreditation (HEA), insurers and their employees will learn about cultural competency within the healthcare field to ensure that every person—regardless of personal characteristics such as gender, race, socioeconomic status and geographical location—receives the same quality of care.

In recent years, health equity has become an important and well-recognized accreditation standard in the healthcare industry. Currently, multiple states and health plans across the country use HEA to identify and close significant health coverage and care gaps that remain in this country. Health equity plays a key role in the advancement of public health, particularly for historically underserved communities that may have inequitable access to critical healthcare services and that also experience worse long-term health outcomes than the general population. Gaining HEA will lead to better health outcomes for historically marginalized communities by requiring insurers to use race and ethnicity data for quality measurement. In addition, this process will help insurers build a diverse staff, reduce biased behavior and improve decision-making among employees. This will ensure that all Exchange Authority customers have access to the culturally competent care they deserve.

By requiring HEA, the Exchange Authority expects a decrease in health inequities among Commonwealth residents who purchase qualified plans through the Exchange Authority and an increase in enrollment among underserved populations.

Explanation of Regulatory Requirements

Proposed § 5001.1 (relating to scope) explains the proposed regulation's applicability.

Proposed § 5001.2 (relating to purpose) explains the purpose of the proposed regulation, which is to ensure that insurers selling qualified plans through the Exchange Authority are certified in health equity.

Proposed § 5001.3 (relating to definitions) defines the words and terms in Chapter 5001.

Proposed § 5001.4 (relating to achieving health equity accreditation) establishes the requirements and timeline to comply with the proposed regulation.

Proposed § 5001.5 (relating to recognized health equity accreditation organizations) establishes the standards that an HEA organization[4] must meet for the Exchange Authority to recognize them as an organization through which insurers selling plans through the Exchange Authority can obtain accreditation.

Proposed § 5001.6 (relating to penalties) establishes the penalties for the regulated community for failure to meet the requirements of this regulation.

External Comments

Prior to the drafting of the annex, the Exchange Authority engaged in significant stakeholder engagement efforts, including with all of the health insurers offering qualified plans through the Exchange Authority (Capital Blue Cross, Highmark, UPMC, Independence Blue Cross, Cigna, Oscar, PA Health & Wellness and Geisinger) as well as the dental insurers (BEST Life, Delta Dental, Dominion National, DSM, Educators and The Guardian). The Exchange Authority received feedback from insurers indicating that many were already in the process of exploring HEA since they have lines of business in states requiring this type of accreditation. At the time of the drafting of this proposed rulemaking, one insurer, Independence Blue Cross, has already achieved HEA. In addition, the Exchange Authority also met with health insurance agents and certified enrollment assisters who work with local organizations across this Commonwealth. The feedback offered by insurers, agents and assisters, aided the Exchange Authority in drafting the annex.

More importantly, the Exchange Authority's board, which is comprised of representatives of insurance companies, consumer advocacy groups and State agencies, has been involved from the beginning of this process and has

[1] Currently, the Exchange Authority does not have any regulations. The proposed HEA regulation would be the Exchange Authority's first regulation. This, and future regulations, will be codified in 31 Pa. Code Part L. The first chapter of the Exchange Authority's regulations will begin with Chapter 5001.

[2] A qualified plan is a health or dental insurance policy offered by a qualified insurer in a state-based or Federally-facilitated health insurance marketplace. Qualified Plans are defined in 40 Pa.C.S. § 9103 (relating to definitions).

[3] The proposed regulation's definition of "health equity" is based on the Centers for Medicare & Medicaid Services' definition of health equity but slightly reworded for clarity purposes only.

[4] Interested HEA organizations will need to submit documentation about their health equity certification program to the Exchange Authority for review to ensure that their programs properly cover all the standards set forth in § 5001.5(b) of this proposed rulemaking. If their program meets the standards, the Exchange Authority will list their names on its web site. Insurers can then select an organization from that list to obtain accreditation.

provided comments and suggestions on the scope and implementation of this proposed rulemaking. Before submitting the regulatory package, the board reviewed a draft of the annex and provided feedback.

Affected parties

This proposed rulemaking will directly affect insurers offering qualified plans through the Exchange Authority: eight health insurers as of August 2023 (Capital Blue Cross, Highmark, UPMC, Independence Blue Cross,[5] Cigna, Oscar, PA Health & Wellness and Geisinger) and six dental insurers (BEST Life, Delta Dental, Dominion National, DSM, Educators and The Guardian). It will also affect insurers who will offer qualified plans through the Exchange Authority in the future.

In addition, this proposed rulemaking will affect individuals currently enrolled in qualified plans through the Exchange Authority (as of March of 2023 approximately 371,516 individuals) by providing for better and more equitable healthcare.

HEA organizations are not regulated by this proposed rulemaking. Only HEA organizations that submit an application to the Exchange Authority to be recognized as HEA organizations are indirectly and minimally affected because they would need to submit documentation to the Exchange Authority to demonstrate they are properly qualified.

Fiscal Impact

State government. There will not be any fiscal impact to the Exchange Authority or any other Commonwealth agency due to this proposed rulemaking.

General public. This proposed rulemaking will have no fiscal impact upon the general public.

Political subdivisions. This proposed rulemaking will have no fiscal impact upon political subdivisions.

Private sector. This proposed rulemaking will have no fiscal impact upon the private sector, except for minimal impact to the regulated entities. The Exchange Authority estimates that each insurer selling qualified plans through the Exchange Authority will pay approximately $6,240 plus $0.06 per member fee every 3 years for accreditation.

Paperwork

There are no forms that insurers selling qualified plans through the Exchange Authority, the regulated community, are required to complete and submit due to this regulation. However, once these insurers obtain HEA, they must submit a copy of their accreditation certificate to the Exchange Authority.

Organizations intending to qualify as a recognized HEA organization by the Exchange Authority must submit documentation (see Appendix A, which was submitted to the Independent Regulatory Review Commission (IRRC) as part of the Proposed Regulation. Appendix is available at https://www.irrc.state.pa.us/regulations/RegSrchRslts.cfm?ID=3416. Select "Download proposed regulation," scroll to Appendix A.) to the Exchange Authority to ensure that their accreditation program satisfies the requirements set forth in the proposed regulation.

The only additional paperwork that would be imposed on the Exchange Authority as a result of this proposed rulemaking would be related to the review of the documentation submitted by HEA organizations that intend to be recognized by the Exchange Authority under § 5001.5(b) of this proposed rulemaking. It is expected that this paperwork will be minimal.

[5] Independence Blue Cross has already received HEA.

Effect Date

This proposed rulemaking will become effective immediately upon final-form publication in the *Pennsylvania Bulletin*.

Sunset Date

The Exchange Authority will monitor the effectiveness of this regulation every other year. Therefore, no sunset date has been assigned.

Contact Person

Questions or comments regarding this proposed rulemaking may be addressed in writing to PennieRegulations@pennie.com or to Ana Paulina Gomez, Chief Counsel, Pennsylvania Health Insurance Exchange Authority, P.O. Box 536, Harrisburg, PA 17108, within 30 days of the publication of this proposed rulemaking in the *Pennsylvania Bulletin*.

Regulatory Review

Under Section 5(a) of the Regulatory Review Act (71 P.S. § 745.5(a)), on May 7, 2024, the Exchange Authority submitted a copy of this proposed rulemaking and a copy of a Regulatory Analysis Form to IRRC and to the chairperson of the Banking & Insurance Committee of the Senate and the chairperson of the Insurance Committee of the House of Representatives. A copy of this material is available to the public upon request.

Under section 5(g) of the Regulatory Review Act, IRRC may convey any comments, recommendations or objections to the proposed rulemaking within 30 days of the close of the public comment period. The comments, recommendations or objections must specify the regulatory review criteria in section 5.2 of the Regulatory Review Act (71 P.S. § 745.5b) which have not been met. The Regulatory Review Act specifies detailed procedures for review, prior to final delivery of the rulemaking, by the Exchange Authority, the General Assembly and the Governor.

DEVON TROLLEY,
Executive Director

Fiscal Note: 130-1. No fiscal impact; recommends adoption.

Annex A

TITLE 31. INSURANCE

PART L. PENNSYLVANIA HEALTH INSURANCE EXCHANGE AUTHORITY

CHAPTER 5001. HEALTH EQUITY ACCREDITATION

(*Editor's Note*: Chapter 5001 is proposed to be added and is printed in regular type to enhance readability.)

§ 5001.1. Scope.

This chapter applies to insurers selling qualified plans through the Exchange Authority.

§ 5001.2. Purpose.

The purpose of this chapter is to increase health equity and enhance the cultural competency of healthcare services provided in this Commonwealth by requiring insurers selling qualified plans through the Exchange Authority to be accredited in health equity by a recognized accrediting body.

§ 5001.3. Definitions.

(a) The definitions in 40 Pa.C.S. § 9103 (relating to definitions) are incorporated by reference and apply to this chapter.

(b) The following words and terms, when used in this chapter, have the following meanings, unless the context clearly indicates otherwise:

Department—The Insurance Department of the Commonwealth.

Exchange Authority—The Pennsylvania Health Insurance Exchange Authority d/b/a Pennie®.

Health equity—The fair and just opportunity for all individuals to attain their optimal health regardless of race, ethnicity, disability, sexual orientation, gender, socioeconomic status, geography, preferred language or other factors that affect access to care and health outcomes.

Recognized health equity accreditation organization—An organization recognized by the Exchange Authority to be qualified to offer health equity accreditation under § 5001.5 (relating to recognized health equity accreditation organizations).

§ 5001.4. Achieving health equity accreditation.

(a) *Compliance.* An insurer offering qualified plans through the Exchange Authority shall be accredited in health equity by a recognized health equity accreditation organization.

(b) *Timeframe to achieve health equity accreditation.*

(1) An insurer offering qualified plans through the Exchange Authority on ____________________ (*Editor's Note*: The blank refers to the effective date of the rulemaking.) shall achieve health equity accreditation by a recognized health equity accreditation organization by the start of the plan year that begins after ________________ . (*Editor's Note*: The blank refers to the date 12 months after the effective date of the rulemaking.)

(2) An insurer seeking to offer qualified plans through the Exchange Authority shall achieve health equity accreditation by a recognized health equity accreditation organization by the start of the plan year immediately following the plan year in which the insurer is first certified to offer qualified plans through the Exchange Authority.

