

**CHAPTER 155. CAPITAL STOCK TAX AND FOREIGN  
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**SUBJECTABILITY TO TAX REPORTING****§ 155.1. Taxpayers.**

(a) *Inclusions.* The following entities organized and incorporated under the statutes of the Commonwealth, the United States or another state, territory, foreign country or dependency and doing business in and liable for taxation in this Commonwealth or carrying on activities in this Commonwealth, including solicitation or either owning or having capital or property employed or used in this Commonwealth by or in the name of a limited partnership or joint-stock association, company, corporation, association, copartnership, person or in another manner are taxpayers for the purpose of this article (See section 601 of the TRC (72 P. S. § 7601)):

- (1) Corporations having capital stock.
- (2) Joint-stock associations.
- (3) Limited partnerships, including:
  - (i) Registered partnerships formed and existing under the act of May 9, 1899 (P. L. 261, No. 153) (59 P. S. §§ 241—311) prior to January 1, 1971, the effective date of its repeal by section 1203(e)(2) of the Business Corporation Law (15 P. S. § 2203(e)(2)).

(ii) Partnership associations formed and existing under the act of June 2, 1874 (P. L. 271, No. 153) (15 P. S. §§ 12701—12710) prior to its repeal effective August 9, 1970, by section 14(a)(1) of the Professional Corporation Law (15 P. S. § 2914(a)(1)).

(4) Professional corporations formed under the Professional Corporation Law (15 P. S. §§ 2901—2914) and professional associations formed under the Professional Association Act (15 P. S. §§ 12601—12619) which elect, under section 4 of the Professional Corporation Law (15 P. S. § 2904) to accept the provisions thereof.

(5) Corporations having authority to issue capital stock and organized or created by or under the nonprofit corporation law of a state but which are not in fact nonprofit corporations.

(6) S corporations, as provided for under section 1361 of the IRC (26 U.S.C.A. § 1361) whether or not they have made a Pennsylvania election.

(7) Domestic International Sales Corporations, commonly known as DISCs, as provided for under section 991 of the IRC (26 U.S.C.A. § 991).

(8) Foreign Sales Corporations, commonly known as FSC's, as provided for under section 921 of the IRC (26 U.S.C.A. § 921).

(9) General or limited partnerships formed under the statutes of the Commonwealth which elect to be governed by 59 Pa.C.S. §§ 701—707 (relating to electing partnerships).

(10) Cooperative associations formed under the act of June 7, 1887 (P. L. 365, No. 252) (15 P. S. §§ 12001—12023).

(b) *Exclusions.* The following entities are not taxpayers for purposes of this article (See section 601 of the TRC):

(1) Massachusetts Trusts or business trusts, or common law trusts or Real Estate Investment Trusts—commonly referred to as REITs—provided for under section 856 of the IRC (26 U.S.C.A. § 856) which are not organized or created by or under the statutory law of a state.

(2) First-class corporations formed under the Corporation Act of 1874 (P. L. 73, No. 32) (15 P. S. §§ 3001—3411).

(3) Corporations organized or created by or under the nonprofit corporation law of a state which are, in fact, nonprofit corporations.

(4) Limited partnerships formed under or governed by 59 Pa.C.S. §§ 501—545 (relating to the Uniform Limited Partnership Act) or the Uniform Limited Partnership Act of another state.

(5) Cooperative agricultural associations formed under or governed by the Cooperative Agricultural Association Act (15 P. S. §§ 12101—12135).

(6) Banks, bank and trust companies, savings banks and trust companies authorized to do business under the statutes of this Commonwealth.

(7) Savings associations authorized to do business under the statutes of the Commonwealth.

(8) Insurance companies and title insurance companies authorized to do business under the statutes of the Commonwealth.

(9) Building and loan associations authorized to do business under the statutes of the Commonwealth.

(10) Agricultural credit associations formed under the act of May 25, 1933 (P. L. 1027, No. 236) (15 P. S. §§ 12201—12216).

(11) Credit unions formed under the Credit Union Act (15 P. S. §§ 12301—12353).

#### Authority

The provisions of this § 155.1 issued under section 270 of the Tax Reform Code of 1971 (72 P. S. § 7270); amended under section 408 of the Tax Reform Code of 1971 (72 P. S. § 7408).

#### Source

The provisions of this § 155.1 adopted July 29, 1977, effective July 30, 1977, 7 Pa.B. 2143; amended January 16, 1987, effective January 17, 1987, 17 Pa.B. 273. Immediately preceding text appears at serial pages (94423) to (94425).

### § 155.2. Family farm corporation exemption.

(a) *General.* A domestic or foreign corporation which qualifies as a family farm corporation is exempt from Capital Stock or Foreign Franchise taxation if the corporation is actually engaged in the business of agriculture.

(1) For the purposes of this exemption, the business of agriculture means commercially cultivating the ground to produce products in fields or in large quantities, including the preparation of soil, the planting of seeds, the raising and harvesting of crops, beekeeping and the rearing, feeding, breeding and management of livestock. The business of agriculture also includes aquaculture, which is defined as the raising of fish and other aquatic animals for direct commercial use as a food or food product.

(2) The following activities are not considered to be the business of agriculture:

(i) Recreational activities, such as hunting, fishing, camping, skiing, show competition or racing.

(ii) The raising, breeding or training of game animals or game birds, fish, cats, dogs or pets or animals intended for use in sporting or recreational activities.

(iii) Fur farming.

(iv) Stockyard and slaughterhouse operations.

(v) Manufacturing or processing operations.

(b) *Conditions precedent.* For a corporation to qualify for the family farm exemption from the Capital Stock or Foreign Franchise Tax, the following conditions shall be met:

(1) At least 75% of the corporation's assets shall be devoted to the business of agriculture. The original cost of the assets is used in determining whether a corporation meets the asset test, unless the taxpayer can show by clear and convincing evidence that market value is different. To qualify as assets used in the business of agriculture, the assets shall be owned and used directly by the corporation claiming the exemption, be principally devoted to the business of agriculture and be property of the sort commonly utilized in the business.

(2) At least 75% of shares of stock issued by the corporation shall be owned by individuals who are members of the same family. Members of the same family include an individual, the individual's brothers and sisters, the brothers and sisters of the individual's parents and grandparents, the ancestors and lineal descendants of the foregoing and a spouse of the foregoing. Individuals related by the half blood or by legal adoption are treated as if they were related by the whole blood. Stock of the corporation owned, directly or indirectly, by or for a partnership, trust or estate are considered as owned proportionately by its partners or beneficiaries. Stock of the corporation owned by another corporation shall be considered owned by a family member in that proportion which the stock of the other corporation owned by family members bears to the stock in the other corporation, if family members own 50% or more of the stock of the other corporation. If more than one class of stock is issued, the 75% stock ownership test shall be met for each class of stock issued.

(c) *Reporting requirements.* In addition to filing requirements imposed upon corporations generally, a corporation claiming this exemption shall also file with the Department:

- (1) A brief description of the agricultural business.
- (2) A schedule of assets listing their original cost and designating which are and which are not used principally in the corporation's agricultural business.
- (3) A schedule of owners of stock including the number of shares of stock owned, the class of stock and the relationship of each stockholder within the family.

#### **Authority**

The provisions of this § 155.2 issued under section 408 of the Tax Reform Code of 1971 (72 P. S. § 7408).

#### **Source**

The provisions of this § 155.2 adopted January 16, 1987, effective January 17, 1987, 17 Pa.B. 273.

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## APPORTIONMENTS

## § 155.10. Single factor apportionment.

(a) *General.*

(1) *All corporations.* Corporations subject to either the Capital Stock or Foreign Franchise Tax, except regulated investment companies, shall be entitled each taxable year to use the single factor fraction. Taxpayers electing to use the single factor fraction for a taxable year shall be prohibited from simultaneously using three factor apportionment for the same taxable year, and use of the single factor fraction shall be limited to the Capital Stock or Foreign Franchise Tax, and will have no applicability to the Corporate Net Income Tax. See the act of June 22, 1931 (P. L. 685, No. 250) (72 P. S. § 1896).

