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PICPA
Pennsylvania Institute of CPAs

Aug. 24, 2026

Via Electronic Submission
Ms. Maria L. Miller
Office of Chief Counsel
Department of Revenue
P.O. Box 281061
Harrisburg, PA 17128-1061

Re: Proposed Regulation #15-464

Dear Ms. Miller:

On behalf of the Pennsylvania Institute of Certified Public Accountants (PICPA) and our nearly 15,000 members, we appreciate the opportunity to comment on the Department of Revenue's (Department's) proposed regulation at 61 Pa. Code Sections 153.26 and 153.26a concerning the sourcing of sales of services for Pennsylvania corporate net income tax (CNIT) purposes.

The PICPA appreciates the Department's effort to provide taxpayers with guidance regarding the sourcing of service receipts. The tax practitioner community has sought formal guidance for many years, and a well-drafted regulation could provide meaningful certainty for taxpayers, practitioners, and the Department alike. Certainty is one of the AICPA's guiding principles of good tax policy.

Simplicity is another guiding principle of good tax policy. Although incorporation of many of the provisions of the Multistate Tax Commission's (MTC's) Regulation IV.17 (MTC Reg. IV.17) and its proposed 2017 amendments promotes this principle, the PICPA is concerned that there are instances where the proposed regulation incorporates provisions of MTC Reg. IV.17 that are inconsistent with the Pennsylvania CNIT statute. Moreover, Pennsylvania has not formally adopted the Multistate Tax Compact and currently is only an associate member of the MTC.

The ultimate objective of the PICPA's comments in this letter is the promulgation of a market-based sourcing regulation that is (1) consistent with the CNIT statute, (2) takes into account how a service provider conducts its business and structures transactions with customers, (3) considers information that is readily available to corporate taxpayers to prepare their tax reports, and (4) does not impose undue burden on taxpayers to substantiate that reported information on audit. The proposed regulation must limit the Department's discretion to adjust a service provider's sourcing methodology to those instances where the taxpayer's method does not reflect its activity within the Commonwealth. In instances when the Department adjusts an otherwise acceptable method of sourcing receipts, the proposed regulation must impose the burden on the Department to prove that the taxpayer's otherwise acceptable method does not accurately reflect the taxpayer's in-state activities and tax liability, but the other methodology does. The shifting of the burden of proof would reduce arbitrary audit adjustments in instances where the use of an alternative acceptable sourcing methodology is applied solely because it results in a greater tax liability. A consistent and reasonable regulation will provide corporate taxpayers and tax preparers with some degree of certainty, increase compliance, and reduce compliance and appeal costs. Certainty also will reduce potential ASC 740 issues for financial statement reporting purposes.

We have significant concerns with the proposal in its current form. The regulation is extraordinarily complex, contains numerous undefined or ambiguous concepts, establishes sourcing methodologies that appear to go beyond the statutory framework enacted by the General Assembly, and grants the Department substantial discretion to substitute its own sourcing methodology for that used by a taxpayer. These provisions will create uncertainty rather than the uniformity and predictability the Department identifies as primary objectives of the rulemaking.

The PICPA, therefore, respectfully requests that the Department revise the proposed regulation before proceeding to final-form rulemaking. The remainder of this letter contains our observations.

I. General Comments

A. The Regulation Must Conform to the Statutory Sourcing Framework.

The Department explains that much of the proposed regulation is modeled after MTC Reg. IV.17 and its proposed 2017 amendments. In the Regulatory Analysis Form, the Department states:

> This rulemaking proposes codifying definitions, rules, and examples clarifying how corporations must source their sales of services. For consistency, the Department bases this regulatory language on both the November 2015 version of the Multistate Tax Commission's (MTC) Regulation IV.17 (regarding Allocation and Apportionment Regulations) and the proposed February 24, 2017, amendments.

The Department further states:

> The Pennsylvania regulation is similar to the tax regulations in the District of Columbia, Alabama, Massachusetts, and Tennessee. As they have similar statutes. The majority of the proposed language mirrors both the November 15, 2015 version of the Multistate Tax Commission's (MTC) Regulation IV.17 (regarding Allocation and Apportionment Regulations) and the proposed February 24, 2017, amendments. The regulation will not put Pennsylvania at a competitive disadvantage with other states.

The PICPA understands the value of uniformity among the states. However, the Department cannot adopt provisions of MTC Reg. IV.17 that are inconsistent with the express language of the CNIT statute. Moreover, other state legislatures, such as Massachusetts, have enacted statutes granting their departments of revenue apportionment-related regulatory authority, powers that are absent from Pennsylvania's CNIT tax statutes.

There are instances where the proposed regulation also is inconsistent with MTC Reg. IV. 17 (e.g., the use of "rules of reasonable approximation"). In those instances, the proposed regulation needs to be revised to be consistent with Pennsylvania's CNIT statute.