(3) Notwithstanding paragraphs (1) and (2), an insurer that has not attained accreditation within the time frame under paragraph (1) or paragraph (2), as applicable, may offer qualified plans through the Exchange Authority at the Exchange Authority's discretion if the insurer submits to the Exchange Authority a plan demonstrating its good faith and timely efforts to achieve health equity accreditation, including a date by which the insurer anticipates attaining accreditation.

(c) *Annual submission.* An insurer offering qualified plans through the Exchange Authority that achieves health equity accreditation as required under subsection (b) shall thereafter submit to the Exchange Authority a copy of its current health equity accreditation certificate by August 31 of every year by e-mail to PennieRegulations@pennie.com using the subject title "Insurer Health Equity Accreditation Certificate."

§ 5001.5. Recognized health equity accreditation organizations.

(a) *Process for recognizing health equity accreditation organizations.*

(1) An organization that seeks to qualify as a recognized health equity accreditation organization shall submit an application to the Exchange Authority to establish that its health equity accreditation program satisfies the requirements under subsection (b).

(2) The organization shall submit its application to the Exchange Authority in a form and manner approved by the Exchange Authority.

(3) The Exchange Authority shall review an organization's application for compliance with the requirements under subsection (b).

(4) The Exchange Authority may decline to approve or terminate the approval of an organization that does not satisfactorily comply with the requirements under subsection (b).

(5) If the Exchange Authority approves an organization's application, the organization shall do one of the following on an annual basis from the date its application was approved:

(i) Submit a letter to the Exchange Authority attesting that its program has not changed and continues to meet the requirements under subsection (b).

(ii) Submit a new application to the Exchange Authority if its program has changed.

(6) If the Exchange Authority approves an organization's application, the Exchange Authority will publish on its web site the organization's name in a list of recognized health equity accreditation organizations.

(b) *Recognized health equity accreditation organizations requirements.* To be recognized as a health equity accreditation organization by the Exchange Authority, an organization shall have a health equity accreditation program in the United States that:

(1) Educates an applicant seeking accreditation about health equity to help the applicant achieve a framework that advances health equity, expands coverage and improves health outcomes for the applicant's customers regardless of their race, ethnicity, disability, sexual orientation, gender, socioeconomic status, geography or preferred language.

(2) Is conducted in accordance with a written plan and curriculum or manual.

(3) Includes, at a minimum, curriculum that covers all of the following topics:

(i) Diversity of the workforce of the applicant seeking accreditation.

(ii) Access and availability of language services.

(iii) Cultural awareness and responsiveness.

(iv) Reduction of healthcare disparities.

(4) Has instructors and administrators with education or certification in health equity education.

(5) Has specific parameters that the applicant seeking accreditation must meet prior to becoming accredited in health equity.

(6) Has renewal criteria.

(7) Includes a health equity accreditation certification that expires in no more than 3 years if renewal criteria are not satisfied.

§ 5001.6. Penalties.

Failure to comply with the provisions of this chapter will subject an insurer offering qualified plans through the Exchange Authority to referral to the Department for enforcement in accordance with 40 Pa.C.S. § 9702 (relating to enforcement) and any other penalty provided by law.

[Pa.B. Doc. No. 24-752. Filed for public inspection May 24, 2024, 9:00 a.m.]

DEPARTMENT OF REVENUE

[61 PA. CODE CH. 5]

Payment Methods for Obligations Due the Commonwealth

The Department of Revenue (Department) and the Treasury Department (Treasury), under the authority contained in section 9 of The Fiscal Code (72 P.S. § 9), propose amendments to Chapter 5 (relating to payments by electronic funds transfer) to read as set forth in Annex A.

Purpose of Proposed Rulemaking

The purpose of this proposed rulemaking is to update the existing regulation that has, for the most part, not changed since it was originally promulgated in 1992. Prior amendments to the regulation consist of additions of taxes to which the electronic payment mandate applies and reductions to the threshold for the electronic payment mandate. For example, the act of July 2, 2012 (P.L. 823, No. 87) and the act of July 18, 2013 (P.L. 574, No. 71) reduced the payment threshold over which electronic payments are required from $20,000 to $10,000 and from $10,000 to $1,000, respectively.

Section 9 of The Fiscal Code requires the Department and the Treasury to promulgate regulations relating to the way payments are made to the Department for obligations due the Commonwealth. Currently, Chapter 5 focuses mostly on the electronic payment mandate. This proposed rulemaking broadens the scope of the original regulation to address all forms of payments to the Department, not just electronic payments. This proposed rulemaking also memorializes existing payment methods and does not broaden or limit the methods by which payments are currently made to the Department.

The existing regulation and electronic fund transfer (EFT) mandate already applies to persons remitting the following tax obligations to the Department: Sales and Use, Corporate Net Income, Employer Withholding, Capital Stock-Franchise, Liquid Fuels, Bank Shares, Fuel, Use, Title Insurance and Trust, Mutual Thrift Institutions, Company Shares, Oil Company Franchise, Insurance Premiums, Malt Beverage, Public Utility Realty, Motor Carrier Road Tax and Gross Receipts.

The Pennsylvania General Assembly has enacted several new taxes since the existing regulation was last updated, including the following: Other Tobacco Products Tax, Wine Excise Tax (WET), Wine Expanded Permit, Carsharing Fee, Consumer Fireworks Tax, Medical Marijuana Gross Receipts Tax and Fantasy Sports Tax. The Department proposes to impose the electronic payment mandate to these taxes as well as other obligations that are not otherwise exempted.

This proposed rulemaking also coincides with system programming of the Department's modernized tax system.

Description of Proposed Amendments

This proposed rulemaking is largely a rewriting and reorganization of the existing regulation. The major change is that the electronic payment mandate for obligations of $1,000 or more will now apply to all tax types, except for certain types of Personal Income Tax payments under Article III of the Tax Reform Code of 1971 (TRC) (72 P.S. §§ 7301—7361) and Inheritance Tax payments under Article XXI of the TRC (72 P.S. §§ 9101—9196), and all other obligations due the Commonwealth paid through the Department.

The Department proposes to amend the title of Chapter 5 to Payment Methods for Obligations Due the Commonwealth to clarify that this chapter addresses how all payments are made to the Department rather than just addressing electronic payments.

The Department proposes to delete §§ 5.1—5.7. Many of the substantive provisions are proposed to be carried over into new, reorganized and rewritten sections which are proposed to be added as §§ 5.11—5.16.

The Department proposes to delete § 5.1 and move the purpose for the chapter into § 5.11 (relating to purpose), with some changes as described in the explanation of § 5.11.

The Department proposes to delete § 5.2 in its entirety and move the definitions into § 5.12 (relating to definitions), with some changes as described in the explanation of § 5.12.

The Department proposes to delete § 5.3 in its entirety. Subsections (a)—(d) are obsolete. Subsections (e)—(g) set forth the current amount and method of payment, which will now be set forth in proposed § 5.14 (relating to payments required to be paid by EFT). Parts of subsections (g) and (h) will be set forth in Department guidance and instructions, thus eliminating the need for those provisions.

The Department proposes to delete § 5.4 because it will now be obsolete with the allowable methods of payment set forth in proposed § 5.13 (relating to payments in general).

Section 5.5 was previously deleted in a prior rulemaking published at 42 Pa.B. 7279 (December 1, 2012).

The Department proposes to delete §§ 5.6 and 5.7 because they contain technical rules related to EFT payments. The Department is proposing to provide these technical rules in Department instructions in the future as set forth in proposed § 5.13(c).

Proposed § 5.11 states the purpose of the regulation, which is to provide for how payments for Commonwealth obligations are to be remitted. The previous § 5.1 contained references to the Department and Treasury, which will not be carried over to proposed § 5.11. In addition, while the previous purpose section limited the scope of the chapter to EFTs, the proposed purpose section does not contain that limitation resulting in the application of this chapter to all obligations due the Commonwealth.

The Department proposes to amend the definitions formerly contained in § 5.2 and move them to § 5.12.

The definitions "ACH," "ACH credit" and "ACH debit" are not carried over to the proposed definitions section, as these are commonly used terms and have generally understood meanings that do not require specialized definitions for the purpose of the regulation. In addition, the Department proposes to forgo the use of "ACH" throughout Chapter 5 in favor of the term "automated clearing house."

The Department has not carried over the term "business day" because the term will not be used in this proposed rulemaking.

The Department proposes to carry over the definition of "EFT—electronic funds transfer" from § 5.2 to proposed § 5.12. The Department also proposes to amend the definition by listing the allowable types of electronic payments. Credit and debit card payments have been added as allowable payment methods, given that they are an expedient means of payment authorized by section 9(a)(1) of The Fiscal Code. This proposed definition is also consistent with the Federal Reserve Board's Regulation E in 12 CFR 205.3(b) (relating to coverage), defining electronic fund transfers. In addition, the proposed definition provides that virtual currency is not a permitted form of EFT.

The definition for "Fedwire" is carried over from § 5.2 and proposed to be amended to be consistent with the provisions found in 12 CFR 210.25—210.32 (relating to funds transfers through the Fedwire funds service).

The definition for "financial institution" is proposed to be added because this term is to be used in the definition of "EFT." The definition is identical to the definition of "financial institution" found in 12 CFR 205.2(i) (relating to definitions).

The definition for "virtual currency" is proposed to be added because the term is to be used in the definition of "EFT." The Department proposes to define "virtual currency" using language that is identical to the Internal Revenue Service definition used in IRS Notice 2014-21 and the IRS Frequently Asked Questions on Virtual Currency Transactions.

Proposed § 5.13 provides for the proposed place, method and procedures by which obligations due the Commonwealth are to be remitted. In subsection (a), the Department proposes a list of methods by which a person may remit payments of obligations due the Commonwealth. In subsections (a) and (c), the Department proposes that the place, procedures and technical criteria for the remittance of payments due the Commonwealth will be published in Department instructions and publications. Placing this information in Department instructions and publications rather than directly in the regulation is necessary to account for frequently changing addresses, systems and technologies. Ways to obtain forms and instruction by mail, phone or online can be found on the Department's web site at https://www.revenue.pa.gov/FormsandPublications/Pages/How-Do-I-Get-Forms.aspx.

Proposed § 5.14 provides the rules for the electronic payment mandate. Subsection (a) applies to payments of $1,000 or more, and to all tax types, with some exceptions as set forth in subsections (b) and (c). Subsections (b) and (c) outline the payment criteria for certain Personal Income Tax payments under Article III of the TRC and Inheritance Tax payments under Article XXI of the TRC. Proposed § 5.14(b) and (c) are the exceptions to the general rule contained in subsection (a).

