pennsylvania
DEPARTMENT OF REVENUE

CORPORATION TAX BULLETIN 2024-01

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Sourcing Sales Other Than Tangible Personal Property and Services

The purpose of this bulletin is to provide the Department of Revenue's interpretation of key terms and concepts necessary to properly apply the statutory rules for sourcing sales affected by the legislative changes adopted as part of Act 53 of 2022. The applicable provision is 72 P.S. § 7401(3)2.(a)(17), which was amended under Section 6 of Act 53 of July 8, 2022, P.L. 513, and shall apply to taxable years beginning after December 31, 2022.[1]

Note that sales of tangible personal property and sales of services are sourced according to subparagraphs (16) and (16.1), respectively; with all other sales sourced under subparagraph (17) of the aforementioned statute.

DEFINITIONS AND TERMINOLOGY

Fair Market Value (FMV). The price that property would sell for on the open market. It is the price that would be agreed on between a willing buyer and a willing seller, with neither being required to act, and both having reasonable knowledge of the relevant facts and a reasonable time period for completing the transaction. If there are restrictions on the use of the property, the FMV must reflect that restriction. The basis, origin, methodology, and assignment of such values should be retained in case of audit.

Located in this State. For individual persons, this term refers to resident individuals. Unless a taxpayer has actual knowledge that the residence or domicile of a person is in a state other than the state in which the person's billing address is located, the person shall be deemed to be located in the state of their billing address.

Whether a corporation is located in this state involves consideration of relevant facts and circumstances which are often unique and will be considered on a case-by-case basis. These include, but are not limited to, headquarters location, billing address, activities of the corporation, and the location of the office from which the transaction was negotiated in the regular course of business.

Motor Vehicle. A vehicle which is self-propelled except an electric personal assistive mobility device or a vehicle which is propelled solely by human power or by electric power obtained from overhead trolley wires, but not operated upon rails.

Regularly Lends Funds. An established pattern of activity in which an entity lends funds to other entities or to individuals; depending on the facts and circumstances it may include an anticipated pattern of future activity. Isolated or unique lending activity will not be construed as constituting regular lending.

[1] In keeping with existing authority, the provisions of 72 P.S. § 7401(3)2.(a)(17) apply to corporations' receipts regardless of whether a corporation receives the receipt directly or based on its interest in an unincorporated entity.

Transportation Property. A vehicle and vessel capable of moving under its own power, such as an aircraft, a train, a water vessel and a motor vehicle. The term includes equipment or a container attached to the property, such as rolling stock, a barge, a trailer or similar equipment or container.

Unaffiliated Entity. For purposes of 72 P.S. § 7401(3)2.(a)(17) this term follows the definitions of 72 P.S § 7401(10) and (11). This term does not include individual persons.

STATUTORY RULES, WITH EXAMPLES

(17) Sales, other than sales under paragraphs (16) and (16.1), are in this State as follows:

(A), (B) Deleted by 2022, July 8, P.L. 513, No. 53, § 6, imd. effective.

(C) Gross receipts from the lease or license of intangible property, including a sale or exchange of property where the receipts from the sale or exchange derive from payments that are contingent on the productivity, use or disposition of the property, if and to the extent the property is used in this State.

Example 1: Taxpayer is a holding company located in Delaware that receives a royalty payment for the license of trademarks by its Pennsylvania based affiliate for the use of the trademarks in Pennsylvania. The Pennsylvania based affiliate has a chain of ten convenience stores located across Pennsylvania where the trademarks in question are used on signage and products offered for sale to customers. Taxpayer sources all of its royalty receipts to Pennsylvania because the trademarks were used solely in Pennsylvania during the year.

Example 2: Same facts as Example 1 except the Taxpayer receives a royalty payment for the license of its trademarks by its Pennsylvania based affiliate based upon the gross receipts produced from each convenience store. In this example, the affiliate has ten stores in Pennsylvania and three stores in New Jersey, but the New Jersey stores produce 60% of the total gross receipts of all the stores combined. Because the royalty payment is based upon the gross receipts produced by the stores, 40% of the royalty receipts would be sourced to Pennsylvania in this scenario.

Example 3: Taxpayer is a corporation located in Maryland that grants restaurant franchises to individuals in specific locations throughout Maryland and Pennsylvania. In exchange for granting a franchise to an individual, Taxpayer leases its trademarks and patented food-processing techniques to its franchisees. The leases are paid annually and entitle the franchisee to use those intangibles in specific restaurants throughout Pennsylvania and Maryland. The receipts from the intangibles leased to Pennsylvania franchisees are sourced to Pennsylvania because the intangibles were used in this State.