B. Critical Terms Need to Be Defined.

1. **The proposed regulation needs to define "tangible personal property," "intangible personal property," and "service."**

In many instances it is difficult to determine whether a sale constitutes a sale of tangible property, intangible property, or a service. As the sales factor sourcing rules differ for each category of sales, the regulations should define these terms.

The proposed regulation should define the terms and provide a framework for determining into which category a sale fits. As a starting point, the Department may want to incorporate the general rule stated in its Information Notice Corporation Taxes 2014-01. The Information Notice provides that:

> A general rule for distinguishing "property" income from "services" income is that a receipt requiring a specific "performance" of activities by the taxpayer is a service, while a receipt in exchange for a taxpayer granting possession or a right to use any type of property (tangible, real, or intangible) to another party is income from property and should be sourced under the applicable rules related to sourcing of income from property.

A definition of "intangible property" may be found in MTC Reg. IV.17(a)(3).

2. **The proposed regulation needs to define "delivered" to determine the location where a service is delivered.**

72 P.S. Section 7401(3)2(a)(16.1)(C) provides that "Sales from the sale of service, if the service is delivered to a location in this State." The statute does not define "delivered" or "location."

Section 153.26a(c) provides rules for determining delivery location; however, the failure to define key terms (e.g., "delivered") and provide guidance for a taxpayer to determine the location where a service is being delivered makes this section subject to uncertainty, interpretation, and litigation.

In Information Notice Corporation Taxes 2014-01, the Department recognizes that "the proper interpretation of 72 P.S. Section 7401(3)2(a)(16.1)(C)(I) requires that the terms "delivered" and "location" be defined. What constitutes delivery is a prerequisite for determining the location where a service is delivered.

Massachusetts Corporate Excise Tax regulations may provide a starting point for defining "delivered." The Massachusetts regulation provides that:

> [I]n general, the term "delivered" shall be construed to refer to the location of the taxpayer's market for the service provided and is not to be construed by reference to the location of the property or payroll of the taxpayer as otherwise determined for corporate apportionment purposes pursuant to 830 CMR 63.38.1(7)-(8).

See also the MTC's Model General Allocation & Apportionment Regulations (Feb. 24, 2017) Section 17(d)(2).

If "delivered" is construed to be the location of the taxpayer's market, the proposed regulation needs to provide additional guidance in ascertaining the taxpayer's market with respect to a particular transaction to source receipts correctly. The determination of a taxpayer's market becomes more complex in instances where a service provider is performing services on behalf of another party, or where services are contracted in one location and performed in a different location. The proposed regulation provides many examples where "delivery" occurs, but fails to provide an explanation why it occurs at a particular location. In certain instances, these conclusions may not be correct or may be subject to different interpretations.

In other instances, the basic examples in the proposed regulation do not provide helpful guidance. More complex examples would be more helpful to taxpayers.

If "delivered" is construed to be the location of the taxpayer's market, the proposed regulation needs to be drafted in a manner that is consistent with this approach and address any ambiguities. In current form, there are instances where the proposed regulation does not appear to be consistent in applying this approach. The sections addressing the sourcing of receipts in instances where services are performed on behalf of a third party is one area where there are apparent inconsistencies that need to be reviewed and more definitive guidance provided.

If the Department chooses to define "delivered" differently (e.g., location of the ultimate recipient), the proposed regulation needs to provide that definition and apply it consistently in the regulation. The location of the ultimate recipient and the taxpayer's market may not be the same.

Leaving the term “delivered” undefined may lead to premature and incorrect decisions of defaulting to secondary sourcing rules. These would be inevitable because taxpayers will have varying interpretations of what “delivered” means. The three-pronged hierarchy of tests under the statute must first be thoroughly evaluated before hastily jumping to the lower-tier tests, but to do this taxpayers need guidance and an abundance of more practical examples on what “delivered” means.

3. “Total Value” must be defined.

Section 153.26a(b)(1) provides that where a service is delivered both inside and outside Pennsylvania, the Pennsylvania portion of the tax is based upon the “percentage of total value” of the service delivered in Pennsylvania. The regulation provides no meaningful guidance regarding how “total value” is defined and measured.

It is unclear value is based upon cost, market value, revenue. the relative value of the services performed, geographic differences in the cost of providing services, or some other measure.

Absent guidance, similarly situated taxpayers could reach materially different results, as could the Department during an audit.

4. Other critical terms that must be defined.

A regulation intended to create uniformity should not depend upon undefined terms that are central to determining the sales-factor numerator. The PICPA recommends that the Department add definitions, examples, or interpretive guidance for other critical terms:

- “Billing address” (MTC Reg. IV.17(a)(3))
- “Location from which the services were ordered in the customer’s regular course of operations”
- “Principally managed”
- “Based”
- “Located”
- “Location from which the services were ordered”
- “State where a contract of sale is principally managed by the customer” (MTC Reg. IV.17(a)(3))
- “Subscription service”
- “Subscription customer”
- “Delivery service”
- “Target market” or “target audience” (The Department has defined “target market or target audience,” but that definition still requires practical guidance regarding the evidence taxpayers should use and how the concept interacts with the sales-factor denominator.)