Proposed § 5.14(b) provides that payments due under Article III of the TRC (Article III payments), as listed in proposed paragraphs (1)—(3) are not subject to the $1,000 EFT requirement. Section 9 of The Fiscal Code creates the EFT requirement, but also provides that the Department and the Treasury cannot impose the EFT payment requirement on Article III payments. Rather, Article III payments are subject to the $15,000 EFT requirement contained in section 332.1 of the TRC (72 P.S. § 7332.1). Section 332.1 of the TRC was specifically added in 2021 to apply to Personal Income Tax payments under Article III of the TRC. The regulatory provisions under § 5.14(b) are consistent with both section 9 of The Fiscal Code and section 332.1 of the TRC.

Proposed § 5.14(c) exempts inheritance tax payments under Article XXI of the TRC from the requirements of subsection (a). Inheritance Tax payments are exempted from the EFT payment requirement because those payments are all made to the County Registers of Wills (ROW), who act as agents for the Department. The ROWs have their own procedures and systems in place to receive payments. Imposing an EFT payment requirement and potential penalty for inheritance tax payments cannot be implemented given the myriad and divergent procedures and systems of the 67 ROW county offices.

Proposed § 5.15 (relating to date of receipt rules) provides the date on which payments are considered received by the Department. Persons with obligations due the Commonwealth are notified they are responsible for their choice of payment and bear the burden of any late payments associated with their choice, even if the late payment is due to circumstances beyond the person's control.

Proposed § 5.16 (relating to penalty) reiterates the statutory penalty for failure to remit payments by EFT when required. See section 9.1 of The Fiscal Code (72 P.S. § 9.1) regarding failure to make payment by EFT. The statute requires the Department to impose a penalty if there is a failure to make a payment by EFT when required. This proposed language clarifies that the penalty is imposed upon the total amount of each payment remitted. It further clarifies that the penalty is imposed upon each payment regardless of whether the payment is for principal tax, interest, penalties, additions, fees or a combination thereof. In addition to the specific amendments cited previously, outdated references to Department Bureaus and addresses are proposed to be deleted. Provisions relating to filing tax returns are beyond the scope of the regulations and are also proposed to be deleted.

Affected Parties

This proposed rulemaking applies to all persons making payment of obligations due the Commonwealth through the Department.

Fiscal Impact

The Department has determined that this proposed rulemaking will have minimal or no revenue impact on the Commonwealth.

Paperwork Requirements

This proposed rulemaking will not result in additional paperwork for the public or the Commonwealth.

Effective Date

This proposed rulemaking will become effective upon final-form publication in the *Pennsylvania Bulletin*.

Sunset Date

This proposed rulemaking is scheduled for review within 5 years of final publication. A sunset date has not been assigned.

Public Comments and Contact Person

Interested persons are invited to submit in writing any comments, suggestions or objections regarding this proposed rulemaking to Maria L. Miller, Office of Chief Counsel, Department of Revenue, Dept. 281061, Harrisburg, PA 17128-1061, within 30 days after the date of the publication of this proposed rulemaking in the *Pennsylvania Bulletin*.

Regulatory Review

Under section 5(a) of the Regulatory Review Act (71 P.S. § 745.5(a)), on May 15, 2024, the Department submitted a copy of this proposed rulemaking and a copy of a Regulatory Review Form to the Independent Regulatory Commission (IRRC) and to the chairperson of the Committee on Finance of the Senate and the chairperson of the Committee on Finance of the House of Representatives. A copy of this material is available to the public upon request.

Under section 5(g) of the Regulatory Review Act, IRRC may convey comments, recommendations or objections to the proposed rulemaking within 30 days of the close of the public comment period. The comments, recommendations or objections must specify the regulatory review criteria in section 5.2 of the Regulatory Review Act (71 P.S. § 745.5b) which have not been met. The Regulatory Review Act specifies detailed procedures for review prior to final publication of the rulemaking by the Department, the General Assembly and the Governor.

PATRICK BROWNE,
Secretary

STACY GARRITY,
State Treasurer

Fiscal Note: 15-463. No fiscal impact; recommends adoption.

Annex A

TITLE 61. REVENUE

PART I. DEPARTMENT OF REVENUE

Subchapter A. GENERAL PROVISIONS

Chapter 5. **[PAYMENTS BY ELECTRONIC FUNDS TRANSFER]** **PAYMENT METHODS FOR OBLIGATIONS DUE THE COMMONWEALTH**

§ 5.1. **[Purpose]** **[Reserved]**.

§ 5.2. **[Definitions]** **[Reserved]**.

§ 5.3. **[Payments required to be paid by EFT]** **[Reserved]**.

§ 5.4. **[Voluntary participation]** **[Reserved]**.

§ 5.6. **[EFT payments]** **[Reserved]**.

§ 5.7. **[Miscellaneous provisions]** **[Reserved]**.

(*Editor's Note*: Sections 5.11—5.16 are proposed to be added and are printed in regular type to enhance readability.)

Sec.

§ 5.11. Purpose.

Under section 9 of the FC (72 P.S. § 9), this chapter provides the method by which obligations due the Commonwealth shall be remitted to the Department.

§ 5.12. Definitions.

The following words and terms, when used in this chapter, have the following meanings, unless the context clearly indicates otherwise:

EFT—electronic funds transfer—A transfer of funds, other than a transaction originated by check, draft or similar paper instrument, which is initiated through an electronic terminal, telephone, computer or magnetic tape to order, instruct or authorize a financial institution to debit or credit an account. For purposes of this chapter, the term includes only the following types of EFT:

(i) Automated clearing house debit or credit.

(ii) Debit or credit card.

(iii) Fedwire or other wire transfer, but only with prior approval of the Department.

(iv) Other EFT as designated in Department instructions or publications. The term does not include virtual currency.

Fedwire—Fedwire funds service—The funds-transfer system, as described in 12 CFR 210.25—210.32 (relating to funds transfers through the Fedwire funds service), owned and operated by the Federal Reserve Banks.

Financial institution—A bank, savings association, credit union, or any other person that directly or indirectly holds an account belonging to a consumer, or that issues an access device and agrees with a consumer to provide EFT services.

Treasury—The Treasury Department of the Commonwealth.

Virtual currency—A digital representation of value, other than a representation of the United States dollar or a foreign currency, that functions as a unit of account, a store of value and a medium of exchange.

§ 5.13. Payments in general.

(a) *Place.* A person shall remit payment of an obligation due the Commonwealth at the location the Department shall designate in Department instructions or publications.

(b) *Method.* Unless otherwise provided in this chapter, a person may remit payment of an obligation due the Commonwealth to the Department by one of the following methods:

(1) Cash.

(2) Check, draft or similar paper instrument, including personal check, certified check or cashier's check.

(3) EFT.

(c) *Procedures and technical criteria.* The Department will provide procedures and technical criteria for remittance of payments in Department instructions and publications.

§ 5.14. Payments required to be paid by EFT.

(a) *General rule.* Unless otherwise provided for in this section, a payment of $1,000 or more toward an obligation due the Commonwealth must be remitted to the Department using one of the following payment methods:

(1) *EFT.* Failure to comply with Department instructions related to the manner and procedures for the remittance of EFT payments will be deemed to be a failure to remit by EFT.

(2) A certified or cashier's check.

(b) *TRC section 332.1 payments.* The following payments are subject to the electronic payment provisions of section 332.1 of the TRC (72 P.S. § 7332.1) and are not subject to the payment provisions in subsection (a):

(1) Form PA-40 (Personal Income Tax Return) and PA-41 (Fiduciary Income Tax Return) tax liability payments, including estimated payments and payments made with the return.

(2) Form PA-40 NRC (Nonresident Consolidated Income Tax Return) tax liability payments.

(3) Withholding payments required under sections 316.2, 324 and 324.4 of the TRC (72 P.S. §§ 7316.2, 7324 and 7324.4).

(4) Other payments made by individuals under sections 301—361 of the TRC (72 P.S. §§ 7301—7361).

(c) *Inheritance tax payments.* Inheritance tax payments under sections 9101—9196 of the TRC (72 P.S. §§ 9101—9196) are not subject to the payment provisions in subsection (a).

§ 5.15. Date of receipt rules.

(a) The receipt date of a payment of an obligation due the Commonwealth depends upon the method of payment.

(1) For an automated clearing house debit payment, the receipt date is the date the payor authorizes the Department to debit the payor's account.

(2) For an automated clearing house credit or Fedwire payment, the receipt date is the settlement date provided by the payor's originating institution.

(3) For a credit or debit card payment, the receipt date is the date the Department's third-party provider approves the payment.

(4) For payments mailed to the Department, the receipt date is the United States Postal Service postmark date.

(5) For payments delivered in person or by courier, the receipt date is the date the payment is delivered to and accepted by the Department.

(b) The person with the obligation due the Commonwealth bears the burden of remitting the payment by the due date. The person with the obligation due the Commonwealth is accountable for errors committed by the person, the payor or third parties. These errors are not justification for the abatement of interest or penalty.

§ 5.16. Penalty.

A person who fails to remit an obligation due the Commonwealth using the method required under § 5.14(a) (relating to payments required to be paid by EFT) shall be subject to a penalty of 3% of the total amount of each payment remitted, not to exceed $500. The penalty will be imposed upon all payment types including principal tax, interest, penalties, additions and fees, or a combination thereof.

[Pa.B. Doc. No. 24-753. Filed for public inspection May 24, 2024, 9:00 a.m.]

DEPARTMENT OF REVENUE

[61 PA. CODE CH. 153]

Business Income and Nonbusiness Income

The Department of Revenue (Department), under the authority of section 408 of the Tax Reform Code of 1971 (TRC) (72 P.S. § 7408(a)), proposes to amend Chapter 153 (relating to corporate net income tax) by adding § 153.24a (relating to business and nonbusiness income) to read as set forth in Annex A.

Purpose of Proposed Rulemaking

The purpose of this proposed rulemaking is to add § 153.24a regarding business income and nonbusiness income due to legislative changes and the further development of the unitary business principle of the United States Constitution in case law.