(2) *Foreign corporations.* Foreign corporations may elect to compute and pay Foreign Franchise Tax on a property tax basis and utilize the single factor fraction. A foreign corporation electing to do so shall be treated as if it were a domestic corporation for the purpose of determining which of its assets are exempt from taxation and for the purpose of determining the proportion of the value of its capital stock which is subject to taxation.

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

(1) *Asset*—Real property and tangible and intangible personal property.

(2) *Book value*—The value at which a particular asset was included in determining net worth as defined in § 155.27 (relating to net worth-fixed formula).

(3) *Exempt assets*—Assets owned by a taxpayer which are exempt from property taxation as set forth in subsection (d), including assets exempt for constitutional, statutory or public policy reasons.

(4) *Intangible personal property*—Checking and savings accounts, advances, notes and accounts receivable, promissory notes, investments in common or preferred stock, bonds, patents, trademarks, goodwill, prepaid and deferred expenses and the like. The term does not include intangible personal property of a purely contingent character, such as claims for damage, including choses in action and contracts not reduced to judgment or treasury stock.

(5) *Located*—The situs of real and tangible personal property.

(6) *Real and tangible personal property*—Land, buildings, machinery, equipment, furniture, fixtures, automobiles, trucks, inventories, leasehold improvements, mineral interests and the like. The term does not include property leased to a taxpayer.

(7) *Taxable assets*—Total assets less exempt assets.

(c) *Taxable assets fraction.* The taxable assets fraction is a fraction, the numerator of which is the average book value of taxable assets owned by the taxpayer during the taxable year and the denominator of which is the average book value of the total assets owned by the taxpayer during the taxable year.

(d) *Exempt and taxable assets.* The following assets are exempt or taxable, as specified, for purposes of the taxable assets fraction. This listing is not exclusive.

(1) Real and tangible personal property having a taxable situs outside this Commonwealth is exempt, including:

(i) Real and tangible personal property located outside this Commonwealth.

(ii) The allocated value of tangible personal property crossing state lines. The value of mobile assets, such as equipment, trucks, automobiles, railroad cars, buses, ships and the like, is exempt to the extent the assets are utilized in another state, if the corporation is subject to tax outside this Commonwealth. The assets shall be allocated to the Commonwealth on an equitable and reasonable basis, such as, on a time used or mileage basis.

(2) Intangible personal property is not exempt based on situs. The taxable situs of a corporation's intangible personal property is the domiciliary state of the corporation. Since a foreign corporation electing to utilize the taxable assets fraction is required to compute its taxable assets fraction as if it were a domestic corporation, no intangible personal property of a corporation, whether foreign or domestic, is exempt based on situs.

(3) Certain assets are specifically exempt by Commonwealth statute. These include:

(i) Assets actually and exclusively employed in manufacturing, processing or research and development in this Commonwealth, except if employed by a corporation which enjoys the right of eminent domain.

(ii) Equipment, machinery, facilities and other assets employed or utilized within this Commonwealth for water and air pollution control or abatement devices for the benefit of the general public. See § 155.11 (relating to exemption).

(iii) Obligations of the Commonwealth, a public authority, commission, board or other agency created by the Commonwealth, a political subdivision of the Commonwealth or a public authority created by the Commonwealth.

(iv) In the case of a corporation owning, directly or through subsidiaries or subsidiary corporation, a majority of the total issued and outstanding shares of voting stock of a corporation, shares of stock owned in the other corporation are exempt. See the act of April 20, 1927 (P. L. 311, No. 177) (72 P. S. § 1894). In the case of a corporation owning less than a majority of the total and outstanding shares of voting stock in a foreign corporation, the shares of stock owned in the other corporation are not exempt by reason of 72 P. S. § 1894.

(v) Student loan assets that are owned or held by an entity created for the securitization of student loans, or by a trustee on its behalf, including:

(A) Student loan notes.

(B) Federal, State or private subsidies or guarantees of student loans.

(C) Instruments that represent a guarantee of debt, certificates or other securities issued by an entity created for the securitization of student loans, or by a trustee on its behalf.

(D) Contract rights to acquire or dispose of student loans and interest rate swap agreements related to student loans.

(E) Interests in or debt obligations of other student loan securitization trusts or entities.

(F) Cash or cash equivalents representing reserve funds or payments on or with respect to student loan notes, the securities issued by an entity created for the securitization of student loans, or the other student loan related assets. Solely for purposes of this exemption for student loan assets, "cash or cash equivalents" shall include:

(I) Direct obligations of the United States Department of the Treasury.

(II) Obligations of Federal agencies which obligations represent the full faith and credit of the United States of America.

(III) Investment grade debt obligations or commercial paper.

(IV) Deposit accounts.

(V) Federal funds and banker's acceptances.

(VI) Prefunded municipal obligations.

(VII) Money market instruments and money market funds.

(4) Certain assets are exempt by reason of public policy. These include:

(i) Stock of domestic corporations which are subject to or relieved from Capital Stock Tax.

(ii) Stock of banks, title insurance companies, trust companies and other companies subject to a tax on shares.

(iii) Stock of nonprofit corporations.

(iv) Stock and obligations of cooperative agricultural associations and agricultural credit associations.

(v) Stock of credit unions.

(5) Certain assets are exempt by reason of constitutional interpretation. These include obligations of the United States government, its agencies, instrumentalities, possessions and territories unless taxation is specifically authorized. This exemption, reflected in 31 U.S.C.A. § 3124, does not apply to obligations of the United States which are secondary, indirect, contingent or mere guarantees. Certain other obligations issued under Federal statutes are specifically exempted from state taxation by the Federal statute authorizing issuance of the obligation. Stock of national banks is not exempt.

(e) *Averaging property values.*

(1) *Annual averaging.* The average value of real and tangible and intangible personal property owned by the taxpayer during the taxable year shall be determined by averaging book values at the beginning and ending of the taxable year.

(2) *Monthly or daily averaging.* The Department may require the monthly or daily averaging of book values of real and tangible and intangible personal property owned by the taxpayer during the taxable year where the averaging is reasonably required to reflect the average value of the taxpayer's property. The Department may require or the taxpayer may request a monthly or daily averaging if substantial property is acquired or disposed of during the taxable year.

(f) *Computation of taxable assets fraction.*

(1) The taxable assets fraction of corporations engaged in manufacturing, processing or research and development in this Commonwealth is computed as follows: the numerator is the average book value of taxable assets and the denominator is the average book value of total assets.

*Example.* The taxpayer owns the following exempt and taxable assets:

	<i>Beginning of Year</i>	<i>End of Year</i>	<i>Average</i>
Book value of taxable assets	\$100,000	\$150,000	\$125,000
Book value of exempt assets	\$400,000	\$600,000	\$500,000
Book value of total assets	\$500,000	\$750,000	\$625,000
The taxpayer's taxable fraction			
	is \$125,000		
	\$625,000		

The decimal equivalent, .200000, which represents the proportion of taxable assets, is then multiplied by the capital stock value to determine the taxable value of the taxpayer's capital stock.

(2) The taxable assets fraction of corporations not engaged in manufacturing, processing or research and development within this Commonwealth is computed as follows: the numerator is the average book value of total assets less the average book value of exempt assets and the denominator is the average book value of total assets.

*Example.* The taxpayer owns the following exempt and taxable assets:

Average book value of total assets:	\$1 million
Less: Average book value of exempt assets:	
(a) Tangible property outside this Commonwealth (\$40,000 at beginning of year and \$20,000 at end of year)	\$30,000
(b) Stocks of other Commonwealth corporations (\$150,000 held for 122/365 of year)	\$50,000

(c) United States Securities of \$20,000 held for the entire year	\$ 20,000
	\$ 100,000
Average book value of taxable assets	\$ 900,000
The taxpayer's taxable assets fraction is:	\$ 900,000
	\$1,000,000

The decimal equivalent, .900000, which represents the proportion of taxable assets, is then multiplied by the capital stock value to determine the taxable value of the taxpayer's capital stock.

#### Authority

The provisions of this § 155.10 issued under section 408 of the Tax Reform Code of 1971 (72 P. S. § 7408); amended under sections 408 and 603 of the Tax Reform Code of 1971 (72 P. S. §§ 7408 and 7603).

#### Source

The provisions of this § 155.10 adopted January 16, 1987, effective January 17, 1987, 17 Pa.B. 273; amended December 4, 1998, effective December 5, 1998, 28 Pa.B. 5986. Immediately preceding text appears at serial pages (205439) to (205440), (216363) to (216364) and (236143).