Example 4: Retailer Corp. is preparing a new TV commercial for broadcast in all 50 states. Retailer Corp. enters into a licensing agreement with Music Corp. to use a certain musical score as background music in all of Retailer Corp.'s commercials for 2023. Retailer Corp. pays Music Corp. $100 for each time Retailer Corp.'s commercial is broadcast on national or local TV stations. During 2023, 5% of Retailer Corp.'s *commercials utilizing Music Corp.'s score are broadcast in this Commonwealth. Music Corp. should source to the Commonwealth 5% of all its receipts related to the licensing agreement with Retailer Corp.*

Example 5: MFG Corp. has a plant located in this Commonwealth and one in the State of New York. It purchases a license to a manufacturing process that is an integral part of its assembly production line from IP Corp. The payments are contingent upon the productivity of the plants that are using the licensed manufacturing process. For every widget that is produced using the process, IP Corp. receives $1. IP Corp. should report to the Commonwealth all the receipts from MFG Corp. that it received for widgets produced in this Commonwealth.

(D) Gross receipts from the sale of intangible property where the property sold is a contract right, government license or similar property that authorizes the holder to conduct a business activity in a specific geographic area, if and to the extent the property is used in or otherwise associated with this State.

Example 1: Baker Corp., located in Pennsylvania, pays Gourmet Corp., located in Virginia, for the exclusive right to be the official baker and distributor of Gourmet Corp.'s breads in Central Pennsylvania. Gourmet Corp. sources 100% of the receipts from the sale of this contract right to Baker Corp. to Pennsylvania because the right was solely used in this State.

Example 2: Wireless Corp. purchases from Spectrum Corp. a license entitling it to use a defined set of frequencies and exclusive use of applicable radio spectrum in well-defined geographic areas in order to transmit data between its various cell towers and a subscriber's handset. Spectrum Corp. earned a $10 million fee for the license from Wireless Corp. 30% of the geographic license covers locations within Pennsylvania while 50% of Wireless Corp.'s subscriber's billing addresses that receive their services through that geographic spectrum license are located in Pennsylvania. Because 50% of the use of the license occurred in Pennsylvania by Wireless Corp. in providing data to its subscribers' handsets, 50% of the licensing fee should be sourced to Pennsylvania.

(E) Gross receipts from the sale, redemption, maturity or exchange of securities, held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business, if the customers are in this State.

Comment: "held by the taxpayer primarily for sale to customers" is interpreted by the Department as requiring greater than 50% of the total receipts from such sales to be derived from such transactions.

Example 1: Security Corp.'s business is the sale of stocks and bonds it holds primarily for sale to customers. Investor Corp., located in this Commonwealth, purchases $100,000 of bonds from Security Corp. Security Corp. sources $100,000 of the gross receipts from its sale of bonds to Investor Corp. to the Commonwealth.

Example 2: Security Corp.'s business is the sale of stocks and bonds it holds for sale to individual investors. Some of Security Corp.'s customers are residents of this Commonwealth and some are residents of other states. Security Corp. is required to report receipts it earned from Pennsylvania resident investors in the numerator of its sales factor.

(F) Gross receipts received by a corporation that regularly lends funds to unaffiliated entities or to individuals from interest, fees and penalties imposed in connection with loans secured by real property as follows:

Comment: The Department interprets the term "unaffiliated" to apply to entities only. Interest on loans to all individuals, whether or not "affiliated" under the provisions of IRC §§ 318, 1563 or any other section of the IRC, is subject to being sourced according to 72 P.S. § 401(3)2.(a)(17)(F), (G) and/or (H).

(i) The following shall apply to a calculation under this subparagraph:

(I) The numerator of the sales factor shall include interest, fees and penalties imposed in connection with loans secured by real property if the property is located within this State.

Example: Restaurant Corp. seeks to expand its business presence from solely this Commonwealth to also include the State of New Jersey. Restaurant Corp. obtains a $25 million loan from Lender Corp. in order to build new restaurants in New Jersey. The loan is secured only by Restaurant Corp.'s real property in Pennsylvania. Lender Corp. shall source all interest, fees and penalties received from Restaurant Corp. in connection with this loan to this Commonwealth.

(II) If the real property under this subparagraph is located both within this Commonwealth and one or more other states, the gross receipts under this subparagraph shall be included in the numerator of the sales factor if more than fifty per cent of the fair market value of the real property is located within this Commonwealth.