Where practical, the Department should consider adopting the definitions in MTC Reg. IV.17(a)(3) to define terms used in both the statute and the proposed regulation. Defining terms would reduce ambiguity in interpretation and application.

C. Adoption of “Rules of Reasonable Approximation” as a Secondary Method to Source Service Receipts Is Inconsistent with the Plain Language of the CNIT Statute.

The proposed regulation’s incorporation of “rules of reasonable approximation” as secondary sourcing provisions in MTC Reg. IV.17 is inconsistent with the express language in Section 401 of the Tax Reform Code (72 P.S. Section 7401(3)2.(a)(16.1)(C)). Pennsylvania statutorily enacted its own secondary sourcing rules for receipts from the sale of services. (See Section 153.26a.(e).)

Pennsylvania's conformity with MTC Reg. IV.17 is more limited than other taxing jurisdictions that source service receipts to their taxing jurisdiction to the extent that the services are delivered to that taxing jurisdiction. (See D.C. Code Section 47.1810.02(g)(3)(A)(iii); Ala. Code Sections 40-27-1(12)(Art. IV) and 40-18-22 (adopts MTC Compact); M.G.L c. 63 Section 38(f)(3); and Tenn. Code Section 67-4-2012(i)(1)(C).) Only Pennsylvania's CNIT statute provides its own secondary rules for sourcing receipts from services in the instance where the service provider is unable to determine where the service is delivered.

The Pennsylvania statute expressly provides the following:

> (I) Sales from the sale of service, if the service is delivered to a location in this State. If the service is delivered both to a location in and outside this State, the sale is in this State based upon the percentage of total value of the service delivered to a location in this State.
>
> (II) If the state or states of assignment under unit (I) cannot be determined for a customer who is an individual that is not a sole proprietor, a service is deemed to be delivered at the customer's billing address.
>
> (III) If the state or states of assignment under unit (I) cannot be determined for a customer, except for a customer under unit (II), a service is deemed to be delivered at the location from which the services were ordered in the customer's regular course of operations. If the location from which the services were ordered in the customer's regular course of operations cannot be determined, a service is deemed to be delivered at the customer's billing address.

In general, the provisions of MTC Reg. IV.17 "establish uniform rules for (1) determining whether and to what extent the market for a sale other than the sale of tangible personal property is in [state], (2) reasonably approximating the state or states of assignment where the state or states cannot be determined." (MTC Reg. IV.17(a)(1)). The proposed regulation is inconsistent with the CNIT statute to the extent that it incorporates methods of "reasonable approximation" in MTC Reg. IV.17 to "reasonably approximate the delivery location" that are inconsistent with the secondary sourcing rules in 72 P.S. Section 7401(3)2.(a)(16.1)(C)(II) or (C)(III).

The PICPA recognizes the practical need for taxpayers to have methods for addressing instances where precise delivery information is unavailable. However, an administrative regulation cannot replace or override the General Assembly's specific statutory rules with an alternative methodology simply because the Department believes the alternative would produce greater uniformity.

The Department's own Regulatory Analysis Form recognizes the limitation on its authority. Section 408 of the Tax Reform Code (72 P.S. Section 7408) authorizes the Department to promulgate regulations "not inconsistent with this article." The regulation should therefore be revised to clearly distinguish between statutory sourcing rules and administrative procedures for applying those rules.

D. Current Statute Does Not Support the Use of the "Look-Through" Rule; Broad Application of That Rule in the Proposed Regulations Results in Service Receipts Not Being Sourced to the Location Where the Services Were Delivered.

1. **The current statute does not support the use of the look-through rule.**

The plain language of the statute does not provide for a look-through to a customer's customer to determine where sourcing should occur. As a result, either the statute needs to be amended or any regulation where there is look-through needs to be eliminated. Alternatively, if the Department wants a total look-through to the customer's customer, the Department should not try to do this through a regulation. The Department should get the General Assembly to amend the statute to make the ultimate rule to be a customer's customer as the ultimate location where services should be sourced.