Under section 402 of the TRC (72 P.S. § 7402), corporations doing business, carrying on activities, having capital or property employed or used, owning property in this Commonwealth or having substantial nexus in this Commonwealth are subject to and shall pay taxes to the Commonwealth. Corporations subject to tax in this Commonwealth must calculate and pay tax based on the entity's taxable income. See, 72 P.S. §§ 7401—7412. As part of calculating taxable income a multistate corporation must determine the amount of its business income, which is then subjected to a statutory apportionment formula, as well as items of nonbusiness income, if any, which are then subject to allocation. See 72 P.S. § 7401. The statutory apportionment formula attempts to determine the percentage of a corporation's income that is subject to corporate taxation in any given state. Under current Commonwealth law, the statutory apportionment formula for most taxpayers consists of a single sales factor where the numerator of the factor is the taxpayer's total sales in this Commonwealth, and the denominator consists of the taxpayer's total sales everywhere. See 72 P.S. § 7401(3)2.(a)(9)(A)(v) and (15).

Business income, by definition in this Commonwealth, includes all income which is apportionable under the Constitution of the United States. 72 P.S. § 7401(3)2.(a)(1)(A). Nonbusiness income is defined as all income that is not business income. It is subject to allocation whereby specific items of nonbusiness income are allocated in total to one specific state for purposes of corporate taxation rather than being apportioned. 72 P.S. § 7401(3)2.(a)(4)—(8).

The Department is promulgating this proposed rulemaking to affirm that the definition of "business income" includes all income of the taxpayer's unitary business in an effort to clarify when income should be classified as business versus nonbusiness income and minimize future disputes between the Department and taxpayers on these issues. The language of 72 P.S. § 7401(3)2.(a)(1)(A) provides:

> *"Business income"* means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if either the acquisition, the management or the disposition of the property constitutes an integral part of the taxpayer's regular trade or business operations. *The term includes all income which is apportionable under the Constitution of the United States.*

(Emphasis added).

Over a series of cases, the United States Supreme Court has developed criteria to determine which income is apportionable under the Constitution of the United States. See generally, *Allied-Signal v. Director, Division of Taxation*, 504 U.S. 768, 119 L. Ed. 2d. 533 (1992); *Exxon Corporation v. Wisconsin Department of Revenue*, 447 U.S. 207, 65 L.Ed.2d 66 (1980); *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 63 L.Ed.2d 510 (1980). The United States Supreme Court, in its criteria, has focused on the concept of the "unitary business principle."

First, companies are presumed to be unitary, and the burden of proof is upon the taxpayer to prove the existence of nonunitary income. For example, in the matter of *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 63 L.Ed.2d 510 (1980), *Mobil* took the position that the dividends it received from foreign subsidiaries were not apportionable income subject to tax in Vermont. Essentially, it argued that the foreign dividends must be excepted from the application of Vermont's apportionment factor and instead, in effect, be treated as nonbusiness income subject instead to allocation because the foreign dividends lacked sufficient nexus with the company's business activities in Vermont. The United States Supreme Court noted that:

> [T]he linchpin of apportionability in the field of state income taxation is the unitary business principal. In accord with this principal, what appellant must show, in order to establish that its dividend income is not subject to an apportioned tax in Vermont, is that the income was earned in the course of activities unrelated to the sale of petroleum products in that State.

Id. at 439.

The United States Supreme Court ultimately held against *Mobil*, finding that the company did not prove that the foreign operations of its affiliates were distinct in any business or economic sense from its petroleum sales activities in Vermont. Moreover, the United States Supreme Court found that the foreign activities were part of *Mobil*'s integrated business and thus subject to tax by Vermont.

Approximately three months after issuing its decision in *Mobil*, the United States Supreme Court further decreed that a taxpayer cannot avoid apportionment of its unitary business income merely by utilizing separate accounting to report its income in one particular state. *Exxon Corporation v. Wisconsin Department of Revenue*, 447 U.S. 207, 65 L.Ed.2d 66 (1980). In *Exxon*, the taxpayer argued that since it was able to separately account for its Wisconsin income, only that income should have been subjected to tax by the state, and application by Wisconsin of the state's statutory apportionment formula violated the Due Process Clause. The United States Supreme Court disagreed, finding that as discussed in *Mobil* "the linchpin of apportionability" is the unitary business principal. Once the finding of a unitary business is present, then a state may constitutionally apply an apportionment formula to determine the tax due to the state. To avoid subjecting income to apportionment the taxpayer would need to prove that the income in question was from unrelated business activities, which constituted a discrete business enterprise. *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 442, 439.

In 1992, the United States Supreme Court outlined the analysis that states must conduct to determine whether a unitary business exists. See *Allied-Signal v. Director, Division of Taxation*, 504 U.S. 768, 119 L. Ed. 2d. 533 (1992). There the United States Supreme Court reiterated that a review of the three factors of a unitary business identified in *Mobil*—(1) functional integration; (2) centralization of management; and (3) economies of scale—was a necessary analysis that a court must engage in before reaching a determination as to whether income from a business was appropriately subject to apportionment. The opinion noted that the unitary business inquiry "focuses on the objective characteristics of the asset's use and its relation to the taxpayer and its activities within the taxing State." Id. It went on to state that a unitary relationship was not necessarily required for a finding that income was subject to apportionment. Instead, that threshold could be reached where no unitary relationship existed, but it could be shown that the income arose from an operational rather than an investment function.

This differentiation between operational and investment functions, albeit nonbinding, was later held by the United States Supreme Court as being a tool that states could use to determine whether an asset was part of a unitary business. In *MeadWestvaco ex rel. Mead Corp. v. Illinois Dept. of Rev.*, 553 U.S. 16, 19, 26, 128 S. Ct. 1498, 170 L.Ed. 2d 404 (2008), the United States Supreme Court clarified that the commentary in *Allied-Signal* did not announce a new ground for the constitutional apportionment of income. Instead, the conclusion that an asset "served an operational function was merely instrumental to the constitutionally relevant conclusion that the asset was a unitary part of the business being conducted in the taxing State rather than a discrete asset to which the state had no claim." Id. The United States Supreme Court went on to affirm that the "hallmarks" of a unitary relationship were, again, functional integration, centralized management and economies of scale.

These four United States Supreme Court cases provide the framework upon which the Commonwealth must determine what taxpayer income is apportionable under the Constitution of the United States and thus meets the definition of "business income" under the language of section 401 of the TRC (72 P.S. § 7401(3)2.(a)(1)(A)) as opposed to what income, by default, is properly classified as "nonbusiness income" and instead subject to allocation.

This proposed rulemaking will require a unitary business analysis applying current pronouncements of the United States Supreme Court. The Department is promulgating this proposed rulemaking to affirm that the definition of "business income" includes all income of the taxpayer's unitary business in an effort to clarify when income should be classified as business versus nonbusiness income and minimize future disputes between the Department and taxpayers on these issues. Given that all states which impose a corporate income tax apportion income, with these regulations the Department seeks to promote the consistent classification of income as either business income or nonbusiness income among different taxing jurisdictions. Consistency with other states' interpretation of the same or substantially similar language was a goal that the Pennsylvania Supreme Court noted was favored in the determination of the proper interpretation of statutory language. See *Commonwealth of Pennsylvania v. Gilmour Manufacturing Company*, 573 Pa. 143, 822 A.2d 676 (2003). To further promote consistent treatment with other states, the majority of the proposed language for this regulation mirrors the rules of the

Multistate Tax Commission's[1] Model General Allocation and Apportionment Regulations.

The TRC's definitions of "business income" and "nonbusiness income" as originally enacted were based upon the Uniform Division of Income for Tax Purposes Act (UDITPA), Uniform Division of Income for Tax Purposes, U.L.A. Div. Inc. Tax and did not contain the last sentence of the definition referring to the Constitution of the United States. The core theory underlying the UDITPA model statute was the unitary business principle. See Multistate Tax Commission *Synopsis of The Project to Revise UDITPA* at https://www.mtc.gov/getattachment/Uniformity/Project-Teams/Multistate-Tax-Compact-Article-IV/The-Project-to-Revise-UDITPA-(NC-Note).pdf.aspx.

Unfortunately, the application of the original UDITPA definitions of the transactional and functional tests was problematic in multiple states and led to litigation in various states across the country. A comprehensive and critical review of these state court decisions is contained in a special report published in *Tax Analysts State Tax Today* (2001 STT 171-26, September 4, 2001), "The Business-Nonbusiness Income Distinction and the Case for its Abolition," by Professor Walter Hellerstein of the University of Georgia. Rather than leading to uniform taxation in the adopting states, the original UDITPA language led to nonuniformity and division.

To clarify the law regarding the determination of business income in this Commonwealth, the definition in section 401(3) of the TRC of "taxable income" was modified by the act of June 22, 2001 (P.L. 353, No. 23) to adopt the United States constitutional standard for determining business income. Correspondingly, the definition of "nonbusiness income" was modified to make clear that the term did not include income which is apportionable under the Constitution of the United States. While Federal constitutional limits on the authority of the Commonwealth were present before the addition of this language to the definitions of business and nonbusiness income in 2001, the addition of this language directly tied the treatment of income to both the existing language emanating from UDITPA, as modified by the Commonwealth, as well as United States Supreme Court jurisprudence. The General Assembly's enactment of the revised definitions of "business" and "nonbusiness income" has established legislative intent consistent with adopting the unitary business principle as the standard for determining business and nonbusiness income in this Commonwealth.

To the extent they are inconsistent with the unitary business principle, 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. These concepts arose at a time when the Commonwealth's tax law lacked the requisite allocation and apportionment provisions to meet Federal constitutionality. To save the constitutionality of the former statutes, Commonwealth courts developed and applied these principles to limit the application of the tax to appropriate United States constitutional limits. Having its origin in the context of property taxation, the doctrine of multiformity as it existed in the 1930s was expressed in restrictive terms requiring concrete connections between taxing state and the property taxed. See, for example, *Commonwealth v. Columbia Gas and Electric*, 336 Pa. 209 (1939). Claims based upon the historical principles of multiformity or unrelated income within this Commonwealth, which purport to provide extra-statutory remedies, will be evaluated by the Department based on whether the income in question should be treated as falling within the current unitary business principle as determined by the United States Supreme Court. To the extent a company realizes income from a unitary business, the Department will apply an apportionment formula to the company's total income to obtain a reasonable approximation of the income associated with the activities conducted within this Commonwealth. On the other hand, to the extent a company can establish that certain income is nonunitary with its normal business activities then the allocation provisions in the existing statutory guidance as well as these proposed regulations would be implicated.