Example: Restaurant Corp. seeks to expand its restaurant business from Pennsylvania and New Jersey locations to also include New York. The FMV of Restaurant Corp.'s Pennsylvania properties is $15 million, while the FMV of Restaurant Corp.'s New Jersey properties is $10 million. Restaurant Corp. obtains a $25 million loan from Lender Corp. to build new restaurants in New York. The loan is secured by both Restaurant Corp.'s Pennsylvania and New Jersey properties, of which 60% of the FMV is located in Pennsylvania. Lender Corp. shall source all interest, fees and penalties received from Restaurant Corp. to this Commonwealth because greater than 50% of the FMV of the properties securing the loan is located in this Commonwealth.

(III) If more than fifty per cent of the fair market value of real property under this subparagraph is not located within any single state, the gross receipts under this subparagraph shall be included in the numerator of the sales factor if the borrower is located in this State.

Example: Restaurant Corp., a corporation located in Pennsylvania, seeks to expand its business presence from Pennsylvania, New Jersey, and New York to include several other locations in other states. Restaurant Corp. obtains a $50 million loan from Lender Corp. to build the new restaurants. The loan is secured by Restaurant Corp.'s Pennsylvania, New Jersey, and New York properties, of which 40% of the FMV is located in Pennsylvania, 30% of the

FMV is located in New Jersey, and 30% of the FMV is located in New York. Since not more than 50% of the FMV of real property is located in any single state, and since the borrower is located in this Commonwealth, Lender Corp. shall include all gross receipts from interest, fees, and penalties in the numerator of its Pennsylvania sales factor.

(ii) The determination of whether real property securing a loan is located within this State shall be made as of the time the original agreement was made, and all subsequent substitutions of collateral shall be disregarded.

Example: Same facts as (F)(i)(II) except that three months after entering into the loan agreement, Restaurant Corp. substitutes as the collateral on the loan its properties in Florida which were not part of the original agreement. Because this was a subsequent substitution it is not relevant for Pennsylvania tax purposes and the securing property will be considered to be the Pennsylvania, New York, and New Jersey properties originally securing the loan.

(G) Gross receipts received by a corporation that regularly lends funds to unaffiliated entities or to individuals from interest, fees and penalties imposed in connection with loans related to the sale of tangible personal property. The following shall apply to a calculation under this subparagraph:

(i) Except as provided under unit (ii), the numerator of the sales factor shall include gross receipts received from interest, fees and penalties imposed in connection with loans related to the sale of tangible personal property if the property is delivered or shipped to a purchaser in this State.

**Note: For all of the examples provided in paragraphs (G) and (H), assume Lender Corp. regularly lends funds to unaffiliated entities.*

Example: Lender Corp. lends $5 million to ABC Corp. to purchase laptop computers from Computer Corp. for its field staff located throughout the US. Computer Corp. ships all of the laptops to ABC's headquarters in this Commonwealth for preloading of specialty software and security programs. Lender Corp. shall source to the Commonwealth, all of the gross receipts from interest, fees and penalties imposed in connection with its $5 million loan to ABC Corp.

(ii) The following shall apply:

(I) Gross receipts received by a corporation that regularly lends funds to unaffiliated entities or to individuals from interest, fees and penalties imposed in connection with loans related to the sale of transportation property shall be included in the numerator of the sales factor to the extent that the property is used in this State.

Example: Lender Corp. loans funds to Freight Corp. for the purchase of 28 forklifts. Twenty of the forklifts are used at Philadelphia International Airport and the rest are used outside this Commonwealth. Lender Corp. should source to the Commonwealth, the gross receipts for interest, fees *and penalties related to the loan to Freight Corp. for the 20 forklifts used in this Commonwealth.*

(II) The extent an aircraft shall be deemed to be used in this State and the amount of gross receipts that shall be included in the numerator of the sales factor shall be determined by multiplying all the gross receipts from the interest, fees and penalties imposed in connection with loans related to the sale of the aircraft by a fraction, the numerator of which is the number of landings of the aircraft in this State and the denominator of which is the total number of landings of the aircraft.

Example: Lender Corp. lends funds to Airline Corp. to purchase two jets from Aircraft Corp. The first aircraft has six out of ten landings in this Commonwealth and the second aircraft has three out of 20 landings in this Commonwealth. In calculating Lender Corp.'s sales factor all interest, fees and penalties paid to Lender Corp. by Airline Corp. in relation to those aircraft shall be multiplied by a fraction of 9/30 and the result included in Lender Corp.'s Pennsylvania sales factor numerator.

(III) A motor vehicle shall be deemed to be used wholly in the state in which it is registered.

Example 1: Automaker Credit Corp. provides car loans to individuals for the purpose of purchasing cars. Automaker Credit Corp. sources to Pennsylvania all interest, fees, and penalties received in relation to the loans used to purchase vehicles registered in this State.