To appropriately address the addition of a "look-through" policy for sourcing sales of services, the Department needs to consider uniformity with the rules for sourcing sales of tangible personal property. The Department has stated, "The Supreme Court found that with regard to sales of personal property, 'the numerator of the sales factor represents the contribution of Pennsylvania consumers and purchasers to the entity's sales, while the denominator represents the contribution of all consumers and purchasers.'" (*Synthes USA HQ Inc. v. Commonwealth*, No. 108 F.R. 2016 (Pa. Commw. 2020),) (citing *Commonwealth v. Gilmour Manufacturing Co.*, 822 A.2d 676 (Pa. 2003).) Accordingly, "there is no reason to calculate the sales factor differently regarding sales of services." (Id.) We agree that there should be uniformity in the Department's sourcing policies for sales of tangible personal property and sales of services. The Uniformity Clause of the Pennsylvania Constitution provides, "All taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws." (Pa. Const. Art. VIII, Section 1.) The Uniformity Clause requires that every tax "operate alike on the classes of things or property subject to it." (*Sands Bethworks Gaming v. Pa. Dept. of Revenue*, 216 MM 2017 citing *Commonwealth v. Overholt & Co.*, 200 A. 849, 853 (Pa. 1938)).) This means that, "when a method or formula for computing a tax will, in its operation or effect, produce arbitrary, unjust, or unreasonably discriminatory results, the uniformity requirement is violated." (Id., citing *Clifton*, 969 A.2d at 1211). Taxpayers that sell tangible personal property are generally not afforded look-through treatment. For example, 75% of Manufacturer X's sales are shipped to a third-party distributor customer's warehouse located in Pennsylvania, thereby resulting in a 75% Pennsylvania sales factor for Manufacturer X. Manufacturer X does not look through to its third-party distributor customer's sales in Pennsylvania in determining its Pennsylvania sales factor numerator. Various examples in the proposed regulation require service providers to look through to their customer's customers in determining the sales factor numerator. Consequently, in adopting a "look-through" policy for sourcing sales of services, the Department should consider uniformity with other sourcing provisions.

2. **Alternatively, the broad application of the "look-through" rule in the proposed regulations results in certain instances where receipts from performing services are not being sourced to the location where the services were delivered.**

There is an increasing amount of litigation surrounding the application of the "look-through" sourcing of service receipts to the locations of the customer's customers. (See e.g., *LendingTree LLC v. State of Washington Department of Revenue*, 460 P.3d 640 (Wash. Ct. App. 2020) and *Defender Security Co. v. McClain*, No. 2019-0531, 2020 WL 5776005 (Ohio Sept. 29, 2020).) In these cases, the courts have held that the customer is the party deriving the benefit from the services, and not the customer's customers.

These court decisions call into question the propriety of a broad application of "look-through" adopted in MTC Reg. IV.17 and the proposed regulation. "Look-through" is applied when the service provider performs "delivery [of a service] on behalf of a customer" to the customer of that customer. The recipient of the service is deemed to be the customer's customer and the service proceeds are sourced to the location of the customer's customer. "Look-though" also may apply in instances where a service provider contracts with its customer to deliver services to a location other than the location of the customer, such as shipping or advertising services.

To determine whether "look-through" should apply, the agreements and relationships among the parties need to be reviewed to determine who is the true recipient of the service. Just because a party is hiring a service provider to perform services that may in some way impact that party's customer, it does not necessarily mean that the party's customer is the recipient of the services.

The proposed regulation lacks guidance for determining who is the recipient of a service. In numerous examples, the proposed regulation improperly concludes the identity of the recipient of the service without any analysis. In most instances, “look-through” ends up being applied to source the service receipts. The regulations need to explain why the recipient is the customer’s customer and provide guidance for making that determination in instances not addressed in the regulations. The adoption of a definition of “delivered” would be a necessary first step in order to support any explanation.

“Look-through” only should apply in instances where there is clear “delivery on behalf of a customer.” This situation occurs when the service provider is performing its customer’s contractual obligation to a third party. For example, an employer agrees to provide medical insurance to its employees. The employer contracts with an insurance company to provide those services directly to the employees. In this instance, the employees are the recipients of the services. The insurance company is “delivering” the contracted services on behalf of the obligated employer where the employees reside. Arguably, “look-through” would apply, and the insurance company should source proceeds received from the employer to the states where the insured employees reside.

“Look-through” also may be permissible in instances where a service provider delivers services pursuant to a contract with the customer that provides for delivery to a location or locations other than where the customer is located. In these instances, the identity of the recipient is known. For example, a retailer contracts with an advertising agency to create a commercial and place the commercial with television stations to broadcast over many states. In this instance, “delivery” entails the broadcasting of the television commercial in multiple states.

In summary, the “look-through” rule is not provided for in the statute, and therefore should not be incorporated into the proposed regulation. The Department should seek to have the statute amended to permit “look-through.” In the alternative, the “look-through” rule is applied too broadly in the proposed regulation. In certain instances, this broad application results in the sourcing of receipts to a location where the services are not delivered. The proposed regulation needs to provide a framework for determining who is the recipient of a service in multiparty transactions. In addition, they must narrow the instances where “look-through” would be applicable.

E. More Complex Examples Are Necessary.

The proposed regulation contains numerous examples, but many involve relatively straightforward fact patterns. Given the complexity of modern multi-state businesses, additional examples are necessary.