#### Notes of Decisions

##### *Exemptions*

A corporation providing scientific analysis of samples provided by clients does not fall under the manufacturing or research and development exemption. *Lancaster Laboratories, Inc. v. Commonwealth*, 578 A.2d 988 (1990); vacated in part 611 A.2d 815 (Pa. Cmwlth. 1992); affirmed in part 631 A.2d 739 (Pa. Cmwlth. 1993).

##### *Foreign Corporations*

Although assets such as the interest from United States obligations is excluded from the property tax imposed by Pennsylvania on its domestic corporations under this regulation, because the company elected to compute its tax as a foreign corporation, the company placed itself on the same footing as a foreign corporation paying its franchise tax. Thus, the interest income was not exempt in calculating the capital stock tax. *Consolidated Rail Corp. v. Commonwealth*, 670 A.2d 722 (Pa. Cmwlth. 1996); affirmed 691 A.2d 456 (Pa. 1997).

### § 155.11. Exemption.

*Pollution control devices exemption.* Exemptions for pollution control devices shall be as follows:



(1) *General.* An exemption will be given for water and air pollution control or abatement devices which have been employed or utilized for the benefit of the general public during the tax year in question. The pollution control devices exemption is expressed as a deduction from the Capital Stock Tax exempt assets fraction, or as a deduction from the Property Factor in the case of a Foreign Franchise Tax taxpayer or a Capital Stock Tax taxpayer which elects to compute and pay its tax on the basis of the Three Factor Formula as provided in section 602(b) of the TRC (72 P. S. § 7602(b)).

(2) *Condition precedent.* As a condition precedent to the granting by the Department to the taxpayer of the pollution control device exemption, the taxpayer is required to apply to the Department of Environmental Protection and obtain a certificate for the purpose of claiming exemption for each specific pollution control device. This certification is designated "Notice of State Certification" (DEP Form ER-BWQ-21). See section 602.1 of the TRC (72 P. S. § 7602.1). The taxpayer is required to file with the Department the Notice of State Certification covering the specific control device for which exemption is claimed during the tax period in question. This requirement for the filing of a Notice of State Certification may apply not only to a new device but may also apply to modifications or changes of an existing device.

(3) *Notice of State Certification by Department of Environmental Protection.* Notice of State Certification shall conform with the following:

(i) The Notice of State Certification issued by the Department of Environmental Protection shall certify:

(A) That certain components are components to a water or air pollution device.

(B) That a device is installed and completed in place.

(C) That is employed or utilized to remove pollutants commencing in, or during, the tax year in question.

(D) That, where a plan approval or permit is required by the Department of Environmental Protection, plan approval or permit has been obtained.

(ii) The Department of Environmental Protection certification is not required to be filed annually. The exemption shall be subject to audit by the Department, or the taxpayer may be called upon by the Department to update the prior Certification upon which the particular exemption has been based.

#### Source

The provisions of this § 155.11 adopted October 7, 1977, effective October 8, 1977, 7 Pa.B. 2899; corrected at 7 Pa.B. 3092; amended February 16, 1979, effective February 17, 1979, 9 Pa.B. 563. Immediately preceding text appears at serial page (36138).

**Cross References**

This section cited in 61 Pa. Code § 155.10 (relating to single factor apportionment).

**VALUATION OF CAPITAL STOCK****§ 155.21. General.**

(a) *Taxable years prior to calendar year 1984.* The Department recognizes and understands that the determination of the capital stock value of a taxpayer is not precise or constant in every instance, and that the determination depends upon the pertinent factors relating to each taxpayer. This section and §§ 155.22—155.30 (relating to valuation of capital stock) are not intended to establish fixed or inflexible rules for the determination of the capital stock value in every instance. These sections provide general guidelines that are to be used as a general basis upon which, if necessary, adjustments can be made in determining the capital stock value of the taxpayer.

(b) *Calendar year 1984 and years thereafter.* The act of December 23, 1983 (P. L. 360, No. 89) that amended Article VI of the TRC (72 P. S. §§ 7601—7606) made certain important changes to the Capital Stock and Foreign Franchise Taxes. Commencing with calendar year 1984 and fiscal years beginning in 1984 and each year thereafter, “actual value” as the standard in determining the value of a corporation’s capital stock has been eliminated. “Capital stock value” is now determined under the act by application of a defined and fixed formula, making the general guidelines set forth by §§ 155.22—155.24 (relating to definitions; determination of valuation factors; and valuation methods) inapplicable to the determination of fixed formula capital stock value. Rules applicable to the determination of fixed formula capital stock value are set forth in §§ 155.25—155.28 (relating to capital stock value—fixed formula; average net income—fixed formula; net worth—fixed formula; and capital stock value methods—fixed formula).

(c) *Calendar year 1983 and years thereafter.* The act of December 23, 1983 (P. L. 370, No. 90) provides for a minimum Capital Stock and Foreign Franchise Tax of \$75. Reference should be made to §§ 155.28(c) and 155.30 (relating to minimum tax).

#### Authority

The provisions of this § 155.21 amended under section 408 of the Tax Reform Code of 1971 (72 P. S. § 7408).

#### Source

The provisions of this § 155.21 adopted September 1, 1982, effective September 2, 1982, 8 Pa.B. 2457; amended January 16, 1987, effective January 17, 1987, 17 Pa.B. 273. Immediately preceding text appears at serial pages (94426) and (40509).

#### Cross References

This section cited in 61 Pa. Code § 155.22 (relating to definitions); and 61 Pa. Code § 155.28 (relating to capital stock value methods—fixed formula).

### § 155.22. Definitions.

The following words and terms, when used in §§ 155.21—155.24, have the following meanings, unless the context clearly indicates otherwise:

*Actual value*—Cash value.

*Book income*—Income as reported in Line 1 of Schedule M-1 of the Federal 1120 Form.

*Capital stock*—Common stock, preferred and special stock.

*Capital stock value*—Defined in section 601 of the TRC (72 P. S. § 7601) as the actual value of the taxpayer in cash as it existed at the close of the year for which the report is made, taking into consideration:

- (i) The average selling price of stock.
- (ii) Corporate earnings.

(iii) Dividends declared.

(iv) Stockholder equity.

*Corporate earnings*—The book income as reported to the shareholders which is adjusted for distortions in the current and prior years created by nonrecurring-type gains and losses or by use or correction of inconsistent or erroneous accounting practices. Reference should also be made to § 155.23(b) (relating to determination of valuation factors).

*Daily weighted average*—Computed by multiplying each listed price of the capital stock during the taxable year by the number of days the price was listed. The product is added and that sum is divided by the number of days the capital stock was listed.

*Example:*

\$20 listed for 80 days	=	1600
15 listed for 40 days	=	600
21 listed for 80 days	=	1680
18 listed for 60 days	=	1080

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260 days    4960

The average selling price is \$19.08 (4960 ÷ 260).

*Disposition*—A transfer, such as a sale or exchange.

*Dividends declared*—Normal distributions of corporate earnings which are not in the nature of liquidating or other nonrecurring or extraordinary distributions. Reference should also be made to § 155.23(c) (relating to determination of valuating factors).

*Mean average*—Computed by taking the average of the highest and lowest price the capital stock was listed during the taxable year.

*Example:* The highest listed price of the taxpayer's capital stock was \$56; the lowest price was \$38. The average selling price is \$47 (\$94 ÷ 2).

*Net book value*—The basis of real property and tangible and intangible personal property after adjustments (depreciation, amortization and other write-downs) as reflected on the corporate financial statements.

*Selling price of the stock*—The average which the capital stock sold for during the taxable year. Reference should also be made to § 155.23(a).

*Stockholder equity*—Defined in section 601 of the TRC (72 P. S. § 7601) as the actual value indicated or measured by consideration of the intrinsic value of a corporation's tangible property and assets, and of the value of its goodwill and franchise and privileges, as indicated by the material results of their exercise, taking into consideration the amount of its indebtedness. Reference should also be made to § 155.23(d).

#### Source

The provisions of this § 155.22 adopted September 1, 1978, effective September 2, 1978, 8 Pa.B. 2457.