Some corporations not domiciled within this Commonwealth have cited *Commonwealth v. ACF Industries, Inc.*, 441 Pa. 129; 271 A.2d 273 (1970) for the proposition that the Commonwealth may not tax all of the income of a multistate unitary business. In *ACF*, the taxpayer stipulated it was a unitary business, yet claimed that certain income of its unitary business could not be subject to tax by the Commonwealth pursuant to the multiformity and unrelated assets concepts. However, what was actually before the court in *ACF* was the interpretation of a 1957 amendment to the Corporate Net Income Tax Act of May 16, 1935 (P.L. 208, No. 91). That 1957 amendment was repealed when the TRC enacted a new corporate net income tax which codified the UDITPA concepts of business and nonbusiness for purposes of apportioning the income of a multistate business. Thus, the *ACF* case is inapplicable.

And Commonwealth courts have followed suit with regard to the unitary business principle. The Pennsylvania Supreme Court in *Glatfelter Pulpwood Co. v. Commonwealth*, 619 Pa. 243, 61 A.3d 993 (2013) dismissed a taxpayer's multiformity claim finding that the income at issue was from the taxpayer's unitary business under the UDITPA functional test for business income stating:

> As the High Court has made clear, to calculate the in-state income of a multistate enterprise for taxation purposes, a state is not required to isolate those income-producing activities that physically occur within its borders; rather, a state may tax a fairly apportioned share of the total income of a multi-state enterprise if that enterprise constitutes a "unitary business." *MeadWestvaco ex rel. Mead Corp. v. Illinois Dept. of Rev.*, 553 U.S. 16, 19, 26, 128 S. Ct. 1498, 170 L.Ed. 2d 404 (2008).

Id., 619 Pa. at 268, 61 A.3d at 1008.

As an additional consideration, under section 404 of the TRC (72 P.S. § 7404), corporations owning or controlling other corporations may not file a consolidated report showing combined net income. Taxable income will continue to be determined on a separate company as opposed to on a consolidated basis. While the analysis of the unitary or nonunitary nature of the income is essentially

[1] As described on its web site: "The Multistate Tax Commission is an intergovernmental state tax agency working on behalf of states and taxpayers to facilitate the equitable and efficient administration of state tax laws that apply to multistate and multinational enterprises. Created by the Multistate Tax Compact, the Commission is charged by this law with:

- Facilitating the proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes;
- Promoting uniformity or compatibility in significant components of tax systems;
- Facilitating taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration;
- Avoiding duplicative taxation.

The commission was created in 1967 as an effort by states to protect their tax authority in the face of previous proposals to transfer the writing of key features of state tax laws from the state legislature. For that reason, the Commission has been a voice for preserving the authority of states to determine their own tax policy within the limits of the U.S. Constitution."

the same between separate company and consolidated filing jurisdictions, the approach to performing the analysis in a consolidated filing jurisdiction necessarily involves examining not only activities within each corporate entity, but also the activities between the entities potentially included in the corporate filing group. This proposed rulemaking will promote the Commonwealth's uniform interpretation of the unitary business concept with other states. Moreover, the proposed regulations are intended to provide additional guidance to taxpayers and incorporate the analysis offered by the United States Supreme Court on the apportionment or allocation of income.

Description of Proposed Amendments

The following paragraphs provide a brief description for each specific section of this proposed rulemaking:

The Department proposes to add § 153.24a. Section 153.24a explains the approach to determining whether corporate income is treated as business income which is subject to apportionment based on the company's sales factor or is nonbusiness income and is allocated to one state. In essence, if income is classified as business income, then the taxpayer determines a fraction where the numerator is its sales sourced to this Commonwealth and the denominator is its sales everywhere. 72 P.S. § 7401(3)2.(a)(15). The taxpayer then multiplies that fraction by the business income and subjects the result to the applicable tax rate. If the income is determined to be nonbusiness income, the income is just taxed by one state and no sales factor is calculated. For nonbusiness income, the Commonwealth either taxes 100% of the income or none of it.

There is a need for additional guidance in this area as it impacts all corporate taxpayers which have operations both inside and outside of this Commonwealth. In preparing annual tax returns, these taxpayers must determine if income falls within the broad definition of business income and is subject to tax in this Commonwealth or whether the income falls outside of the definition of business income and for the Commonwealth's purposes should only be taxed by one state.

Proposed subsection (a), regarding apportionment and allocation, establishes the statutory references in this Commonwealth regarding the classification of income as being either business income or nonbusiness income. Subsection (a) further clarifies that income is business income if it meets the definition of business income and nonbusiness income if it does not meet the definition of business income. This is important because all income of a multistate taxpayer falls into one of these two categories and once categorized, it triggers different tax calculations for that company.

Proposed subsection (b), regarding the transactional test, describes the transactional test for determining business or nonbusiness income and discusses its application to taxpayers. This subsection identifies that if a transaction or activity is in the regular course of a taxpayer's trade or business it is treated as business income whether it occurs on a regular or irregular basis. It also makes clear that whether a transaction or activity takes place inside or outside of this Commonwealth is not determinative of whether the income generated by it constitutes business or nonbusiness income. This subsection is important as the transactional test is one of the principal tests used to determine whether an item of income is business income for Pennsylvania's purposes and is consequently subject to apportionment or will be treated as nonbusiness income by the Commonwealth and be subject to allocation.

Proposed subsection (c), regarding the functional test, describes a second test relating to property, the functional test, that is used in determining whether income is business or nonbusiness income and discusses its application to taxpayers. The subsection paraphrases the applicable statutory language from section 401 of the TRC by describing business income as including income from tangible and intangible property if either the acquisition, management or disposition of the property constitutes an integral part of the taxpayer's trade or business. It goes on to provide additional descriptions of the types of property covered by the test, the meaning of the language "acquisition, management or disposition" and provides a test for how long property must be removed from use in a taxpayer's business activities before the Department will consider income related to it changing from business to nonbusiness. To aid taxpayers with making this determination the subsection contains four examples highlighting specific scenarios involving the use of property by businesses and whether income arising from that property constitutes business or nonbusiness income under the functional test.

Proposed subsection (c) also addresses an issue historically raised by taxpayers regarding whether there is a "liquidation" exception to the functional test by clarifying that even if transactions are infrequent, if the property involved was used in the operation of the business while owned by the taxpayer, its sale results in business income. This subsection also clarifies that the determination of business versus nonbusiness income is not impacted by whether the activity or property involved is located inside or outside this Commonwealth. Examples are also provided which provide further guidance on these points.

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 these deductions against business income in earlier periods will not create a presumption for or against business or nonbusiness income treatment in future periods. Finally, this subsection makes clear that the functional test applies equally to all types of property whether they be tangible or intangible, real or personal.

Proposed subsection (d), regarding the unitary business principle, outlines the unitary business concept as the foundation for the apportionment of income from a multistate business. Specifically, the unitary business concept, which is further described in proposed subsection (e) regarding principles for determining the existence of a unitary business, requires apportionable income to be derived from the same unitary business that is conducted, at least in part, in this Commonwealth. If income meets the previously discussed transactional and functional tests it is also going to be unitary income, but even if it does not meet either of these tests, it may still constitute unitary business income of the taxpayer and be subjected to apportionment by the Commonwealth under the United States Constitution. This concept that the test for business versus nonbusiness income is broader than just the transactional and functional tests is very important for taxpayers to understand and consider as they attempt to determine the classification of their income. It has also been an area of dispute between the Department and taxpayers in the past and this subsection provides important guidance to taxpayers in this regard.

Proposed subsection (e) describes what a unitary business is and why it is important to determine whether a business is unitary or not and provides significant guidance based on established United States Supreme Court precedence as to what characterizes a unitary business. Those tests as set forth by the United States Supreme Court focus on functional integration, centralization of management and economies of scale. This subsection describes each of these three characteristics in detail. It also provides higher level guidance to taxpayers concerning the general indicators of a unitary business and provides specific tests as to what constitutes a commonly controlled group for purposes of determining whether a unitary relationship exists. Even though the Commonwealth taxes each separate corporation, rather than an entire affiliated group of corporations, it is still essential to include guidance on commonly controlled groups in this proposed rulemaking. Frequently, taxpayers subject to the Commonwealth's corporate income taxation are members of an affiliated group of corporations that file one or more consolidated Federal income tax returns, including multiple entities in each, as well as owning direct or indirect interests, or both, in foreign entities, which while engaged in the same business as the Commonwealth taxpayer, may not be part of the same Federal consolidated return or returns. These other entities may transact significant business with their affiliate that files in this Commonwealth and understanding 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 subsection (f), regarding examples of business and nonbusiness income, provides additional examples of business and nonbusiness income to aid taxpayers in making determinations of the classification of items of income. The examples address rents received from real or tangible property, gains or losses from the sale of assets, interest and royalties.

Proposed subsection (g), regarding consistency and uniformity in reporting, requires taxpayers to notify the Department if the classification of an item previously reported to the Commonwealth as either business or nonbusiness income changes on a current return. Additionally, to the extent the taxpayer is not uniform across all jurisdictions in which it files as to whether an item of income is apportionable or non-apportionable income under the United States Constitution, the report filed with the Commonwealth must disclose the variances and the rationale for them. These requirements aid the Department in evaluating the determinations reached by taxpayers regarding the classification of income as business or nonbusiness. It also promotes uniformity in the interpretation of similar state laws across the country, which is a goal that the Commonwealth's courts have previously recognized.

Proposed subsection (h), regarding definitions, includes the following definitions of key terms that are used in this proposed rulemaking for clarity and consistency: "allocation," "apportionment," "business activity," "business income," "nonbusiness income" and "trade or business."

Affected Parties

Corporate taxpayers and tax practitioners within this Commonwealth will be affected by this proposed rulemaking in a positive way as it will promote uniform tax compliance.

Fiscal Impact

This proposed rulemaking will have no fiscal impact on the Commonwealth as it is a clarification of Commonwealth law.

Paperwork Requirements

This proposed rulemaking will not generate substantial paperwork for the public or the Commonwealth.

Effective Date

This proposed rulemaking will become effective upon publication of the final-form rulemaking in the *Pennsylvania Bulletin*.

Sunset Date

This proposed rulemaking is scheduled for review within 5 years of final-form publication. A sunset date has not been assigned.

