

Philadelphia VIP's "How-To" Guide for Small Businesses

Note: This guide will serve as an overview of legal topics someone should consider when starting a small business. As background, community partners who provide technical assistance to small business owners in Philadelphia highlight that small business owners “don't know what they don't know.” The example they used was business owners often quickly sign a lease for a business as an individual, when they should consider putting the lease in the name of the business.

Table of Contents

	<u>Page</u>
I. BUSINESS FORMATION.....	1
A. Choose Your Business Structure	1
B. Filings	2
C. Register Your Business.....	3
D. Additional Licenses and Permits	4
II. REAL PROPERTY.....	4
A. Leases.....	4
B. Zoning.....	5
C. Construction Considerations.....	5
III. TAXES.....	6
A. Business Income and Receipts Tax (“BIRT”)	6
B. Net Profits Tax (“NPT”).....	7
C. Business Use and Occupancy Tax	7
D. Wage Tax	7
IV. EMPLOYMENT.....	7
A. Employee vs. Independent Contractor	7
B. Employees – What to Know	8
V. OTHER	10
A. Job Creation Tax Credit (JCTC).....	10
B. StartupPHL Fund II.....	10
C. Kiva Micro Lending.....	10

I. BUSINESS FORMATION

A. Choose Your Business Structure

When seeking to start a business, the first decision to make is the type of business structure you are interested in developing. The basic differences between the various structures relate to legalities and income tax return. The most common types of businesses are described briefly below:

- i. **Sole proprietorship.** This is the simplest form of ownership to set up. No state filing is required to form a sole proprietorship. However, you will still have to follow local business registration, license, and permit regulations. With a sole proprietorship, the owner reports profit or loss on his or her personal tax return.

Pros. No formation filing necessary. Subject to fewer federal regulations. No corporate taxes. Full decision-making power. Easy to dissolve.

Cons. More difficult to raise capital. Owner is personally responsible for paying income taxes and business-related debts and may be otherwise liable.

- ii. **Partnership.** A form of business operation between two or more individuals who share management and profits in accordance with terms of the partnership agreement. There are no formation filings necessary for a partnership. Partners are personally responsible for business debts and must report profits or losses on their personal tax returns. Partnerships can be a good choice for businesses with multiple owners, professional groups, and groups who want to test their business idea before forming a more formal business.

Partnerships can be either *general* or *limited*. A *general partnership* – the most common type of partnership – is one in which partners share equal liabilities, contributions, and responsibilities. A *limited partnership* is composed of general and limited partners. General partners are responsible for daily management and are liable for the company’s financial obligations. Limited partners provide capital but cannot make managerial decisions and are not responsible for any debts beyond their initial investment.

- iii. **Corporation.** A corporation can either be formed as a C corporation (“C-corp”) or S corporation (“S-corp”). The C-corp is the standard corporation, while the S-corp elects a special tax status with the IRS.

The C-corp and S-corp share many qualities:

Limited liability protection. Shareholders (owners) are typically not personally responsible for business debts and liabilities.

Filing documents. Formation documents must be filed with the state. These documents, typically called the Articles of Incorporation, are the same for both C-corps and S-corps.

Structure. Both have shareholders, directors, and officers. Shareholders are the owners of the company and elect the board of directors to oversee business operations. Directors hire officers to manage the day-to-day operations. Profits, called dividends, are distributed to shareholders according to the number of shares each owns.

Corporate formalities. Both are subject to corporate formalities, such as adopting bylaws, issuing stock, filing annual reports with the state, and paying annual fees.

The differences between a C-corp and an S -corp:

Formation. All corporations begin as C-corps. A C-corp can elect to be converted to an S-corp by filing IRS Form 2553, Election by a Small Business Corporation.

Taxation. C-corps face “double taxation,” which means that the corporation pays tax on its income for the corporate year and the shareholders pay tax on dividends received from the corporation. An S-corp avoids double taxation because the profits (or losses) are passed through the S-corp to the shareholders, and are only taxed to the shareholders and reported on their personal income tax returns.