The final regulation should include examples that reflect the following situations:

- Centralized procurement departments
- Shared services organizations
- Customers with offices in multiple states
- Global and regional customers
- SaaS and cloud-based services
- AI-enabled services
- Subscription services
- Omnibus financial accounts
- Regulated investment companies
- Professional services involving multiple customer locations
- Contract research and development
- Customized software
- Customers with multiple residences
- Delivery and fulfillment services
- Services delivered electronically to users in multiple jurisdictions

More complex examples would provide taxpayers with substantially greater certainty regarding how the Department intends the regulation to operate.

II. Comments on Specific Sections

Section 153.26a(b)(1) – Primary Sourcing Rules

The regulation would be more meaningful if it defined "total value" and provided guidance as to how a taxpayer would determine "the percentage of total value of the service delivered to a location in this Commonwealth."

Section 153.26(b)(2) – Secondary Sourcing Rules

As addressed in the General Comments, the regulation should provide guidance as to what efforts a taxpayer must undertake to ascertain the location or locations of delivery before the taxpayer is permitted to use a secondary sourcing method. (See e.g., MTC Reg. IV.17(a)(4).) Assuming the taxpayer follows that guidance, the taxpayer should be protected from arbitrary adjustments on audit.

As previously noted, the proposed regulation needs to define "billing address," and "location from which the services were ordered … ."

Section 153.26a(c)(1)(iii)(D) – Tangible Personal Property – Shipped or Delivered.

In light of *Commonwealth v. Gilmour Manufacturing Co*.(822 A.2d 676, 573 Pa. 143 (Pa. 2003)), clarification is needed on "if the tangible personal property is shipped or delivered to the customer in this Commonwealth" in the context where a customer picks up serviced property at a location in Pennsylvania and immediately takes that property outside the Commonwealth. Assuming *Gilmour* applies to both tangible personal property and services, these services would not be delivered in Pennsylvania.

Section 153.26a(c)(1)(iv) (Examples 3.a – 3.e).

The terms "based" and "located" in the Commonwealth are used in the examples. The terms need to be defined. If they have the same meaning, either "based" or "located" should be used for consistency purposes.

Example 3.c – The regulation needs to address how service receipts would be sourced if the customer was located or based in New Jersey in this example.

Example 3.e – The regulation appears to follow *Gilmour* in the instance involving a customer located in Pennsylvania who picks up serviced goods in New Jersey and brings them back to Pennsylvania.

The regulation needs to provide an example of how service receipts would be sourced in the instance where a customer located in New Jersey, picks up serviced goods in Pennsylvania, and takes them back to New Jersey.

Section 153.26a(c)(2)(i) – Where Delivery of a Service Is by Electronic Transmission.

The proposed rules governing electronic delivery are particularly important given the growth of software as a service (SaaS), cloud computing, digital information, artificial intelligence (AI), and other technology-enabled services.

Section 153.26a(c)(2)(i) provides that when an electronic service is delivered to customers in multiple states, the service is to be sourced among those states in a "reasonable and proportionate manner" consistent with subsection (e). This standard is too open-ended.

The final regulation should identify a preferred methodology for common electronic-delivery circumstances. For example, population-based allocation may provide a clear, objective, and readily verifiable method when transaction-specific or user-specific information is unavailable. Similarly, website or internet traffic may be appropriate for certain services delivered through the internet.

The Department should also provide clear standards regarding the use of website traffic, target-market information, and other third-party data. Taxpayers need to know what information will be considered sufficiently reliable, verifiable, and representative.

The Department should also clarify the treatment of AI, SaaS, platform as a service (PaaS), and digital information or research services accessed through a SaaS portal. The regulation should explain when these transactions constitute services and when they constitute software or tangible personal property for sourcing purposes.

Similarly, the distinction between prewritten software and custom software requires clarification. The proposed regulation treats custom software as a service where development results in software "unique to the customer." The regulation should explain how much customization is necessary before a transaction moves from the tangible-personal-property sourcing rules to the service-sourcing rules, particularly in those instances when prewritten software is customized for a particular customer and the customization is separately stated.

Section 153.26a(c)(2)(ii) – Electronic Delivery of Services

The CNIT statute does not provide for the use of rules of reasonable approximation as secondary sourcing rules. See General Comments.

Section 153.26a(c)(2)(ii) (Example 3.)

This example does not correctly interpret the statute. "AnswerCo" is not providing phone-answering services on behalf of "Retail Corporation" to its customers or prospective customers. Rather, Retail Corporation is merely outsourcing its customer service function to AnswerCo. The phone-answering services are being delivered to Retail Corporation at the call centers of AnswerCo. The answer may be different if the contract between the parties also required AnswerCo to process, fulfill, and deliver customer orders. In this instance, delivery would not occur until the customers receive their purchases.