Public Comments and Contact Person

Interested persons are invited to submit in writing any comments, suggestions or objections regarding this proposed rulemaking to Maria L. Miller, Office of Chief Counsel, Department of Revenue, P.O. Box 281061, Harrisburg, PA 17128-1061, within 30 days after the date of the publication of this proposed rulemaking in the *Pennsylvania Bulletin*.

Regulatory Review

Under section 5(a) of the Regulatory Review Act (71 P.S. § 745.5(a)), on May 15, 2024, the Department submitted a copy of this proposed rulemaking and a copy of a Regulatory Review Form to the Independent Regulatory Review Commission (IRRC) and to the chairperson of the Committee on Finance of the Senate and the chairperson of the Committee on Finance of the House of Representatives. A copy of this material is available to the public upon request.

Under section 5(g) of the Regulatory Review Act, IRRC may convey comments, recommendations or objections to the proposed rulemaking within 30 days of the close of the public comment period. The comments, recommendations or objections must specify the regulatory review criteria in section 5.2 of the Regulatory Review Act (71 P.S. § 745.5b) which have not been met. The Regulatory Review Act specifies detailed procedures for review prior to final publication of the rulemaking by the Department, the General Assembly and the Governor.

PATRICK BROWNE,
Secretary

Fiscal Note: 15-462. No fiscal impact; recommends adoption.

Annex A

TITLE 61. REVENUE

PART I. DEPARTMENT OF REVENUE

Subpart B. GENERAL FUND REVENUES

ARTICLE VI. CORPORATION TAXES

CHAPTER 153. CORPORATE NET INCOME TAX ALLOCATIONS AND APPORTIONMENTS

(*Editor's Note*: Section 153.24a is proposed to be added and is printed in regular type to enhance readability.)

§ 153.24a. Business and nonbusiness income.

(a) *Apportionment and allocation.* Article IV of the TRC requires that every item of income be classified either as business income or nonbusiness income. For purposes of this classification, income includes gains and losses. Business income is apportioned among jurisdictions by use of a formula. Nonbusiness income is specifically allocated to one or more specific jurisdictions in accordance with express rules. The following apply:

(1) An item of income is classified as business income if it falls within the definition of business income in subsection (h).

(2) An item of income is nonbusiness income only if it does not meet the definitional requirements in subsection (h) for being classified as business income.

(b) *Transactional test.* Business income includes income arising from transactions and activity in the regular course of the taxpayer's trade or business. The following apply:

(1) If the transaction or activity is in the regular course of the taxpayer's trade or business, the income arising from the transaction or activity is business income. If the income arose from the unitary business of the taxpayer, income is business income even though the actual transaction or activity that gives rise to the income does not occur in this Commonwealth.

(2) For a transaction or activity to be in the regular course of the taxpayer's trade or business, the transaction or activity need not be one that frequently occurs in the trade or business. It is sufficient to classify a transaction or activity as being in the regular course of a trade or business, if it is reasonable to conclude transactions of that type are customary in the kind of trade or business being conducted or are within the scope of what that kind of trade or business does. The transactional test includes income from sales of inventory, property held for sale to customers and services which are commonly sold by the trade or business. The transactional test also includes income from the sale of property used in the production of business income of a kind that is sold and replaced with some regularity, even if replaced less frequently than once a year.

(c) *Functional test.* Business income also includes income from tangible and intangible property if either the acquisition, management or disposition of the property constitutes an integral part of the taxpayer's regular trade or business. Income arising from property, which was depreciated, amortized, expensed or for which management costs were expensed in computing taxable income while owned by the taxpayer is business income under the functional test. The following apply:

(1) Property includes any direct or indirect interest in, control over, or use of real property, tangible personal property and intangible property by the taxpayer. Property that constitutes an integral part of the trade or business refers to property that is or was used to contribute to the production of business income directly or indirectly, without regard to the materiality of the contribution. Property that is held solely for investment purposes does not constitute an integral part of the trade or business.

(2) Acquisition, management or disposition refers to a taxpayer's activities in acquiring property, exercising control and dominion over property and disposing of property, including dispositions by sale, lease or license. Income arising from the liquidation, disposition or other use of property which was acquired or developed in the course of the taxpayer's trade or business constitutes business income even if the property was not directly employed in the operation of the taxpayer's trade or business.

(3) Income from the disposition or other use of property which has been withdrawn from use in the taxpayer's trade or business and is instead held solely for unrelated investment purposes is nonbusiness income. Property that was used in the taxpayer's trade or business is not considered converted to investment purposes merely because it is offered for sale, but any property which has been withdrawn from use in the taxpayer's trade or business for 5 years or more is presumed to be held for investment purposes.

(4) The classification of income by the labels occasionally used, such as manufacturing income, compensation for services, sales income, interest, rents, royalties, gains, income derived from accounts receivable, operating income, non-operating income, and the like, is of no aid in determining whether income is business or nonbusiness income.

Example 1: The taxpayer purchases a chain of 100 retail stores for the purpose of merging those store operations with its existing business. Five of the retail stores are redundant under the taxpayer's business plan and are sold 6 months after acquisition. Even though the five stores were never integrated into the taxpayer's trade or business, the income is business income because the property's acquisition was related to the taxpayer's trade or business.

Example 2: The taxpayer is in the business of developing adhesives for industrial and construction uses. In the course of its business, it accidentally creates a weak but non-toxic adhesive and patents the formula, awaiting future applications. Another manufacturer uses the formula to create temporary body tattoos. The taxpayer wins a patent infringement suit against the other manufacturer. The entire damages award, including interest and punitive damages, constitutes business income.

Example 3: The taxpayer is engaged in the oil refining business and maintains a cash reserve for buying and selling oil on the spot market as conditions warrant. The reserve is held in overnight "repurchase agreement" accounts of United States treasuries with a local bank. The interest on those amounts is business income because the reserves are necessary for the taxpayer's business operations. Over time, the cash in the reserve account grows to the point that it exceeds any reasonably expected requirement for acquisition of oil or other short-term capital needs and is held pending subsequent investment opportunities unrelated to the taxpayer's business operations. The interest received on the excess amount is nonbusiness income.

Example 4: A manufacturer decides to sell one of its redundant factories to a real estate developer and transfers the ownership of the factory to a special purpose subsidiary, SaleCo (Taxpayer) immediately prior to its sale to the real estate developer. The parties elect to treat the sale as a disposition of assets under section 338(h)(10) of the IRC (26 U.S.C. § 338(h)(10)), resulting in Taxpayer recognizing a capital gain on the sale. The capital gain is business income.

(i) Under the functional test, income from the liquidation, disposition or other utilization of property is business income if the property is or was an integral part of the taxpayer's trade or business. The income is business income even though the transaction or activity from which it is derived did not occur in the regular course of the taxpayer's trade or business.

(ii) Income that is derived from isolated sales, leases, assignments, licenses, and other infrequently occurring dispositions, transfers or transactions involving property, including transactions made in the full or partial liquidation or the winding-up of any portion of the trade or business, is business income, if the property is or was related to the taxpayer's trade or business. Income from the licensing of an intangible asset, such as a patent, copyright, trademark, service mark, know-how, trade secrets, or the like, that was developed or acquired for use by the taxpayer in its trade or business, constitutes business income whether or not the licensing itself constituted the operation of a trade or business, and whether or not the taxpayer remains in the same trade or business from or for which the intangible asset was developed or acquired.

(iii) Under the functional test, income from intangible property is business income when the intangible property serves an operational function as opposed to solely an investment function.

(iv) If either the acquisition, management or disposition of the property is or was an integral part of the taxpayer's trade or business, then income from that property is business income even though the actual transaction or activity involving the property that gives rise to the income does not occur in this Commonwealth.

Example 1: A manufacturer purchases raw materials to be incorporated into the product it offers for sale. The nature of the raw materials is such that the purchase price is subject to extreme price volatility. To protect itself from extreme price increases or decreases, the manufacturer enters into future contracts pursuant to which the manufacturer can either purchase a set amount of the raw materials for a fixed price, within a specified time period, or resell the future contracts. Any gain on the sale of the future contracts would be considered business income, regardless of whether the contracts were either made or resold in this Commonwealth.

Example 2: A National retailer produces substantial revenue in its business activities. It invests a large portion of the revenue in fixed income securities which are divided into two categories: (a) short-term securities held pending use of the funds in the taxpayer's trade or business; and (b) long-term securities held solely as an investment. Interest income on the short-term securities held pending use of the funds in the taxpayer's trade or business (a) is business income because the funds represent working capital necessary to the operations of the taxpayer's trade or business. Interest income derived from the long-term investment securities (b) is nonbusiness income as those securities were held solely as an investment and not in furtherance of the taxpayer's trade or business.

(5) If with respect to an item of property a taxpayer takes a deduction from income that is apportioned to this Commonwealth including depreciation, amortization, expensing or for which management costs were expensed in computing taxable income while owned by the taxpayer, it is presumed that the item or property is or was an integral part of the taxpayer's trade or business. No presumption arises from the absence of any of these actions.

(6) Application of the functional test is unaffected by the form of the property, tangible or intangible property, real or personal property. Income arising from an intangible interest, for example, corporate stock or other intangible interest in an entity or a group of assets, is business income when the intangible itself or the property underlying or associated with the intangible is or was an integral part of the taxpayer's trade or business. While apportionment of income derived from transactions involving intangible property may be supported by a finding that the issuer of the intangible property and the taxpayer are engaged in the same trade or business, the establishment of a relationship is not the exclusive basis for concluding that the income is subject to apportionment. It is sufficient to support the finding of business income if the holding of the intangible interest served an operational rather than an investment function.

(d) *Unitary business principle.* The Due Process Clause and the Commerce Clause of the Constitution of the United States restrict states from apportioning income that has no rational relationship with the taxing state. The protection against extra-territorial state taxation afforded by these clauses is often described as the "unitary business principle." The unitary business principle requires apportionable income to be derived from the same unitary business that is being conducted at least in part in this Commonwealth. 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. 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. Items of income that do not satisfy the transactional or functional tests for business income may still be classified as business income if the income is apportionable business income under the unitary business principle. The application of the unitary business principle to this income assures that income over which the Commonwealth has Constitutional authority to tax does not escape taxation. 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.