**Cross References**

This section cited in 61 Pa. Code § 155.21 (relating to general); 61 Pa. Code § 155.23 (relating to determination of valuation factors); 61 Pa. Code § 155.24 (relating to valuation methods); and 61 Pa. Code § 155.28 (relating to capital stock value methods—fixed formula).

**§ 155.23. Determination of valuation factors.**

(a) Selling price of stock shall be computed as an average price for the taxable year on a daily weighted or mean average. This selling price is that applicable to an active, continuing market involving a substantial number of capital stock transactions, that is, the capital stock of a corporation is registered or traded on a security exchange or over the counter on a regular and orderly basis under circumstances which usually and generally apply to the transactions. However, when the taxpayer's capital stock is not traded in an active and continuing market and the taxpayer disposes of a substantial number of shares of capital stock or the taxpayer is involved in a substantial number of capital stock transactions during the taxable year, the selling price of stock shall be the average selling price of the disposed stock. Isolated or sporadic sales or sales of fractional interests of minority holdings are generally not determinative of the selling price of stock. Reference should also be made to § 155.22 (relating to definitions) wherein "corporate earnings" is defined. What is determined to be a substantial number of transactions shall depend upon the facts and circumstances pertinent to an individual case.

(b) Earnings of industrial taxpayers shall be capitalized at 10% ( $10 \times$  earnings); for earnings of public utilities, at 8.0% ( $12 \frac{1}{2} \times$  earnings). If the earnings figure shows a loss, it shall be entered as zero. However, in the determination of the average earnings the loss shall be entered as computed. Reference should also be made to § 155.22 (relating to definitions).

(c) Dividends declared by industrial taxpayers shall be capitalized at 8.0% ( $12 \frac{1}{2} \times$  annual dividends); for public utilities, at 7.0% ( $14.285 \times$  annual dividends). Reference should also be made to § 155.22.

(d) Stockholder equity shall be determined by taking the actual value, if available and determinable, of the total corporate assets less the total corporate liabilities.

(1) What is included as corporate assets and liabilities:

(i) Total corporate assets means real property and tangible and intangible personal property recorded on the corporate balance sheet.

(ii) Total corporate liabilities means current liabilities, funded debt and accrued liabilities. Generally, contingent liabilities and surplus reserves may not be considered corporate liabilities. A reserve for deferred Federal taxes may not be included as contingent liability. Other exclusions shall be made on a case-by-case basis.

(2) Valuation when the actual value is not available or cannot be determined:

(i) Real property and tangible and intangible personal property, other than marketable and nonmarketable securities and stock of affiliate and subsidiary corporations, shall be valued at net book value.

(ii) Marketable securities selling in an established market shall be valued at its quoted selling price.

(iii) Nonmarketable securities shall be valued at appraised market values.

(iv) Stock of subsidiary and affiliate corporations are valued on the basis of the capital stock reported by the subsidiary or affiliate corporation for Capital Stock or Foreign Franchise Tax purposes. However, if the subsidiary or affiliate corporation is not subject to Capital Stock or Foreign Franchise taxation, the corporation is valued at stockholder's equity.

(3) Changes in the taxpayer's capital structure during the tax year or years in question shall be prorated.

*Example 1.* The taxpayer acquired treasury stock on July 1. The value of the treasury stock is \$300,000. The stockholder equity at the end of the tax year (December 31) is \$1,000,000.

The revised stockholder equity is computed as follows:

Stockholder equity	\$1,000,000
Acquisition of Treasury	
Stock (\$300,000 × 181/365)	148,767
	<hr/>
	\$1,148,767

The revised stockholder equity is \$1,148,767.

*Example 2.* The taxpayer issued common stock on July 1. The value of the common stock issued is \$300,000. The stockholder equity at the end of the tax year (December 31) is \$1,000,000. The revised stockholder equity is computed as follows:

Stockholder equity	\$1,000,000
Issuance of Common Stock	
(\$300,000 × 181/365)	148,767
	<hr/>
	\$ 851,233

The revised stockholder equity is \$851,233.

#### Source

The provisions of this § 155.23 adopted September 1, 1978, effective September 2, 1978, 8 Pa.B. 2457.

**Cross References**

This section cited in 61 Pa. Code § 155.21 (relating to general); 61 Pa. Code § 155.22 (relating to definitions); 61 Pa. Code § 155.24 (relating to valuation methods); and 61 Pa. Code § 155.28 (relating to capital stock value methods—fixed formula).

**§ 155.24. Valuation methods.**

(a) *General.* In general valuation will be made in accordance with the following:

(1) The Department recognizes that no arithmetical method is of itself adequate and complete in all instances in determining the capital stock value. In using an arithmetical method, further adjustments may be needed to take into consideration other influencing factors, in addition to those factors set forth in § 155.23 (relating to determination of valuation factors), such as the nature of the business of the taxpayer (industrial, manufacturing, investment, personal service, utility and so forth), the financial history of the taxpayer, the liquidity of the taxpayer's balance sheet assets, extraordinary and nonrecurring transactions and other pertinent factors. The amount of weight given each factor may vary depending upon the facts and circumstances pertinent to each taxpayer.

(2) As a general rule, since the stockholder equity, as determined in subsection (b)(1), is representative of the taxpayer's financial history, its balance sheet assets and liabilities, and the taxpayer's present worth as represented by the taxpayer itself, stockholder equity will represent the minimum value the Department will employ to determine the capital stock value.

(i) Generally, the stockholder equity will adequately reflect the capital stock value of those taxpayers whose operations have produced a loss or low earnings in the current tax year or in the preceding tax years.

(ii) If, for those taxpayers whose operations have produced high earnings in the current tax year or in the preceding tax years the stockholder equity generally does not adequately reflect the capital stock value. Therefore, to account for the effect of the high earnings, those taxpayers will also employ the Three-way and Five-way Methods to determine the capital stock value.

(iii) What is determined to be high or low earnings shall depend upon the facts and circumstances pertinent to each individual case.

(3) When the taxpayer's stock is involved in a substantial number of transactions or when a substantial number of the taxpayer's shares are traded or disposed during the taxable year, the market value of stock becomes a factor for the determination of the capital stock value.

(4) A copy of the taxpayer's Annual Report to the Securities and Exchange Commission or any other documents or reports which set forth the taxpayer's corporate financial statements shall be submitted to the Department.

(b) *Determination of the capital stock value.* As a general rule, the Department requires that the valuation of capital stock of domestic corporations and foreign corporations doing business in this Commonwealth, for the purpose of determining Capital Stock-Foreign Franchise Tax liability, shall be computed by using one of the following methods:

(1) *Stockholder Equity Method.* This method uses 70% of stockholder equity to determine the capital stock value. Reference should also be made to §§ 155.22 and 155.23(d) (relating to definitions; and determination of valuation factors).

(2) *Three-Way Method (Computed Value Using Earnings Method).* This method is to be used principally when earnings and average earnings capitalized are comparable to stockholder equity. This method uses the current earnings, the 5 year average earnings and stockholder equity to determine the capital stock value. This method is used when the taxpayer does not distribute dividends.

*Example:*

Earnings (\$450,000) capitalized at 10%	(10 × \$450,000)	\$4,500,000
Average Earnings (\$250,000) capitalized at 10%	(\$250,000 × 10)	2,500,000
Stockholder Equity		2,000,000
		<hr/>
		\$9,000,000
Average (Total divided by 3)		\$3,000,000

The average may be adjusted depending upon various other pertinent factors in determining the capital stock value.

(3) *Five-Way Method (Computed Value Using Earnings and Dividends Method).* This method is to be used when the taxpayer distributes dividends. This method uses the current earnings, 5 year average earnings, the current dividends, the 5 year average dividends, and stockholder equity to determine the capital stock value. This method is used principally when dividends capitalized, average dividends capitalized, earnings capitalized and average earnings capitalized are comparable to stockholder equity.