Ownership. An S-corp faces restrictions on ownership that a C-corp does not face. For instance, S-corps may not have more than 100 shareholders, issue more than one class of stock, have shareholders who are not U.S. citizens or residents, or be owned by a C-corp, another S-corp, LLC, partnership, or various trusts.

C-Corp or S-Corp: Which is Best for You?

Generally, S-corp status is preferred by small businesses because of the likely tax savings. The C-corp entity is more popular with larger companies because of the greater familiarity and flexibility to raise capital.

- iv. **Limited liability company (LLC).** An LLC is a hybrid entity that offers the liability protection of a C-corporation with the tax option to be treated as a partnership. The member’s liability is limited to the amount of capital contributed. An LLC is governed by its operating agreement, which outlines plans for business management. LLCs are not required to hold annual meetings or record minutes. LLCs are typically more flexible than a corporation and well-suited for companies with a single owner. Some states, including Pennsylvania, levy franchise or capital value taxes on LLCs.

You can also refer to the City’s Business Service site for an introduction and comparison of these business structures at <https://business.phila.gov/decide-your-ownership-structure/>

B. Filings

Unless you are operating a sole proprietorship or general partnership you will have to file certain documents with the Pennsylvania Department of State, such as Articles of Incorporation for corporations or a Certificate of Organization for a limited liability company and the New Entity Docketing Statement.

C. Register Your Business

i. **Register for an Employer Identification Number (EIN)**

The Department of Licenses and Inspection (L&I) processes applications, issues licenses, issues permits, and conducts inspections to insure that regulations are met. Every person who desires to engage in any business in the City of Philadelphia must obtain a Federal **Employer Identification Number (EIN)** or, if you do not have employees and are a sole proprietor, a Social Security Number. You can apply for an EIN by going to www.irs.gov → Employer ID Number (EIN) → Apply for an EIN Online.

i. **All** businesses must register for a **Business Tax Account number** and obtain a **Commercial Activity License**.

Obtain your **business tax account number** by one of three methods:

i. **Online** at <https://ework.phila.gov/revenue/>

ii. **Mail** the application to:

Philadelphia Dept. of Revenue
P.O. Box 1600
Philadelphia, PA 19105-1600

Application can be found at <https://beta.phila.gov/documents/business-tax-account-application/>

iii. **In Person** – Go to the Department of License & Inspections:

1401 John F. Kennedy Blvd.
Concourse Level
Philadelphia, PA 19102

After successful registration, you will receive an e-mail confirmation that includes your account number and PIN.

Commercial Activity License

An Activity License (formerly known as the Business Privilege License) is required for **all** businesses operating in the City of Philadelphia and must be obtained prior to apply for *any* additional business license in the City. This includes businesses that are located outside the city limits but that do some or all of their business activity in the City. There is **NO FEE** for the Activity License and it is a one-time license. Obtain an Activity License by one of three methods:

(1) **Online:** You can apply for the Activity License Online by going to <https://business.phila.gov> → Find a License or Permit → Obtain an Commercial Activity License

(1) **Via Fax or Mail:** Download and print the paper application at <https://business.phila.gov/media/combined-BIRT-and-CAL.pdf>. The fax number and mailing address are listed on the application.

Note: by submitting this application by fax or mail, there may be a delay in processing your license. Applicants are urged to apply online.

- (2) **In Person** – Go to the Department of License & Inspections:
1401 John F. Kennedy Boulevard
Concourse Level
Philadelphia, PA 19102

Some business operators will only need a Commercial Activity License. However, other business operators need a combination of licenses depending on the kind of business activity.

D. Additional Licenses and Permits

Licenses, permits and certificates are required for specific business types, ranging from retail to professional services businesses. For instance, if you are planning on selling alcohol at your business, you must apply for a permit through the Commonwealth of Pennsylvania Liquor Control Board. You can visit the Business Service Center at <https://business.phila.gov> to guide you to the right documents.

Some taxes are specific to certain business types. The Business Service Center has all of the business tax information you need. For more information, go to <https://business.phila.gov/understand-taxes/>.

