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Subject: Recent Decision in Pennsylvania May Provide Planning Opportunities
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To Our Clients and Friends:

A recent holding in Pennsylvania may offer taxpayers planning opportunities with respect to the apportionment of income. In UPS Worldwide Forwarding, Inc. v. Commonwealth of Pennsylvania, Commonwealth Court of Pennsylvania, March 1, 2004, exceptions denied, December 8, 2004, affirmed, Supreme Court of Pennsylvania, December 30, 2005, the taxpayer was unable to utilize the payroll factor of the three-factor apportionment formula because it had no employees.

The taxpayer argued that it had payroll expenses since it reimbursed an affiliate, dollar for dollar, for certain payroll costs incurred by the affiliate. This affiliate served as the "formal employer" of a group of employees who actually carried out the taxpayer's core business functions. On the taxpayer's books, records and pro forma federal income tax returns, the taxpayer reported these expenses as payroll costs. There was no written contract between the taxpayer and its affiliate with regard to the payroll arrangement. The court held that the taxpayer paid no compensation within the meaning of the Pennsylvania tax statutes, and excluded a payroll factor from the taxpayer's apportionment formula.

The holding may provide planning opportunities for taxpayers that would benefit from Pennsylvania's position with respect to what constitutes compensation for payroll factor purposes. If you would like a copy of the UPS Worldwide Forwarding case, or would like to discuss the implications of the holding and the potential planning that may be available, please do not hesitate to contact me.

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