*Example:*

Earnings (\$450,000) capitalized at 10%	(10 × \$450,000)	\$4,000,000
Average Earnings (\$400,000) capitalized at 10%	(10 × \$400,000)	\$400,000
Dividends Declared (\$400,000) capitalized at 8%	(12 1/2 × \$400,000)	\$400,000
Average Dividends Declared (\$400,000) capitalized		5,000,000

Earnings (\$450,000) capitalized at 10%	
at 8% ( $12\frac{1}{2} \times \$400,000$ ) $\times$ \$400,000)	5,000,000
Stockholder Equity	5,000,000
	<hr/>
	\$23,500,000
Average (Total divided by 5)	\$4,700,000

The average may be adjusted depending upon various other pertinent factors in determining the capital stock value.

(4) As a general rule, the value of the capital stock shall be the highest of the preceding three amounts. The amount, that is, the highest of (1), (2) or (3), as finally determined by the Department, taking into consideration the various factors and circumstances pertinent to each taxpayer, shall be the value of the capital stock of domestic corporations and foreign corporations doing business in this Commonwealth for the purpose of determining Capital Stock-Foreign Franchise Tax liability.

(c) *Exceptions.* Exceptions shall be as follows:

(1) *Minimum capital stock value.* The Department requires a minimum of \$1,000 capital stock value for domestic companies. There is no minimum capital stock value for foreign corporations doing business in this Commonwealth.

(2) *Incorporation—first year companies.* A taxpayer for its first tax year (the year of incorporation) should compute the capital stock value based upon the daily average of the value of capital paid in during the tax year or the market value of stock. From that value the first year book income should be added or the first year book loss deducted.

*Example 1.* The taxpayer incorporated (in this Commonwealth) on January 1. It issued capital stock in the amount of \$50,000 at that time. During the year ending December 31, its operations resulted in a loss of \$15,000. The capital stock value is \$35,000 (\$50,000 minus \$15,000).

*Example 2.* The taxpayer incorporated (in this Commonwealth) on January 1. It had no capital transactions until April 1 at which time it issued capital stock in the amount of \$50,000. During the year ending December 31, its operations resulted in a loss of \$15,000. The capital stock value is computed by apportioning the minimum value of \$1,000 for 90/365 year (\$247) and the paid in capital of \$50,000 for 275/365 year (\$37,671) and deducting the book loss of \$15,000. The capital stock value is \$22,918 (\$37,918 minus \$15,000).

*Example 3.* The taxpayer incorporated (in this Commonwealth) on April 1. It had no capital transactions until July 1 at which time it issued capital stock in the amount of \$50,000. During the year ending December 31, its operations produced book income of \$10,000. The capital stock is computed by apportioning the minimum value of \$1,000 for 91/275 year (\$331) and the paid in capital of \$50,000 for 184/275 year (\$33,455) and adding the book income of \$10,000. The capital stock value is \$43,786 (\$33,786 plus \$10,000). However, if the first year

corporate taxpayer operated in prior years in another business form, such as a partnership or sole proprietorship, its earnings history shall be adjusted to reflect reasonable compensation to owners and Federal and State taxes which would have been imposed had the predecessor been a corporation. After the adjustments, the taxpayer shall apply the valuation methods set forth in subsection (b) to determine its capital stock value.

(3) *Dissolution—last year companies.* The taxpayer's capital stock value is computed for the year of its dissolution by reference to the amount or value of its liquidating distributions. The amount or value of each distribution is averaged for the portion of the tax year held by the taxpayer. The average amounts are added and the total represents the taxpayer's capital stock value.

*Example 1.* On December 31, (the last day of the tax year) the taxpayer files a certificate of election to dissolve. On the same day it distributes the assets to the stockholders. The actual value of the assets distributed is \$100,000. The capital stock value is \$100,000.

*Example 2.* On September 30, the taxpayer files a certificate of election to dissolve. The tax year ends December 31. The actual value of the assets to be distributed is \$125,000. Distribution to the stockholder is made as follows: on October 1, \$50,000; on November 1, \$25,000; and a final distribution on December 31, \$50,000. The capital stock value is calculated as follows:

$$\begin{aligned} \$50,000 \times 274/365 &= \$ 37,534 \\ \$25,000 \times 304/365 &= \$ 20,822 \\ \$50,000 \times 365/365 &= \$ 50,000 \\ \text{Total} &= \$108,356 \end{aligned}$$

The capital stock value is \$108,356.

(4) *Liquidation in progress.* When a taxpayer is going out of business or has already discontinued business and is in the process of complete liquidation, its capital stock value is computed by reference to the net value of assets remaining at the end of the taxable year plus, if any, the value of liquidating distributions during the tax year averaged for the period of the tax year the distributed assets were held by taxpayer.

*Example 1.* The taxpayer has discontinued business operations and is in the process of complete liquidation. It makes no distribution during the tax year. On the last day of the tax year the actual value of net assets is \$75,000. The capital stock value is \$75,000.

*Example 2.* The taxpayer has discontinued business operations and is in the process of complete liquidation. The taxable year ends December 31. It makes one distribution on October 1 of \$50,000. On the last day of the tax year the actual value of net assets remaining is \$25,000. The capital stock value is computed as follows:

$$\begin{array}{r}
 \$50,000 \times 274/365 = \$ 37,534 \\
 \quad 25,000 \quad \quad 25,000 \\
 \hline
 \quad \quad \quad \$ 62,534
 \end{array}$$

The capital stock value is \$62,534.

If the remaining \$25,000 is distributed on January 31 of the following year, the capital stock for the short period is \$25,000.

(5) *Cash sale of assets or outstanding shares.* In cash sales the value is generally determined by reference to the selling price.

*Example 1.* The taxpayer transfers for cash and notes totaling \$100,000 all of its assets and liabilities. The capital stock value is \$100,000.

*Example 2.* The outstanding shares of the taxpayer were sold in a single transaction for \$50,000. The taxpayer's capital stock value is \$50,000.

(6) *Regulated investment companies.* Section 602(g)(1) of the TRC (72 P. S. § 7602(g)(1)) provides that the capital stock value of a regulated investment company shall be determined by adding its net asset value as of the last day of each month during the taxable period or year and dividing the total sum by the number of months involved, for which purpose net asset value means the actual market value (that is, the quoted selling price or the appraised market value on a designated day) of assets owned by the corporation without exemptions or exclusions less its liabilities, debts and other obligations.

*Example 1.* The sum of the net asset values for the tax year is \$267,000,000. The capital stock value is \$22,250,000 ( $\$267,000,000 \div 12$ ).

(7) *Sale of an asset.* When a taxpayer sells an asset (real property or tangible or intangible personal property) at a value substantially higher or lower than book value, the stockholder's equity is revised for the prior tax year by adding or subtracting the actual value of the asset sold in the current year. Therefore, the capital stock value is recomputed in prior years by considering revised equity. The adjustment of the capital stock value of a prior tax year or years whereby the capital stock value is increased shall be made by the Department under section 407(b) of the TRC (72 P. S. § 7407(b)). When the adjustment would result in a decrease of the capital stock value of a prior tax year or years, the taxpayer shall initiate the adjustment under sections 503(a)(1), 1102 or 1103 of the FC (72 P. S. §§ 503(a)(1), 1102 or 1103).

*Example 1.* An asset had a book value of \$50,000 for the current tax year. Taxpayer disposed of the asset for \$500,000 which resulted in a \$450,000 capital gain. The taxpayer's capital stock value in the prior tax year was \$70,000 based on a stockholder's equity of \$100,000 ( $\$100,000 \times 70\%$ ). The revised stockholder's equity in the prior tax year is \$550,000 ( $\$450,000$  plus  $\$100,000$ ). The capital stock value recomputed for the prior tax year shall be \$385,000 ( $\$550,000 \times 70\%$ ).

*Example 2.* An asset had a book value of \$500,000 for the current year. Taxpayer disposed of the asset for \$100,000 which resulted in a \$400,000 loss. The

taxpayer's capital stock value in the prior tax year was \$700,000 based on a stockholder equity of \$1,000,000 ( $\$1,000,000 \times 70\%$ ). The revised stockholder's equity in the prior tax year is \$600,000 ( $\$1,000,000$  minus  $\$400,000$ ). The capital stock value recomputed for the prior tax year shall be \$420,000 ( $\$600,000 \times 70\%$ ).

