

STATEMENTS OF POLICY

Title 61—REVENUE

DEPARTMENT OF REVENUE

[61 PA. CODE CH. 170]

Nonbusiness Income—Application of *Canteen Corporation* Decision

The Department of Revenue (Department) has adopted a statement of policy under the authority in § 3.2 (relating to statements of policy). The statement of policy adds § 170.3 (relating to nonbusiness income—application of *Canteen Corporation* decision) and takes effect upon publication in the *Pennsylvania Bulletin*.

This statement of policy is promulgated by the Department to clarify the scope and application of *Canteen Corp. v. Commonwealth*, 818 A.2d 594 (Pa. Cmwlth. 2003) to the Corporate Net Income Tax.

Specific questions regarding information provided in this statement of policy should be directed to the Department of Revenue, Office of Chief Counsel, Dept. 281061, Harrisburg, PA 17128-1061.

(*Editor's Note:* Title 61 of the *Pennsylvania Code* is amended by adding a statement of policy in § 170.3 to read as set forth in Annex A.)

GREGORY C. FAJT,
Secretary

Fiscal Note: 15-434. No fiscal impact; (8) recommends adoption.

Annex A

TITLE 61. REVENUE

PART I. DEPARTMENT OF REVENUE

Subpart B. GENERAL FUND REVENUES

ARTICLE VI. CORPORATION TAXES

CHAPTER 170. CORPORATION TAX PRONOUNCEMENTS—STATEMENTS OF POLICY

§ 170.3. Nonbusiness income—application of *Canteen Corporation* decision.

(a) *Canteen Corp. v. Commonwealth*, 818 A.2d 594 (Pa. Cmwlth. 2003) will not be applied to taxable years beginning after December 31, 1998.

(b) The policy implications are as follows:

(1) It is the policy of the Department of Revenue that the part of the decision in *Canteen Corp. v. Commonwealth*, 818 A.2d 594 (Pa. Cmwlth. 2003), which held that gains or losses from section 338 transactions produce nonbusiness income, does not apply to taxable years beginning after December 31, 1998, because of statutory amendments to the definition of "business income." In accordance with § 153.81 (relating to elections under 26

U.S.C.A. § 338) taxable income generated as a result of a section 338 election will be treated as business income.

(2) The part of the decision which held that the fictional sale of assets by the target corporation must be recognized by the Commonwealth will be followed so that the target corporation's sales factor will include, when required by law, the proceeds assigned to each asset which is deemed to have been sold.

(c) The rationale for this statement of policy is as follows:

(1) The Commonwealth Court in *Canteen* reasoned that the Commonwealth could not include the fictional gain produced by this Federal election in taxable income and then ignore the additional fiction that under this election the company is deemed to have sold all of its assets in a complete liquidation and distribution of assets. Following this reasoning, the Commonwealth Court relied on the Pennsylvania Supreme Court's holding in *Laurel Pipe Line v. Board of Finance and Revenue*, 537 Pa. 205, 642 A.2d 472 (1994) that the gain realized from a partial liquidation of a discrete business segment and distribution of proceeds to shareholders is nonbusiness income.

(2) The Pennsylvania Supreme Court in *Laurel Pipe Line* emphasized that the statutory definition of the functional test of business income is conjunctive in that it required "the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations" to find business income. The court held that the pipeline was not disposed of as an integral part of Laurel's regular trade or business; therefore, the gain was nonbusiness income.

(3) The act of June 22, 2001, (P. L. 353, No. 23) (Act 23), made it clear through the amended definition of "business income" that the functional test of business income is disjunctive in that it merely requires that "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 income is business income.

(i) Therefore, although this type of disposition is not an integral part of taxpayer's regular trade or business, the gain or loss realized from the sale of any asset that was either acquired or managed as an integral part of the taxpayer's regular trade or business operations is business income.

(ii) In addition, Act 23 further provided that "business income . . . includes all income which is apportionable under the Constitution of the United States." As of March 25, 2006, no United States Supreme Court decision has addressed the imposition of a state corporate income tax relative to corporate liquidations.

(d) This section shall be effective immediately and apply to all open cases, tax settlements and appeals.

[Pa.B. Doc. No. 06-488. Filed for public inspection March 24, 2006, 9:00 a.m.]