You can also consult the Philadelphia Department of Licenses and Inspection to determine if you need any additional licenses. The Department of Licenses & Inspection main office is located at

Municipal Services Building – 11th floor
1401 John F. Kennedy Boulevard
Philadelphia, PA 19102

For general information, call (215) 686-2400 or go to <http://www.phila.gov/li/aboutus/Pages/Contact.aspx>

II. REAL PROPERTY

A. Leases

Unless you are operating out of your home, most small business owners will eventually need to lease commercial space. A commercial lease is not like a residential lease, which is generally more favorable to tenants. Commercial leases are typically much longer than residential leases, which increase your potential liability.

As a small business owner, a commercial lease will likely be one of your biggest liabilities. **Do not make the mistake of signing your commercial lease without fully understanding what it is you are signing and making sure you are fully protected.** Consider signing the lease in the name of the business as opposed to an individual for liability purposes.

B. Zoning

In choosing your location, consult the Philadelphia Department of Licenses and Inspections for zoning requirements to ensure that you are using your new property within the bounds allowed by law. If you are starting a home based business in the City of Philadelphia you may need a zoning certificate or variance to locate a business in your home, particularly if you will see customers at your home.

Zoning regulations dictate land use, the height and bulk of buildings, population density, parking requirements, the placement of signs, character of development on private property, and how property is “used,” inside and out.

Zoning laws tell business operators where you can legally locate a restaurant, pawn shop, or other commercial activity

Zoning Permits authorize construction or an addition to a building.

Use Registration Permits authorize a particular use of the building or ground.

All zoning permit applications require a \$100 filing fee at the time of application. This non-refundable fee will be credited toward the final permit fee. You will be notified when your permit is ready or that your permit has been denied up to 20 business days after submitting your application.

Get more information at <https://business.phila.gov/zoning-basics/>. Review zoning checklist at <https://business.phila.gov/media/Zoning-Use-Registration-Permit-App-Requirements.pdf> and complete the zoning use registration permit application at <https://business.phila.gov/media/Zoning-Use-Registration-Permit-Application.pdf>.

C. Construction Considerations

If you are planning on undertaking construction (either an alteration to an existing structure or a new structure), contact the Department of L&I to ensure proper compliance with building standards in the City of Philadelphia. You will likely need to apply for a building permit. An L&I representative will be able to advise you on how and when to apply for which permits or certificates. Call 311 and ask to speak to an L&I Building Unit representative.

You can find the application for a building permit at <https://business.phila.gov/licenses-and-inspections-building-permits/>.

You may need an air permit if you plan to install or modify equipment that causes or controls emissions (boilers, generators, and paint booths are common examples), large parking facilities, or certain asbestos abatement or demolition projects. For permit applications, regulations, or more information, please contact Air Management Services (AMS) at (215) 685-7572 or visit the AMS website at <http://www.phila.gov/health/AirManagement/>.

Signs: If you plan to have accessory signs for your business at your business location, you should contact the Philadelphia Art Commission to determine what is allowed for your property and whether you need a sign permit. Depending on the type and location of the sign you may also need approvals from other city departments.

Philadelphia Art Commission
1515 Arch Street – 13th floor
Philadelphia, PA 19102
Phone: (215) 683-2095

III. TAXES

All businesses must register for a Business Tax Account number from the Department of Revenue and obtain a Commercial Activity License from the Department of Licenses and Inspections (see Section I(C), “Register Your Business”).

If you are setting up a business for the first time, you can call (215) 686-8686 (or 311 if local) and ask to speak with a L&I representative. Inform the representative if you are setting up a business for the first time. You will receive a packet of information which will explain what and when you need to file taxes.

The most common business taxes are listed below:

A. Business Income and Receipts Tax (“BIRT”)

BIRT applies to every entity doing business in the City of Philadelphia, whether or not they earned a profit during the preceding year. The BIRT is a two part tax on gross receipts and net income and both parts must be filed. There is an exemption of the first \$100,000 in gross receipts and a proportionate share of net income from the business income and receipts tax.