(8) *Stock for stock exchange transaction.* When a taxpayer's total outstanding shares are purchased in exchange for the shares of the purchasing company, the capital stock value for the current tax year and prior tax year or years will be based upon the exchange value of the stock. The exchange value of the shares will be based upon the current market value of the shares. The capital stock value for the current tax year shall be computed at approximately 90% of the exchange value of shares. The capital stock value for the immediate prior tax year shall be computed at approximately 80% of the exchange value of shares. The capital stock value for the second prior tax year shall be computed as approximately 70% of the exchange value of shares and so forth.

*Example 1.* The taxpayer's total outstanding shares are purchased by A corporation for one million shares of A corporation. The value of the one million shares is \$25,000,000. The capital stock value for the current tax year shall be \$22,500,000 ( $\$25,000,000 \times 90\%$ ). The capital stock value for the immediate prior tax year shall be \$20,000,000 ( $\$25,000,000 \times 80\%$ ). The capital stock value for the second prior tax year shall be \$17,500,000 ( $\$25,000,000 \times 70\%$ ).

#### Source

The provisions of this § 155.24 adopted September 1, 1978, effective September 2, 1978, 8 Pa.B. 2457.

#### Notes of Decisions

The capitalization rates for earnings and dividends incorporated into 61 Pa. Code § 155.24 have no applicability to capital stock valuation for years prior to the promulgation of the provisions in August of 1979. *Commonwealth v. Bessemer and Lake Erie Railroad Co.*, 427 A.2d 699 (Pa. Cmwlth. 1981); exceptions dismissed 433 A.2d 909 (Pa. Cmwlth. 1981).

#### Cross References

This section cited in 61 Pa. Code § 155.21 (relating to general); 61 Pa. Code § 155.22 (relating to definitions); and 61 Pa. Code § 155.28 (relating to capital stock value methods—fixed formula).

### § 155.25. Capital stock value—fixed formula.

(a) For calendar years 1984, 1985 and 1986 and fiscal years beginning in 1984, 1985 and 1986:

Capital Stock Value is the amount computed under the following formula: one-half times the sum of the average net income capitalized at the rate of 9 1/2% plus 75% of net worth, the algebraic equivalent of which is:

$$.5 \times (\text{average net income}/.095 + (.75) (\text{net worth})).$$

(b) For calendar year 1987 and fiscal years beginning in 1987 and each year thereafter:

Capital Stock Value is the amount computed under the following formula: the product of one-half times the sum of the average net income capitalized at the rate of 9 1/2% plus 75% of net worth from which product shall be subtracted \$50,000, the algebraic equivalent of which is:

$$(.5 \times (\text{average net income} / .095 + (.75) (\text{net worth}))) - 50,000$$

**Authority**

The provisions of this § 155.25 issued under section 408 of the Tax Reform Code of 1971 (72 P. S. § 7408).

**Source**

The provisions of this § 155.25 adopted January 16, 1987, effective January 17, 1987, 17 Pa.B. 273.

**Cross References**

This section cited in 61 Pa. Code § 155.21 (relating to general).

**§ 155.26. Average net income—fixed formula.**

(a) Average net income is the sum of the taxpayer's net income or loss for each of the current and immediately preceding 4 years, divided by five.

(b) Net income or loss is the amount set forth as income per books on the income tax return filed by the taxpayer with the Federal government, or if no return is made, as would have been set forth had the return been made. The net income or loss shall be computed on an unconsolidated basis exclusive of the net income or loss of an investee corporation and exclusive of the net income or loss of an investee corporation accounted for under the equity method of accounting. The amount set forth as income per books on the income tax return filed with the Federal government or as would have been set forth had the return been made, shall be adjusted to include dividends received from investee corporations, including dividends from investments accounted for under the consolidated or equity methods of accounting.

(c) In computing average net income, losses shall be entered as computed, but the average net income may not be less than zero.

(d) Net income or loss shall be subject to correction by the Department for fraud, evasion or error.

(e) In the case of a taxpayer which has not been in existence for a period of 5 calendar years, average net income is the average net income for the number of years that the taxpayer has been in existence. A taxpayer in existence for a part of a year shall be considered to have been in existence for that year based on the number of days in the year that the taxpayer was in existence.

*Example 1.* The taxpayer, incorporated August 1, 1982, reports on a calendar year basis. Its net income for the period August 1 through December 31, 1982

(153 days) was \$20,000. Its net income for 1983 was \$50,000 and for 1984, \$70,000. Average net income for 1984 would be \$57,870 ( $\$140,000 \div 2 \frac{153}{365}$ ).

*Example 2.* The taxpayer filed on a calendar year basis until December 1980. In 1981 it changed its filing period to a fiscal year ending June 30. In order to do so, it filed a short period report for January 1 through June 30, 1981. Thereafter, taxpayer continued to file on a fiscal year basis. In computing average net income for the period ending June 30, 1985, taxpayer would include its January 1 through June 30, 1981 net income or loss as well as its July 1, 1981 through June 30, 1985 net income or loss and divide the result by  $4 \frac{181}{365}$ .

*Example 3.* The taxpayer, incorporated May 1, 1971, filed a calendar year report for 1980. Between January 1, 1981 and December 31, 1984, the taxpayer, as a result of various mergers and filing period changes, had 6 book years. The taxpayer's average net income for 1984 would include the net income or loss for each of the 6 book years between January 1, 1980 and December 31, 1984, divided by five.

(f) Average net income does not include net income or loss of the corporation for a period of time prior to incorporation, such as net income or loss of a partnership prior to incorporation. Net income or loss of a predecessor corporation may not be attributed to a successor corporation. In the case of a mere change in identity, form or place of organization of one corporation, net income or loss prior to the change shall be utilized in determining average net income. Net income or loss may not be adjusted in the event of a change in corporate structure, but to the extent that a change occurs as a result of a tax evasion motive, net income or loss may be adjusted to negate the effects of the change in corporate structure. The following examples demonstrate the application of this subsection with respect to mergers, consolidations and reincorporations. Where there is evidence of a tax evasion motive, average net income will be determined based on the substance of the transaction.

*Example 1.* Effective December 31, 1984, Corporation A merges into Corporation B. The net income or loss for the two corporations are:

Year	Corporation A	Corporation B
1981	\$60,000	\$150,000
1982	\$10,000	\$100,000
1983	(\$100,000)	\$ 80,000
1984	(\$100,000)	\$ 60,000
Total 1985	—	\$100,000

The average net income for 1985 for Corporation B, the corporation which survived the merger, would be \$98,000 ( $\$490,000 \div 5$ ), determined without regard to the net income or loss of Corporation A prior to the merger.

*Example 2.* Effective December 31, 1984, Corporation A and Corporation B consolidate to form a new corporation, Corporation C. Both Corporations A and B had been in existence for more than 5 years prior to the consolidation. Corpo-

ration C's average net income would be determined for 1985 based only on the corporation's net income or loss for 1985, and no recognition would be given to the net income or loss of either Corporation A or Corporation B prior to the consolidation.

*Example 3.* Effective December 31, 1984, Corporation A, formerly incorporated in State Y, reincorporates in State X. The average net income for 1985 would be computed taking into account net income or loss for 1985, as well as net income or loss for the 4 years prior to January 1, 1985.

(g) No adjustment to net income or loss may be made for Federal income tax which would have been paid by a corporation electing S Corporation treatment under Section 1361 of the IRC (26 U.S.C.A. § 1361) or for Commonwealth Corporate Net Income Tax which would have been paid by a corporation electing Pennsylvania S corporation treatment under article 3 of the TRC (72 P. S. §§ 7301—7361), or for Commonwealth personal income tax paid by the shareholders of the corporation.

(h) No adjustment to net income or loss may be permitted on account of non-recurring or extraordinary items.

(i) A taxpayer which totally ceases operations, has abandoned the business for which it was incorporated and is divested of assets shall be deemed to have ceased to exist for the purpose of computing average net income and upon recommencing business activities, shall be considered to have come into existence upon the date activities recommence. This subsection does not apply to situations where the cessation of activities occurred due to a tax evasion motive.

(j) Corporations planning significant reductions in business operation, as well as corporations in the process of liquidating, should be aware of the effects tail earnings may have on subsequent years' tax liability and plan accordingly.

#### Authority

The provisions of this § 155.26 issued under section 408 of the Tax Reform Code of 1971 (72 P. S. § 7408).

#### Source

The provisions of this § 155.26 adopted January 16, 1987, effective January 17, 1987, 17 Pa.B. 273.