Example 2: Lender Corp. lends funds to Freight Corp. to purchase 20 trucks. Eight of the trucks are registered in this Commonwealth and the rest are registered in other states. Lender Corp. should source to the Commonwealth the gross receipts for interest, fees and penalties for the 8 trucks that were registered in this Commonwealth.

(IV) If the extent of the use of transportation property within this State cannot be determined, the property shall be deemed to be used wholly in the state in which the property was delivered or shipped to the purchaser.

Example: Same facts as (G)(III) Example 2 except that Lender Corp. has no way of determining where each of Freight Corp.'s trucks are registered. However, all of the trucks were originally delivered to Freight Corp.'s headquarters in this Commonwealth. Accordingly, Lender Corp. should source to the Commonwealth all of the gross receipts from interest, fees and penalties collected in connection with its loan to Freight Corp.

(H) Gross receipts received by a corporation that regularly lends funds to unaffiliated entities or to individuals from interest, fees and penalties imposed in connection with loans not described in subparagraph (F) or (G) if the borrower is located in this State.

Example: Service Corp., located in this Commonwealth, borrows funds from Lender Corp. to hire several additional field personnel. The loan is unsecured by either real property or tangible personal property. Lender Corp. should source to the

Commonwealth all of the gross receipts from interest, fees and penalties imposed in connection with its loan to Service Corp.

(I) Gross receipts received from interest, fees and penalties in the nature of interest from credit card receivables and gross receipts from fees charged to cardholders, such as annual fees, if the billing address of the cardholder is in this State.

Example: CC Corp. receives annual fees and interest from its cardholders. One hundred thousand cardholders have billing addresses in this Commonwealth. All annual fees and interest associated with these cardholders are included in CC Corp.'s Pennsylvania sales.

(J) Gross receipts received from interest, not otherwise described in this paragraph, shall be included in the numerator of the sales factor if the lender's commercial domicile is in this State.

Comment: This provision applies primarily to the following types of taxpayers:
(1) Entities who regularly lend funds to entities that meet the definition of "affiliated entities" under 72 P.S. § 7401(10); and
(2) Entities who do not regularly lend funds.

NOTE: "Commercial Domicile" is defined under 72 P.S. § 7401(3)2.(a)(1)(B).

Example 1: CC1 Corp., commercially domiciled in this Commonwealth, regularly lends funds to affiliated entities. CC1 Corp. lends funds to CC2 Corp, which is an affiliated entity located in Indiana. CC1 Corp's interest receipts from this loan should be sourced to the numerator of CC1 Corp.'s sales factor because its commercial domicile is in Pennsylvania.

Example 2: Sandwich Corp., commercially domiciled in this Commonwealth, receives interest from a loan it made to an affiliated entity, Crepe Corp., in order to sustain its business during an economic downturn. Sandwich Corp. has never made a loan before. Because it is not an entity that regularly lends funds, the interest receipts should be sourced to Pennsylvania, Sandwich Corp.'s domicile.

(K) Gross receipts received from intangible property, not otherwise described in this paragraph, shall be excluded from the numerator and the denominator of the sales factor.

Comment: The Department interprets this provision to apply to the receipts from the sale of goodwill and from the sale of other intangibles, including but not limited to: workforce in place, contracts in place, going concern value, patents and copyrights, customer lists, and any covenant not to compete entered into in connection with the acquisition of an interest in a trade or a business.

Example 1: ABC Corp is a corporation doing business within and outside Pennsylvania. The actual value of ABC Corp. is $10 million, including all of ABC Corp.'s tangible and intangible assets. XYZ Corp. is interested in purchasing ABC Corp. Based on current and future market conditions, ABC Corp. agrees to sell its assets to XYZ Corp. for $12 million. Consequently, $2 million of the sale price could accurately be characterized as representing goodwill. While the gross receipts from the sale of ABC Corp.'s assets to XYZ Corp. totals $12 million, only $10 million is included in its sales factor; the remaining $2 million of goodwill is an intangible asset associated with the sale of the *company, but it is not described under paragraphs (C) – (J), so this amount is not included in either the numerator or denominator of ABC Corp.'s Pennsylvania sales factor.*

Example 2: ABC Corp. is a corporation doing business within and outside Pennsylvania that engages in hedging transactions via the use of futures contracts. Because receipts from hedging transactions are not primarily held for sale to customers in the regular course of business and are not described under paragraphs (C) – (J), those receipts are excluded from both the numerator and the denominator of ABC Corp.'s Pennsylvania sales factor.

NOTE: As with any sourcing scenario, if the apportionment provisions of this section do not fairly represent the extent of the taxpayer's business activity in this State, the taxpayer may petition the Secretary of Revenue or the Secretary of Revenue may require the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income as allowed under 72 P.S. § 7401(3)2.(a)(18).