Section 153.26a(d)(1)(i) – Certain Digital Services.

Clarification is needed on the sourcing of data services "to the location of a subscriber or customer who specifically requested the service" in the context where a corporate purchasing department orders digital services for employees. Please explain if there is a delivery of data services to all employees in the instance where a corporation makes the purchased services available to all employees, but only a few employees actually use those services.

Section 153.26a(d)(1)(ii)(C) – Internet Access.

The CNIT statute does not provide for reasonable approximation as a secondary sourcing rule. See General Comments.

Section 153.26a(d)(3) – Architectural and Engineering Services.

The proposed regulation is inconsistent with the statute in that the architectural and engineering services are delivered to the location of the real and/or tangible property, and not the location of the purchaser. MTC Reg. IV.17(d)(1) provides, "[I]n general, the term "delivered to a location" refers to the location of the taxpayer's market for the service, which may not be the location of the taxpayer's employees or property." In these instances, the location of the taxpayer's market is the location from where the services are being ordered, and not the location of the underlying tangible or real property.

Section 153.26a(d)(5) – Brokerage Services.

The proposed regulation needs to address the sourcing of receipts from an omnibus account in instances where a brokerage firm does not know or have access to the identities of individual investors. The sourcing of receipts attributable to trades through an omnibus account is a common issue among large brokerage firms and needs to be addressed.

Section 153.26a(d)(6) – Subscription Services.

The proposed regulation needs to define "subscription service" and "subscription customer" and provide guidance as to who the customer is when a subscription is purchased for, and delivered to, a third-party (e.g., a gift).

Section 153.26a(d)(7)(ii) – Advertising.

The CNIT statute does not provide for reasonable approximation as a secondary sourcing rule. See General Comments.

Section 153.26a(d)(8) – Card Network Businesses.

The CNIT statute provides secondary sourcing rules that may be inconsistent with this section. In addition, the CNIT statute does not provide for reasonable approximation.

Section 153.26a(d)(15)(ii)(C) – Telecommunications.

The CNIT statute does not provide for reasonable approximation as a secondary sourcing rule. See General Comments.

Section 153.26a(d)(16) – Other Transportation and Delivery Services.

The regulation should define "delivery service" and provide examples distinguishing this provision from transportation services to which Section 153.26a(d)(11) would apply.

Section 153.26a(d)(17) – Other Professional Services.

- ***(d)(17)(ii)*** – This section does not accurately address the instance where the customer's primary residence is Pennsylvania, but has a home in Florida where he/she spends four months a year. There are instances where the taxpayer would seek professional services related to residing in Florida, such as legal expenses related to the Florida property. Under market-based sourcing, receipts specifically related to residing in Florida should not be sourced to Pennsylvania.
- ***(d)(17)(iii)*** – This section states that professional services provided to business customers are sourced to the state where the contract is "principally managed" by the customer and where an employee or representative of the customer serves as the primary contact. This concept presents substantial practical problems for modern businesses.

  A contract may be negotiated by a procurement department in one state, reviewed by legal personnel in another state, administered by a business unit in a third state, and performed by personnel throughout the country. It is unclear how a taxpayer is expected to determine which location "principally manages" the contract.

  The regulation should define "principally managed" and provide multiple examples involving complex, multistate corporate organizations. At a minimum, the Department should clarify that a taxpayer may rely on reasonable contemporaneous information supplied by its customer and should not be required to conduct an independent investigation into the customer's internal management structure.

  (d)(17)(vii) – The Department is providing a different treatment for sourcing professional services provided to an affiliated entity and professional services provided to an unaffiliated business customer. There is no authority in the statute for treating the sourcing of service receipts from affiliates and third parties differently. The Department needs to explain the basis for this disparate treatment.

  The regulation also should provide additional guidance for sourcing receipts from contract research and development (R&D) arrangements involving **both affiliates and nonaffiliates.** For example, additional guidance is needed in determining where delivery occurs in the instance where an affiliate of a pharmaceutical company or unrelated third-party is compensated for performing R&D services for its parent corporation. Are the services received at the location of the parent where the results of the R&D activities are communicated, the location where the drug will be manufactured, or some other location? In R&D arrangements involving affiliates, the use of the rules in Section 153.26a(d)(17)(vii) may not accurately reflect delivery of the R&D results.

- ***(d)(17)(iii), (iv) and (vii)*** – The CNIT statute does not provide for reasonable approximation as a secondary sourcing rule. See general comments.
- ***(d)(17)(ix) (B) (Example B)*** – The examples in this section need to address how contract research organizations (CRO) should source receipts and provide examples.
- ***(d)(17)(ix)*** – This example is inconsistent with Section 153.26a(d)(17)(v). Under that section, Mutual Fund Service Provider Corp. would source investor service fees to the location of Mutual Fund Co. if Mutual Fund Co. entered into the contract for the services. For regulated investment companies, services contracted for and received by the fund should generally be sourced to the location of the regulated investment company or its relevant operating office rather than to the locations of the unidentified underlying shareholders.