(e) *Principles for determining the existence of a unitary business.*

(1) *Unitary business principle.*

(i) *The concept of a unitary business.* A unitary business is a single economic enterprise that is made up either of separate parts of a single entity or of a commonly controlled group of entities that are sufficiently interdependent, integrated and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts. This flow of value to an entity located in this Commonwealth that comes from being part of a unitary business conducted both within and without this Commonwealth is what provides the constitutional due process definite link and minimum connection necessary for this Commonwealth to apportion income of the unitary business, even if that income arises in part from activities conducted outside the Commonwealth. The income of the unitary business is then apportioned to this Commonwealth. This sharing or exchange of value may also be described as requiring that the operation of one part of the business be dependent upon, or contribute to, the operation of another part of the business. Phrased in the disjunctive, the foregoing means that if the activities of one business either contributes to the activities of another business or are dependent upon the activities of another business, those businesses are part of a unitary business.

(ii) *Constitutional requirement for a unitary business.* The sharing or exchange of value described in subparagraph (i) that defines the scope of a unitary business requires more than the mere flow of funds arising out of a passive investment or from the financial strength contributed by a distinct business undertaking that has no operational relationship to the unitary business. The unitary business principle shall be applied to the fullest extent allowed by the Constitution of the United States. The unitary business principle shall not be applied to result in the combination of business activities or entities under circumstances where, if it were adverse to the taxpayer, the combination of these activities or entities would not be allowed by the Constitution of the United States.

(iii) *Separate trades or businesses conducted within a single entity.* A single entity may have more than one unitary business. In these cases it is necessary to determine the business income attributable to each separate unitary business as well as its nonbusiness income, which is specifically allocated. The business income of each unitary business is then apportioned by a statutory formula that takes into consideration the in-State and the out-of-State factors that relate to the respective unitary business whose income is being apportioned.

(iv) *Unitary business unaffected by formal business organization.* A unitary business may exist within a single entity or among a commonly controlled group of entities. The scope of what is included in a commonly controlled group of entities is set forth in paragraph (4).

(2) *Determination of a unitary business.*

(i) A unitary business is characterized by significant flows of value evidenced by factors such as those described in *Mobil Oil Corp. v. Vermont*, 445 U.S. 425 (1980): functional integration, centralization of management and economies of scale. These factors provide evidence of whether the business activities operate as an integrated whole or exhibit substantial mutual interdependence. Facts suggesting the presence of the previously mentioned factors should be analyzed in combination for their cumulative effect and not in isolation. A particular business operation may be suggestive of one or more of the previously mentioned factors.

(ii) *Description and illustration of functional integration, centralization of management and economies of scale.*

(A) *Functional integration.* Functional integration refers to transfers between, or pooling among, business activities that significantly affect the operation of the business activities. Functional integration includes, but is not limited to, transfers or pooling with respect to the unitary business's products or services, technical information, marketing information, distribution systems, purchasing and intangibles such as patents, trademarks, service marks, copyrights, trade secrets, know-how, formulas and processes. There is no specific type of functional integration that must be present. The following is a list of examples of business operations that can support the finding of functional integration. The order of the list does not establish a hierarchy of importance.

(I) *Sales.* Sales, exchanges or transfers, collectively "sales" of products, services and intangibles between business activities provide evidence of functional integration. The significance of the intercompany sales to the finding of functional integration will be affected by the character of what is sold, and the percentage of total sales or purchases represented by the intercompany sales. For example, sales among entities that are part of a vertically integrated unitary business are indicative of functional integration. Functional integration is not negated by the use of a readily determinable market price to effect the intercompany sales, because these sales can represent an assured market for the seller or an assured source of supply for the purchaser.

(II) *Common marketing.* The sharing of common marketing features among entities is an indication of functional integration when the marketing results in significant mutual advantage. Common marketing exists when a substantial portion of the entities' products, services or intangibles are distributed or sold to a common customer, when the entities use a common trade name or other common identification or when the entities seek to identify themselves to their customers as a member of the same enterprise. The use of a common advertising agency or a commonly owned or controlled in-house advertising office does not by itself establish common marketing that is suggestive of functional integration. However, the activity is relevant to determining the existence of economies of scale and centralization of management.

(III) *Transfer or pooling of technical information or intellectual property.* Transfers or pooling of technical information or intellectual property, such as patents, copyrights, trademarks and service marks, trade secrets, processes or formulas, know-how, research or development, provide evidence of functional integration when the matter transferred is significant to the businesses' operations.

(IV) *Common distribution system.* Use of a common distribution system by the entities, under which inventory control and accounting, storage, trafficking and transportation are controlled through a common network provides evidence of functional integration.

(V) *Common purchasing.* Common purchasing of substantial quantities of products, services or intangibles from the same source by the entities, particularly where the purchasing results in significant cost savings or where the products, services or intangibles are not readily available from other sources and are significant to each entity's operations or sales, provides evidence of functional integration.

(VI) *Common or intercompany financing.* Significant common or intercompany financing, including the guarantee by, or the pledging of the credit of, one or more entities for the benefit of another entity or entities provides evidence of functional integration if the financing activity serves an operational purpose of both borrower and lender. Lending which serves an investment purpose of the lender does not necessarily provide evidence of functional integration.

(B) *Centralization of management.* Centralization of management exists when directors, officers or other management employees jointly participate in the management decisions that affect the respective business activities and that may also operate to the benefit of the entire economic enterprise. Centralization of management can exist whether the centralization is effected from a parent entity to a subsidiary entity, from a subsidiary entity to a parent entity, from one subsidiary entity to another, from one division within a single entity to another division within an entity, or from any combination of the foregoing. Centralization of management may exist even when day-to-day management responsibility and accountability has been decentralized, so long as the management has an ongoing operational role with respect to the business activities. An operational role can be effected through mandates, consensus building, or an overall operational strategy of the business, or any other mechanism that establishes joint management.

(I) *Facts providing evidence of centralization of management.* Evidence of centralization of management is provided when common officers participate in the decisions relating to the business operations of the different segments. Centralization of management may exist when management shares or applies knowledge and expertise among the parts of the business. The existence of common officers and directors, while relevant to a showing of centralization of management, does not alone provide evidence of centralization of management. Common officers are more likely to provide evidence of centralization of management than are common directors.

(II) *Stewardship distinguished.* Centralized efforts to fulfill stewardship oversight are not evidence of centralization of management. Stewardship oversight consists of those activities that any owner would take to review the performance of or safeguard an investment. Stewardship oversight is distinguished from those activities that an owner may take to enhance value by integrating one or more significant operating aspects of one business activity with the other business activities of the owner. For example, implementing reporting requirements or mere approval of capital expenditures may evidence only stewardship oversight.

(C) *Economies of scale.* Economies of scale refer to a relation among and between business activities resulting in a significant decrease in the average per unit cost of operational or administrative functions due to the increase in operational size. Economies of scale may exist from the inherent cost savings that arise from the presence of functional integration or centralization of management. The following are examples of business operations that can support the finding of economies of scale. The order of the list does not establish a hierarchy of importance.

(I) *Centralized purchasing.* Centralized purchasing designed to achieve savings due to the volume of purchases, the timing of purchases or the interchangeability of purchased items among the parts of the business engaging in the purchasing provides evidence of economies of scale.

(II) *Centralized administrative functions.* The performance of traditional corporate administrative functions, such as legal services, payroll services, pension and other employee benefit administration, in common among the parts of the business may result in some degree of economies of scale. An entity that secures savings in the performance of corporate administrative services due to its affiliation with other entities that it would not otherwise reasonably be able to secure on its own because of its size, financial resources or available market, provides evidence of economies of scale.

(3) *Indicators of a unitary business.*

(i) *Same type of business.* Business activities that are in the same general line of business generally constitute a single unitary business as, for example, a multistate grocery chain.

(ii) *Steps in a vertical process.* Business activities that are part of different steps in a vertically structured business almost always constitute a single unitary business. For example, a business engaged in the exploration, development, extraction and processing of a natural resource and the subsequent sale of a product based upon the extracted natural resource is engaged in a single unitary business, regardless of the fact that the various steps in the process are operated substantially independently of each other with only general supervision from the business's executive offices.

(iii) *Strong centralized management.* Business activities which might otherwise be considered as part of more than one unitary business may constitute one unitary business when there is a strong central management, coupled with the existence of centralized departments for functions such as financing, advertising, research or purchasing. Strong centralized management exists when a central manager or group of managers makes substantially all of the operational decisions of the business. For example, some businesses conducting diverse lines of business may properly be considered as engaged in only one unitary business when the central executive officers are actively involved in the operations of the various business activities and there are centralized offices that perform for the business activities, the normal matters that a truly independent business would perform for itself, such as personnel, purchasing, advertising or financing.

(4) *Commonly controlled group of entities.*

(i) Separate corporations can be part of a unitary business only if they are members of a commonly controlled group.

(ii) "Commonly controlled group" means any of the following:

(A) A parent corporation and any one or more corporations or chains of corporations, connected through stock ownership or constructive ownership with the parent, but only if one of the following apply:

(I) The parent owns stock possessing more than 50% of the voting power of at least one corporation.

(II) Stock cumulatively possessing more than 50% of the voting power of each of the corporations, except the parent, is owned by the parent, one or more corporations described in clause (A), or one or more other corporations that satisfy the conditions of this subclause.

(B) Two or more corporations, if stock possessing more than 50% of the voting power of the corporations is owned, or constructively owned, by the same person.

(C) Two or more corporations that constitute stapled entities. The following apply:

(I) For purposes of this clause, stapled entities means any group of two or more corporations, if more than 50% of the ownership or beneficial ownership of the stock possessing voting power in each corporation consists of stapled interests.

(II) Two or more interests are stapled interests if, by reason of form of ownership, restrictions on transfer or other terms or conditions in connection with the transfer of one of the interests, the other interest or interests are also transferred or required to be transferred.

(D) Two or more corporations, if stock possessing more than 50% of the voting power of the corporations is cumulatively owned without regard to the constructive ownership rules of clause (A) by, or for the benefit of, members of the same family. Members of the same family are limited to an individual, his or her spouse, parents, brothers or sisters, grandparents, children and grandchildren and their respective spouses.

(iii) *Commonly controlled group.*

(A) If, in the application of subparagraph (ii), a corporation is a member of more than one commonly controlled group of corporations, the corporation shall elect to be treated as a member of only the commonly controlled group or part thereof with respect to which it has a unitary business relationship. If the corporation has a unitary business relationship with more than one of those groups, it shall elect to be treated as a member of only one of the commonly controlled groups with respect to which it has a unitary business relationship. This election shall remain in effect until the unitary business relationship between the corporation and the rest of the members of its elected commonly controlled group is discontinued or unless revoked with the approval of the Department.