#### Notes of Decisions

##### *Application*

This section does not apply retroactively and the Department of Revenue followed the Department's previously established interpretation of section 408 of the Tax Reform Code of 1972 (72 P. S. § 7408). *Doyle Equipment Co. v. Commonwealth*, 542 A.2d 644 (Pa. Cmwlth. 1988).

##### *Calculating Tax Liability*

Under subsection (g), an S corporation may not assume the tax liability of its shareholders and then deduct that as an expense in calculating its annual net income for capital stock purposes. *Scott Electric Co. v. Commonwealth*, 692 A.2d 289 (Pa. 1997); exceptions overruled, decision adhered to 704 A.2d 205 (Pa. Cmwlth. 1998).

“Net income per books” as the term is used in calculating tax liability on capital stock values for Subchapter S Corporations did not permit corporations to deduct hypothetical Federal income tax it did not pay. *Tool Sales and Service Co., Inc. v. Commonwealth*, 613 A.2d 143 (Pa. Cmwlth. 1992); affirmed 637 A.2d 607 (Pa. 1993).

#### *Capital Stock Value*

Corporation has not demonstrated a due process violation, but can claim only that where the total property, payroll, and sales of the unitary business enterprise included in the fractions of the three-factor formula, its tax due would be approximately 44.5% less than the figure arrived at by the Board of Finance and Revenue in its calculation under the three-factor formula because the 44.5% disparity between calculations does not lie outside of the constitutional margin of error delineated by the United States Supreme Court. *Unisys Corp. v. Commonwealth*, 812 A.2d 448 (Pa. 2002); cert. denied 540 U. S. 812 (U. S. 2003).

#### *Consistent with GAAP*

The regulatory treatment of income per books, by not allowing for adjustments for extraordinary or nonrecurring items, is consistent with the GAAP treatment of the same. *Shawnee Development, Inc. v. Commonwealth*, 799 A.2d 882 (Pa. Cmwlth. 2002); dec. vacated 799 A.2d 882 (Pa. Cmwlth. 2002), ord. aff’d 819 A.2d 528 (Pa. 2003).

#### *Fiscal Year*

There was no inconsistency between this regulation and section 601 of the Tax Reform Code (72 P. S. § 7601). This regulation reasonably supplements the statute by providing for a case where a corporation changes its fiscal year and shortens the period of its taxable year. The Department’s expertise in this area is entitled to deference in interpreting the statutes they enforce, particularly when such interpretation treats both new and old corporations in a uniform rather than discriminatory manner. *Consolidated Rail Corp. v. Commonwealth*, 670 A.2d 722 (Pa. Cmwlth. 1996); affirmed 691 A.2d 456 (Pa. 1997).

#### *Not Clearly Erroneous; Nonconfiscatory*

The taxpayer’s bald assertion that its stock must be of no value because it is insolvent is not sufficient to meet its heavy burden to show that the regulation is clearly erroneous, or that it works an unconstitutional confiscation of its property. *Shawnee Development, Inc. v. Commonwealth*, 799 A.2d 882 (Pa. Cmwlth. 2002), dec. vacated 799 A.2d 882 (Pa. Cmwlth. 2002), order aff’d. 819 A.2d 528 (Pa. 2003).

#### **Cross References**

This section cited in 61 Pa. Code § 155.21 (relating to general).

### **§ 155.27. Net worth—fixed formula.**

(a) Net worth is the sum of the taxpayer’s issued and outstanding capital stock, surplus and undivided profits as per books set forth on the income tax return filed by the taxpayer with the Federal government, or if no return is made, as would have been set forth had a return been made.

(b) In the case of a taxpayer which has investments in the common stock of another corporation, net worth is the consolidated net worth of the taxpayer computed in accordance with generally accepted accounting principles. Book value for investments of stock of other corporations includes original cost plus the investor’s share of the investee’s earnings or losses. For the purpose of this subsection, investments in the common stock of another corporation means investments which shall be accounted for using the equity method of accounting or which shall be consolidated under generally accepted accounting principles.

(c) Net worth may not be less than zero.

- (d) Net worth does not include the cost of treasury stock.
- (e) Net worth as reported by the taxpayer is subject to correction by the Department for fraud, evasion or error.
- (f) Net worth includes the amount of a contingent liability or surplus reserve which is not recorded as a liability or a reduction in an asset account by an entry in the books of account of the corporation. Contingent liability or surplus reserve which is included as a parenthetical comment in the main body of the financial statements or by a footnote to the financial statements may not result in a reduction or increase to net worth.



(g) Changes in a taxpayer's capital structure, including contributions and distributions of capital, purchases of treasury stock and liquidation distributions, may not be prorated.

*Example 1.* The taxpayer, which files on a calendar year basis, issued common stock on July 1. The value of the common stock issued is \$300,000. The net worth at the end of the tax year is \$1 million. The net worth to be used in computing capital stock value is \$1 million.

*Example 2.* The taxpayer, which reports on a calendar year basis, has discontinued business operations. On January 1 of the taxable year, taxpayer has a net worth of \$100,000 and total assets of \$1 million. On December 1 of the taxable year, taxpayer distributes all of its assets. The net worth to be used in computing capital stock value is zero.

(h) Commencing with calendar year 1987 and fiscal years beginning in 1987 and each year thereafter, the following rule applies: if net worth as arrived at under subsections (a)—(g) for the current tax year is greater than twice or less than 1/2 of the net worth which would have been calculated under subsections (a)—(g) as of the first day of the current tax year, then net worth for the current tax year shall be the average of these two amounts.

#### Authority

The provisions of this § 155.27 issued under section 408 of the Tax Reform Code of 1971 (72 P. S. § 7408).

#### Source

The provisions of this § 155.27 adopted January 16, 1987, effective January 17, 1987, 17 Pa.B. 273.

#### Notes of Decisions

##### *Capital Stock Value*

Corporation has not demonstrated a due process violation, but rather can claim only that where the total property, payroll, and sales of the unitary business enterprise included in the fractions of the three-factor formula, its tax due would be approximately 44.5% less than the figure arrived at by the Board of Finance and Revenue in its calculation under the three-factor formula, where a 44.5% disparity between calculations does not lie outside of the constitutional margin of error delineated by the United States Supreme Court. *Unisys Corp. v. Commonwealth*, 812 A.2d 448 (Pa. 2002); cert. denied 540 U. S. 812 (U. S. 2003).

#### Cross References

This section cited in 61 Pa. Code § 155.10 (relating to single factor apportionment); and 61 Pa. Code § 155.21 (relating to general).

### § 155.28. Capital stock value methods—fixed formula.

(a) *Prior methods inapplicable.* The capital stock value arrived at by application of the formula set forth in section 601(a) of the TRC (72 P. S. § 7601(a)) may not be affected by the valuation factors or methods set forth in §§ 155.21—155.24 (relating to general; definitions; determinations of valuation factors; and valuation methods). This includes methods formerly applied to valuing first year companies (§ 155.24(c)(2)), last year companies (§ 155.24(c)(3)), companies

with liquidations in progress (§ 155.24(c)(4)), valuations relating to cash sales of assets or outstanding shares (§ 155.24(c)(5)), valuations based on the sale of an asset (§ 155.24(c)(7)) or valuations based on a stock for stock exchange transaction (§ 155.24(c)(8)).

(b) *Short taxable year.* Tax due for a short taxable year shall be prorated as follows:

(1) *First year companies.* Tax due for a short taxable year resulting from the commencement of business activities within this Commonwealth during the taxable year shall be prorated either on the basis of proration of tax, or proration of the property factor, as required in this section. The payroll of sales factors may not be prorated.

(i) In the case of a corporation which has done business outside this Commonwealth for more than 1 year but has been subject to Commonwealth taxation for less than 1 year, the numerator of the property factor shall be prorated to reflect the portion of the year for which business was done in this Commonwealth. The tax due shall be prorated only where all three factors are 100% Commonwealth.

*Example 1.* A foreign corporation has operated outside of this Commonwealth for more than 1 year, but was only subject to Pennsylvania taxation for the last 90 days of the taxable year. The average value of real and tangible personal property in this Commonwealth is \$80,000, and the average value of the property everywhere is \$150,000. The numerator of the property factor would be \$19,726 ( $\$80,000 \times 90/365$  days.) The tax would not otherwise be prorated.