Jump Start Philly (BIRT Exemption)

Jump Start Philly is designed to attract new businesses and entrepreneurs that create jobs in Philadelphia by exempting new businesses from paying the BIRT during the first two years of operation. Additionally, fees will be waived for eligible new businesses for a variety of licenses and registrations, including the Commercial Activity License.

Qualifications for Jump Start Philly:

- 1) New businesses must have at least three full-time employees by the first 12 months of business operations continuously through the 18-month anniversary of becoming a new business.
- 2) New businesses must have at least six full-time employees from the 18-month anniversary of business operations continuously through the 24-month anniversary of operations.
- 3) Employees must work in Philadelphia at least 60% of the time.

- 4) Employees may not be family members (a parent, spouse, life partner, child, sibling or relative-in-law).

Apply to Jump Start Philly. The application for Jump Start Philly is automatically part of the online process of registering for BIRT, and within the paper application for the Commercial Activity License.

B. Net Profits Tax (“NPT”)

NPT is imposed on the net profits from the operation of a business by (1) Philadelphia residents, even if their business is conducted outside of Philadelphia, and (2) Non-residents who conduct business in Philadelphia. Businesses must pay NPT if they are organized as sole proprietors, partnerships, associations, or LLCs.

The rental of property, in most cases, is considered the operation of a business.

In 2018, the NPT for Philadelphia residents was 3.8809% and the rate for non-residents was 3.4567%.

C. Business Use and Occupancy Tax

A tax on the business, trade or other commercial use and occupancy of real estate located in Philadelphia. The tax is due if your business is physically located in Philadelphia; you operate your business from your Philadelphia residence; or tenants, sub-tenants or owners use the Philadelphia property for business purposes. This tax is often wrapped into business leases and remitted by the landlord.

D. Wage Tax

The wage tax is not a business tax, but businesses must withhold wage tax from the salaries, wages, commissions, and other compensations paid to persons who either live or work in Philadelphia.

If you need help determining how often you must file or pay for any city taxes, visit the Taxpayer Service Unit at the Municipal Services Building, Public Concourse Level, 1401 John F. Kennedy Boulevard, or call (215) 686-6600. For more information, please visit <https://www.phila.gov/services/payments-assistance-taxes/business-taxes/wage-tax-employers/>.

IV. EMPLOYMENT

A. Employee vs. Independent Contractor

As a business owner, you may pay an employee and an independent contractor for the same or similar work, but there are important legal differences between the two. For the employee, the business withholds income tax, Social Security, and Medicare from wages paid. For the independent contractor, the company does not withhold taxes. Generally, employment and labor laws also do not apply to independent contractors.

To determine whether a person is an employee or an independent contractor, businesses must weigh several factors to determine whether a worker is an employee or independent contractor. Factors largely fall into three categories:

- 1) Behavioral: Does the company control or have the right to control what the worker does and how the worker does his or her job? The greater company control over the worker, the more likely the worker is an employee.
- 2) Financial: Are the business aspects of the worker’s job controlled by the company? (these include things like how worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)
- 3) Type of Relationship: Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business? If so, the worker is likely an employee.

There is no “magic” or set number of factors that “makes” the worker an employee or an independent contractor, and no one factor stands alone in making this determination. The key is to look at the entire relationship and consider the degree or extent of the right to direct and control.

In Pennsylvania, the most important factor of an independent contractor are that: (i) the independent contractor controls the method and manner in which the work is done; and (ii) the business controls the result of the work.

Incorrect classification could lead to claims for: (i) unpaid overtime compensation and reimbursement of work-related expenses; (ii) reasonable accommodation and return-to-work benefits under the ADA and its state equivalents; (iii) mass layoff notice under WARN and its state equivalents and (iv) discrimination under Title VII, the ADEA and other federal, state or local anti-discrimination laws.

i. Best Practices to Minimize the Risks of Misclassification

- a. Provide detailed descriptions for all positions;
- b. Compensate independent contractors on a per-job basis rather than hourly;
- c. Do not let independent contractors with work related supplies; and
- d. Do not reimburse independent contractors for work-related expenses.