(B) Membership in a commonly controlled group shall be treated as terminated in any year, or fraction thereof, in which the conditions of subparagraph (ii) are not met, except as follows:

(I) When stock of a corporation is sold, exchanged or otherwise disposed of, the membership of a corporation in a commonly controlled group shall not be terminated if the requirements of subparagraph (ii) are again met immediately after the sale, exchange or disposition.

(II) The Department may treat the commonly controlled group as remaining in place if the conditions of subparagraph (ii) are again met within a period not to exceed 2 years.

(iv) A taxpayer may exclude some or all corporations included in a commonly controlled group by reason of subparagraph (ii)(D) by showing that those members of the group are not controlled directly or indirectly by the same interests, within the meaning of the same phrase in section 482 of the IRC (26 U.S.C. § 482). For purposes of this subparagraph, the term "controlled" includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised.

(v) Except as otherwise provided, stock is owned when title to the stock is directly held or if the stock is constructively owned.

(A) An individual constructively owns stock that is owned by any of the following:

(I) His or her spouse.

(II) Children, including adopted children of that individual or the individual's spouse who have not attained the age of 21 years.

(III) An estate or trust, of which the individual is an executor, trustee or grantor, to the extent that the estate or trust is for the benefit of that individual's spouse or children.

(B) Stock owned by a corporation, or a member of a controlled group of which the corporation is the parent corporation, is constructively owned by any shareholder owning stock that represents more than 50% of the voting power of the corporation.

(C) In the application of subparagraph (ii)(D) dealing with stock possessing voting power held by members of the same family, if more than 50% of the stock possessing voting power of a corporation is, in the aggregate, owned by or for the benefit of members of the same family, stock owned by that corporation shall be treated as constructively owned by members of that family in the same ratio as the proportion of their respective ownership of stock possessing voting power in that corporation to all of the stock of that corporation.

(D) Except as otherwise provided, stock owned by a partnership is constructively owned by any partner, other than a limited partner, in proportion to the partner's capital interest in the partnership. For this purpose, a partnership is treated as owning proportionately the stock owned by any other partnership in which it has a tiered interest, other than as a limited partner.

(E) In any case where a member of a commonly controlled group, or shareholders, officers, directors or employees of a member of a commonly controlled group is a general partner in a limited partnership, stock held by the limited partnership is constructively owned by a limited partner to the extent of its capital interest in the limited partnership.

(F) In the application of subparagraph (ii)(D) dealing with stock possessing voting power held by members of the same family, stock held by a limited partnership is constructively owned by a limited partner to the extent of the limited partner's capital interest in the limited partnership.

(vi) For purposes of the definition of "commonly controlled group," each of the following shall apply:

(A) "Corporation" means any entity defined as a corporation, as defined in section 401(1) of the TRC (72 P.S. § 401(1)).

(B) "Person" means an individual, a trust, an estate, a qualified employee benefit plan, a limited partnership or a corporation.

(C) "Voting power" means the power of all classes of stock entitled to vote that possess the power to elect the membership of the board of directors of the corporation.

(D) "More than 50% of the voting power" means voting power sufficient to elect a majority of the membership of the board of directors of the corporation.

(E) Stock possessing voting power includes stock where ownership is retained but the actual voting power is transferred in either of the following manners:

(I) For 1 year or less.

(II) By proxy, voting trust, written shareholder agreement or by similar device, where the transfer is revocable by the transferor.

(F) In the case of an entity treated as a corporation under clause (A), "stock possessing voting power" refers to an instrument, contract or similar document demonstrating an ownership interest in that entity that confers power in the owner to cast a vote in the selection of the management of that entity.

(G) In the general application of paragraph 4, if an entity may elect to be treated as a partnership or as a corporation under the laws of this Commonwealth or under section 7701 of the IRC (26 U.S.C. § 7701) and elects to be treated as a partnership, that entity shall be treated as a general partnership. If, however; contractual agreements, member agreements, or other restrictions limit the power of some or all of the members to participate in the vote of stock possessing voting power owned by that entity, similar to the restrictions of limited partners in a limited partnership, the Department may permit or require that entity to be treated as a limited partnership.

(f) *Examples of business income and nonbusiness income.* The examples used in these regulations are illustrative only and are limited to the facts they contain.

(1) *Rents from real and tangible personal property.*

Example 1: The taxpayer operates a multistate car rental business. The income from car rentals is business income.

Example 2: The taxpayer is engaged in the heavy construction business in which it uses equipment such as cranes, tractors, and earth-moving vehicles. The taxpayer makes short-term leases of the equipment when particular pieces of equipment are not needed on any particular project. The rental income is business income.

Example 3: The taxpayer operates a multistate chain of men's clothing stores. The taxpayer purchases a five-story office building for use in connection with its trade or business and uses the street floor as one of its retail stores and the second and third floors for its general corporate headquarters. The remaining two floors are held for future use in the trade or business and are leased to tenants on a short-term basis in the meantime. The rental income is business income.

Example 4: The taxpayer operates a multistate chain of grocery stores. The taxpayer purchases as an investment an office building in another state with surplus funds and leases the entire building to others. The net rental income is nonbusiness income of the grocery store trade or business. Therefore, the net rental income is nonbusiness income.

Example 5: The taxpayer operates a multistate chain of men's clothing stores. The taxpayer invests in a 20-story office building and uses the street floor as one of its retail stores and the second floor for its general corporate headquarters. The remaining 18 floors are leased to others. The rental of the 18 floors is not done in furtherance of but rather is separate from the operation of the taxpayer's trade or business. The net rental income is nonbusiness income of the clothing store trade or business. Therefore, the net rental income is nonbusiness income.

Example 6: The taxpayer constructed a plant for use in its multistate manufacturing business and 20 years later the plant was closed and offered for sale. The plant was rented for a temporary period from the time it was closed by the taxpayer until it was sold 18 months later. The rental income is business income and the gain on the sale of the plant is business income.

(2) Gains or losses from sales of assets.

Example 1: In conducting its multistate manufacturing business, the taxpayer systematically replaces automobiles, machines and other equipment used in the trade or business. The gains or losses resulting from those sales constitute business income.

Example 2: The taxpayer constructed a plant for use in its multistate manufacturing business and 20 years later sold the property at a gain while it was in operation by the taxpayer. The gain is business income.

Example 3: Same as "Example 2" except that the plant was closed and offered for sale but was not in fact sold until a buyer was found 18 months later. The gain is business income.

Example 4: Same as "Example 2" except that the plant was rented while being held for sale. The rental income is business income and the gain on the sale of the plant is business income.

(3) *Interest.*

Example 1: The taxpayer operates a multistate chain of department stores, selling for cash and on credit. Service charges, interest or time-price differentials and the like are received with respect to installment sales and revolving charge accounts. These amounts are business income.

Example 2: The taxpayer conducts a multistate manufacturing business. During the tax year, the taxpayer receives a Federal income tax refund pertaining to the taxpayer's trade or business and collects a judgment against a debtor of the business. Both the tax refund and the judgment bear interest. The interest income is business income.

Example 3: The taxpayer is engaged in a multistate manufacturing and wholesaling business. In connection with that business, the taxpayer maintains special accounts to cover such items as workmen's compensation claims, rain and storm damage, machinery replacement, and the like. The funds in those accounts earn interest. Similarly, the taxpayer temporarily invests funds intended for payment of Federal, State and local tax obligations pertaining to the taxpayer's trade or business. The interest income is business income.

Example 4: The taxpayer is engaged in a multistate money order and traveler's check business. In addition to the fees received in connection with the sale of the money orders and traveler's checks, the taxpayer earns interest income by the investment of the funds pending their redemption. The interest income is business income.

Example 5: The taxpayer is engaged in a multistate manufacturing and sales business. The taxpayer usually has working capital and extra cash totaling $200,000 which it regularly invests in short-term interest-bearing securities. The interest income is business income.

(4) *Patent and copyright royalties.*

Example 1: The taxpayer is engaged in the multistate business of manufacturing and sales of industrial chemicals. In connection with that business, the taxpayer obtained patents on certain of its products. The taxpayer licensed the production of the chemicals in foreign countries, in return for which the taxpayer receives royalties. The royalties received by the taxpayer are business income.

Example 2: The taxpayer is engaged in the music publishing trade or business and holds copyrights on numerous songs. The taxpayer acquires the assets of a smaller publishing company, including music copyrights. These acquired copyrights are used by the taxpayer in its trade or business. Any royalties received on these copyrights are business income.

(g) *Consistency and uniformity in reporting.*

(1) *Year-to-year consistency.* In filing reports with the Commonwealth, if the taxpayer departs from or modifies the manner in which income has been classified as business income or nonbusiness income in reports for prior years, the taxpayer shall disclose the nature and extent of the modification in the report for the current year.

(2) *State-to-state consistency.* If the returns or reports filed by a taxpayer for all states to which the taxpayer files income or gross receipts tax reports are not uniform in the classification of income as apportionable or non-apportionable income under the United States Constitution, the taxpayer shall disclose in its report to the Commonwealth the nature and extent of the variance.

For purposes of this paragraph, the phrase "returns or reports filed by a taxpayer for all states" includes returns or reports filed by a taxpayer with political subdivisions of a state.

(h) *Definitions.* The following words and terms, when used in this section, have the following meanings, unless the context clearly indicates otherwise:

Allocation—The assignment of items of nonbusiness income to a particular state.

Apportionment—The division of business income between states by the use of a formula containing apportionment factors.

Business activity—The transactions and activities occurring in the regular course of a particular trade or business of a taxpayer and includes the acquisition, management or disposition of property that constitutes an integral part of the taxpayer's trade or business.

Business income—All income which is apportionable under the Constitution of the United States, including the following:

(i) Income arising from transactions and activity in the regular course of the taxpayer's trade or business.

(ii) Income arising from tangible and intangible property if either the acquisition, management or disposition of the property constitutes an integral part of the taxpayer's regular trade or business.

Nonbusiness income—All income other than business income. The term does not include any income that is apportionable under the Constitution of the United States.

Trade or business—Transactions and activity that are included in the unitary business of the taxpayer under the unitary business principle as applied by the United States Supreme Court.

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END OF ISSUE