*Example 2.* If, in Example 1, all three apportionment factors were 100% Commonwealth, the property factor would not be prorated, but the tax would be prorated by multiplying the tax by a fraction, which is 90/365 days.

(ii) In the case of a corporation which has been doing business outside of this Commonwealth for the same period for which it has been subject to Commonwealth taxation, which is less than 1 year, the property factor is not prorated, but the tax due is prorated based on the portion of the year during which the corporation did business in and out of this Commonwealth.

(iii) In the case of a corporation which has done business outside of this Commonwealth for a period of less than 1 year and has been subject to Commonwealth taxation for a shorter period than it has done business outside of this Commonwealth, the property factor shall be prorated unless it reports 100% Commonwealth factors—in which case the property factor would not be prorated—and the tax would be prorated for the period of operation everywhere.

*Example 1.* A corporation did business outside of this Commonwealth commencing July 15, but did not become subject to Commonwealth taxation until October 1, and files on a calendar year basis. The numerator of the property fac-

tor would be prorated by multiplying it by a fraction, which is 92/170 days. The tax due would be prorated by multiplying the tax by a fraction, which is 170/365 days.

*Example 2.* If, in Example 1, the corporation was incorporated July 15 but did not transact business anywhere until October 1, the numerator of the property factor would not be prorated, but the tax would be prorated for the Commonwealth period only, by multiplying the tax by a fraction, which is 92/365 days.

*Example 3.* If the corporation in examples 1 and 2 reported 100% Commonwealth factors, the property factor would not be prorated but the tax would be prorated for the Commonwealth period only, by multiplying the tax by a fraction, which is 92/365 days.

(2) *Last year companies.*

(i) In the case of a corporation ceasing business activities everywhere, tax due shall be prorated on a per day basis.

*Example.* The taxpayer, a domestic corporation which files on a calendar year basis, is not entitled to apportionment and has no exempt assets. Its capital stock value for the calendar year 1985 was \$20,000. Taxpayer made its final distribution on August 31, 1985. Its tax, at the rate of 10 mills, would be \$133.15, computed as follows:

\$20,000 at 10 mills = \$200

\$200 × 243/365 days = \$133.15

(ii) In the case of a corporation withdrawing from this Commonwealth but continuing to do business elsewhere, the numerator of the property factor shall be prorated.



(c) *Minimum Capital Stock and Foreign Franchise Tax.* The minimum tax due is \$75 which will be prorated if the corporation does not have a full tax year in this Commonwealth. See section 7602 of the TRC (72 P. S. § 7602). This subsection applies to corporations which file reports with the Department, with the exception of family farm corporations. See § 155.29 (relating to minimum tax).

#### Authority

The provisions of this § 155.28 issued under section 408 of the Tax Reform Code of 1971 (72 P. S. § 7408).

#### Source

The provisions of this § 155.28 adopted January 16, 1987, effective January 17, 1987, 17 Pa.B. 273.

#### Cross References

This section cited in 61 Pa. Code § 155.21 (relating to general).

### § 155.29. Minimum tax.

(a) *General.* Under the act of December 23, 1983 (P. L. 370, No. 90) that amended Article VI of the TRC (72 P. S. §§ 601—614), applicable commencing with calendar year 1983 and to each year thereafter, a minimum Capital Stock or Foreign Franchise Tax of \$75 is imposed on corporations maintaining a corporate tax account. The minimum tax shall be due even in those instances where the actual tax due under the fixed formula or alternative capital stock valuation methods is less than \$75. The minimum tax will be prorated if the corporation does not have a full tax year in this Commonwealth.

(b) *Family farm corporations.* Corporations qualifying as family farm corporations under section 602.2 of the TRC (72 P. S. § 7602.2) are not subject to the minimum tax.

(c) *Inactive corporations.* Corporations which are inactive and which have qualified to file and have filed an Out of Existence Affidavit (Form REV-238 CT), in the case of domestic corporations, or a Withdrawal Affidavit (Form REV-238 CT), in the case of foreign corporations, are not subject to the minimum tax commencing with the date the affidavit is filed. Corporations which are inactive and which have not filed either an Out of Existence or Withdrawal Affidavit are subject to the minimum tax. An inactive corporation is one which owns no property, has no employees, does no business and carries on no activities. See § 151.11 (relating to termination).

(d) *Skeleton reports.* Corporations which are inactive and which have been qualified to file and have filed Skeleton Reports under § 151.12 (relating to minimum reporting) are subject to the minimum tax.

*Example.* Corporation A, an inactive foreign corporation, has not filed a Withdrawal Affidavit. In order to retain its corporate name, Corporation A files a Skeleton Report for the calendar year 1985. Corporation A, being inactive, has no

net worth. Corporation A had average net income of \$20,000 for 1985, based on the following net income or loss:

1981	\$90,000
1982	\$40,000
1983	(\$10,000)
1984	(\$20,000)
1985	\$0

Notwithstanding the fixed formula value of Corporation A of \$105,263 ( $.5 \times (\$20,000/.095 + (.75)(0))$ ), the Foreign Franchise Tax due would be the minimum tax of \$75.

#### Authority

The provisions of this § 155.29 issued under section 408 of the Tax Reform Code of 1971 (72 P. S. § 7408).

#### Source

The provisions of this § 155.29 adopted January 16, 1987, effective January 17, 1987, 17 Pa.B. 273.

#### Cross References

This section cited in 61 Pa. Code § 155.28 (relating to capital stock value methods—fixed formula).

### § 155.30. Regulated investment companies.

(a) *General.* Commencing with the calendar year 1985 and each year thereafter, the Capital Stock or Foreign Franchise Tax of a regulated investment company is the sum of the following products:

- (1) Seventy five dollars multiplied by the quotient, rounded to the nearest whole number, produced by dividing the net asset value of the regulated investment company by 1 million.
- (2) The apportioned undistributed Personal Income Tax income of the regulated investment company multiplied by the Personal Income Tax rate for the same tax year.

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

*Apportioned undistributed Personal Income Tax income*—Undistributed Personal Income Tax income multiplied by a fraction, the numerator of which is income distributed during the taxable period to shareholders who are Commonwealth resident individuals, estates or trusts and the denominator of which is income distributed during the taxable period.

*Monthly net asset value*—The actual market value of assets owned by the regulated investment company without exemptions or exclusions, less liabilities, debts and other obligations as of the last day of the month.

*Net asset value*—Determined by adding the monthly net asset values for each month during the taxable period and dividing the sum by the number of months involved.

*Personal Income Tax income*—Income computed in the same manner and on the same basis as the income of an individual under Article V (relating to personal income tax).

*Regulated investment company*—A domestic corporation and a foreign corporation which is registered to do business in this Commonwealth, maintains an office in this Commonwealth, has filed a timely election to be taxed as a regulated investment company with the Federal government and qualifies to be taxed as a regulated investment company under the IRC.

*Undistributed Personal Income Tax income*—Personal Income Tax income, other than Personal Income Tax income undistributed on account of the Capital Stock or Foreign Franchise Tax liability of the regulated investment company, less Personal Income Tax income distributed to shareholders.

(c) *Determination of income considered to be distributed.*

(1) Personal Income Tax income is deemed to be either distributed to shareholders or undistributed in the same proportion that the total income received by the regulated investment company during the taxable year is distributed to shareholders or undistributed.

(2) At the election of the regulated investment company, income distributed after the close of a taxable year, but deemed distributed during the taxable year for Federal income tax purposes, is deemed distributed during the year.

(3) If a regulated investment company in a taxable year has both current income and income accumulated from a period year, distributions made during the year shall be deemed to have been made first from current income.

#### **Authority**

The provisions of this § 155.30 issued under sections 408 and 603 of the Tax Reform Code of 1971 (72 P. S. §§ 7408 and 7603).

#### **Source**

The provisions of this § 155.30 adopted January 16, 1987, effective January 17, 1987, 17 Pa.B. 273; amended December 10, 1999, effective December 11, 1999, 29 Pa.B. 6249. Immediately preceding text appears at serial pages (205462) to (205463).

#### **Cross References**

This section cited in 61 Pa. Code § 155.21 (relating to general).

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