Section 153.26a(e) – Rules of Reasonable Approximation.

The CNIT statute does not provide for reasonable approximation as a secondary sourcing rule. See General Comments.

If the Department retains reasonable-approximation concepts in any portion of the regulation, substantially greater guidance is necessary. For example, Section 153.26a(e) permits the use of increasingly broad proxies, ultimately including GDP and population demographics. Yet the regulation does not adequately explain the following:

- What constitutes sufficient information to use a higher-priority method.
- The efforts a taxpayer must undertake to obtain such information.
- When information may be considered unavailable.
- The degree of accuracy required.
- How a taxpayer should select among potentially reasonable methods.
- When the Department may conclude that a taxpayer's method is unreasonable.

These omissions create substantial audit risk.

The Department should establish a clear safe harbor, provided a taxpayer follows the regulatory hierarchy, maintains contemporaneous records supporting its methodology, and applies that methodology consistently. It should be presumed the taxpayer used a reasonable method. The Department should bear the burden of demonstrating that a method is unreasonable before substituting an alternative methodology.

This is particularly important because Section 153.26a(g)(1)(ii) gives the Department authority to substitute one of its prescribed approximation methods when it determines that the taxpayer's method is unreasonable. Without objective standards, the provision effectively gives the Department substantial discretion to substitute its judgment for that of the taxpayer after the fact.

The PICPA is concerned that portions of the regulation appear to redefine the sales-factor denominator administratively.

The statute provides that the sales factor is based upon total sales of the taxpayer in Pennsylvania compared with total sales everywhere. The final regulation should not effectively redefine "total sales" through administrative sourcing provisions.

Likewise, Section 153.26a(e)(3) provides that, when sourcing sales based upon a particular geography, the denominator should include only the target-market segment for the service and authorizes the Department to invoke alternative apportionment if it determines that the target market is overinflated.

The PICPA is concerned that this provision could operate as an administrative "throw-out" rule without clear statutory authorization.

The Department should remove this provision or provide a clear statutory basis and substantially greater safeguards against arbitrary adjustments.

Section 153.26a(f) – Recordkeeping and Documentary Evidence.

- ***26a(f)(1) and (2).*** – The Department's Regulatory Analysis Form states that the proposed regulation will not generate substantial paperwork. The PICPA is concerned that the regulation, as drafted, could impose significant documentation and compliance burdens.

  Sections 153.26a(f)(1) and (2) require taxpayers to retain contemporaneous records supporting sourcing methodologies and provides that the Department may apportion up to 100% of a taxpayer's sales to Pennsylvania when records and supporting data are deemed insufficient.

  The final regulation must impose a reasonableness standard on Department requests for documentation. Taxpayers should not be required to produce transaction-level records for millions of transactions when statistically valid sampling or other reasonable methods can substantiate the sales factor. On field audits, the Department has, in fact, requested that taxpayers produce transaction-level records to substantiate their sales factor denominators or risk arbitrary adjustment. The regulation should expressly authorize statistical sampling where appropriate.

  The Department should also provide that a taxpayer who maintains records consistent with the regulation and uses a reasonable, consistently applied methodology will not be subject to an adjustment merely because the Department believes another reasonable methodology would produce a different result.

- ***26a(f)(3).*** – The PICPA strongly objects to this section. Section 153.26a(f)(3) would require taxpayers to disclose situations in which their Pennsylvania sourcing position differs from the treatment of the same receipts in other states, and would permit the Secretary to consider alternative apportionment based on that difference.

  Pennsylvania's sourcing rules are established by Pennsylvania law. The fact that another state has adopted different sourcing rules does not establish that a taxpayer's Pennsylvania sourcing position is unreasonable under Pennsylvania law, or that Pennsylvania should impose an alternative apportionment methodology just because the taxpayer uses a different sourcing method in another state. Not all market-based sourcing states have uniform statutes, regulations, policies, and/or court decisions. A taxpayer should not be penalized merely because it does not use the same sourcing methodology in every market-based sourcing state.

  The provision is particularly troubling because it could operate as a *de facto* throwback or "throw-out" mechanism, causing receipts that Pennsylvania determines are delivered elsewhere to become subject to Pennsylvania taxation merely because another state interprets them differently.

  The Pennsylvania Supreme Court's decision in *Paris Manufacturing Co. Inc. v. Commonwealth* (505 Pa. 15 (1984)) should be considered in evaluating any provision that effectively causes receipts to be returned to Pennsylvania through an administrative mechanism. The final regulation should delete Section 153.26a(f)(3).

  If the Department requires alternative apportionment under 72 P.S. 7401(3)2.(a)(18), the Department also must have the affirmative burden of proving that the taxpayer's method of sourcing receipts resulted in distortion and that the alternative method results in a tax liability that more accurately reflects the taxpayer's in-state activities. Prior to asserting alternative apportionment, the Department should be required to provide the taxpayer with documentation supporting its position. Imposing the burden of proof on the Department may reduce arbitrary assessments.

Section 153.26a(g) – Changes in Sourcing Methodology

- ***26a(g)(1)*** – This section gives the Department broad authority to adjust a taxpayer's sourcing methodology, including when the Department concludes a taxpayer's approximation method is unreasonable. Should a taxpayer follow the regulation, maintain reasonable contemporaneous supporting documentation, and use a reasonable methodology in good faith, the Department should be required to demonstrate why that methodology is unreasonable before substituting another methodology. The Department should have the burden of proving with a preponderance of the evidence that the method that the taxpayer used was not reasonable. The Department should be required to provide the taxpayer with the basis for its adjustment and detailed documentation supporting why the taxpayer's method is unreasonable and why its proposed method would result in a more accurate reflection of the taxpayer's in-state business activities. Setting the burden of proof on the Department would provide taxpayers with meaningful certainty while preserving the Department's ability to correct genuinely unreasonable or unsupported positions.
- **26a(g)(2)** – This section imposes additional requirements when a taxpayer changes its sourcing methodology prospectively, including disclosure on the taxpayer's return and retention of documentation explaining the change. The PICPA questions the statutory authority for these requirements.

  A taxpayer should be permitted to improve its sourcing methodology as better information becomes available without being effectively required to alert the Department to a change in its tax position. Taxpayers routinely refine accounting and tax methodologies as facts, systems, and available information change. If the Department believes additional disclosure is necessary, it should clearly identify the statutory authority for imposing that requirement.

III. Additional Comment.

Applicability of the Proposed Regulation to the Personal Income Tax – The proposed regulation refers to "corporations," while the underlying statutory language concerning the sourcing of service receipts has implications for other taxpayers subject to Pennsylvania's income tax laws. The Department's position following *Synthes USA HQ Inc. v. Commonwealth (289 A.3d 846 (Pa. 2023)*) regarding the application of market-based sourcing principles to S corporations and partnerships, should be expressly addressed so that taxpayers and practitioners understand the intended scope of the rules.

IV. Conclusion.

The PICPA appreciates the Department's effort to provide long-awaited guidance concerning the sourcing of service receipts. We agree that taxpayers and the Department would benefit from clear, predictable, and administrable rules.

However, the proposed regulation in its current form does not yet achieve those objectives. In several important respects, it substitutes MTC-based concepts for already instituted Pennsylvania-specific statutory sourcing rules, relies upon undefined concepts and subjective standards, grants the Department overly broad discretion to substitute a preferred methodology, and creates significant documentation and compliance burdens.

Most importantly, the regulation must remain within the authority granted to the Department by the General Assembly. Section 408 of the Tax Reform Code expressly authorizes regulations only to the extent they are "not inconsistent" with the Tax Reform Code.

The PICPA respectfully requests the following from the Department:

1. Revise the regulation to conform expressly to the statutory sourcing hierarchy in 72 P.S. Section 7401(3)2.(a)(16.1)(C).

2. Remove or substantially revise reasonable-approximation provisions that conflict with the existing statutory secondary-sourcing rules.
3. Define critical terms and establish objective standards for applying them.
4. Establish a safe harbor for taxpayers using reasonable, documented, and consistently applied sourcing methodologies.
5. Clarify how "total value" is to be determined.
6. Provide substantially greater guidance regarding electronic, digital, SaaS, AI, and subscription services.
7. Address omnibus accounts, regulated investment companies, and other financial-industry structures.
8. Clarify professional-services sourcing, including the meaning of "principally managed."
9. Delete the state-to-state consistency provision in Section153.26a(f)(3).
10. Establish reasonable limitations on recordkeeping and audit requests, including authorization for statistical sampling.
11. Require the Department to demonstrate that a taxpayer's reasonable methodology is unreasonable before substituting another methodology.
12. Reconsider the provisions governing prospective changes in sourcing methodology.
13. Add substantially more complex examples addressing common multistate business arrangements.

The PICPA believes that addressing these concerns will result in a regulation that provides taxpayers with the certainty they have sought while giving the Department the administrative tools necessary to consistently and fairly administer Pennsylvania's corporate net income tax.

We appreciate the Department's consideration of these comments and would welcome the opportunity to work with the Department as it moves toward final-form regulations. Given the significance and complexity of this rulemaking, the PICPA would be pleased to participate in further discussions with the Department and other stakeholders to help develop a final regulation that is consistent with Pennsylvania law and workable for taxpayers and tax practitioners.

Respectfully submitted,

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CC: Independent Regulatory Review Commission