B. Employees – What to Know

○ **“At-Will” Employees.**

In Pennsylvania (like a number of other states), workers are generally considered “**at will**” employees unless they have an employment contract or statutory right that provides otherwise. An employer may terminate the services of an “at will” employee, with or without cause, at any time — as long as an employee is not let go for an unlawful purpose, such as age or racial discrimination. Conversely, “at

will” employees have a similar right to resign their employment, for any reason (or no reason at all), at any time.

- **Hiring**

- When advertising for employee hiring, the job description should clearly and adequately identify the job title, responsibilities, required qualifications, physical requirements (if any); salary range, benefits information, any other essential information.
- Before hiring an employee, you should conduct a thorough interview and background check, and contact references of the potential employee’s past employers.

- **Employment Contracts**

Make sure the contract terms comply with Pennsylvania and Federal laws regarding minimum wage, employment of minors, overtime payment, family and medical leave, safety and health standards, and immigration. Certain points to consider:

- **Wages**

- Overtime. If employees work overtime, you may need to pay them extra. Employers in all states in the United States are generally required to pay nonexempt (e.g. hourly/line) workers 150 percent of their hourly pay for each hour that they work in excess of 40 hours a week. Pennsylvania is the same as every other state in this regard. Employers, however, generally do not have to pay overtime wages to certain categories of salaried employees, including those employed in a bona fide executive, administrative or professional capacity, or as outside salesmen. Managers and supervisors usually work on a salary basis, and therefore do not receive extra compensation for overtime work.
- Unpaid Leave. Employees who meet certain legal requirements are entitled to twelve weeks leave for birth of a child, adoption of a child, poor health or the need to care for a family member in poor health.

- **Training Employees**

The following resources may assist business owners in training employees:

- PA CareerLink Customized Job Training. Members of Philadelphia’s PA CareerLink Business Services Team can work with you to customize training programs to fit your company’s needs. Your business may be eligible for direct funding to train prospective employees. For more information on customized job training policies, procedures, and employer responsibility, visit <https://www.pacareerlink.pa.gov/jponline/Common/LandingPage/Employer>.
- PA CareerLink On-The-Job Training (OJT). OJT is a federally funded program that helps participating employers by reimbursing them for a portion

of the new employee wage during the specified training period. OJT offers the potential employee the opportunity to acquire new job-specific skills while receiving the same wages as current employees in the same or similar position. Employers are eligible for a 50% reimbursement of the new worker's salary to offset the training costs, not to exceed \$6,000. The training is provided by the company during a fixed training period between 12 and 16 weeks. The candidate cannot currently be working for the company. If you're interested in learning more about the program, visit <https://www.pacareerlink.pa.gov/jponline/Common/LandingPage/Employer>.

- **Philadelphia Works.** A public workforce agency that connects employers to skilled workforce and helps individuals develop the skills needed to thrive in the workplace. Philadelphia Works can help you expand your business providing on the job training, customized job training, and apprenticeships. For more information, visit <https://www.philaworks.org/>.

V. OTHER

A. **Job Creation Tax Credit (JCTC)**

JCTC awards businesses that increase the number of jobs available in the City. A business can apply this credit to its BIRT liability if it either (1) creates 25 new jobs; or (2) increases its number of employees by at least 20% within five years of the designated start date. The credit amount for jobs created is two percent (2%) of annual wages paid for each new job or \$5,000 per new job created, whichever is higher.

For more information, visit <https://www.phila.gov/services/payments-assistance-taxes/tax-credits/job-creation-tax-credit/>.

B. **StartupPHL Fund II**

A collaborative effort between the City of Philadelphia's Department of Commerce and Philadelphia Industrial Development Corporation (PIDC), StartupPHL aims to support entrepreneurs in the City. StartupPHL Seed Fund II is a \$5 million public/private venture to support Philadelphia-based startups. Seed Fund II will target investments averaging \$150,000-\$200,000 in seed and early-stage technology companies in Philadelphia.

For more information, visit <http://startupphl.com/about/fund-your-startup/>

C. **Kiva Micro Lending**

Kiva is a website that enables financially excluded and socially impactful entrepreneurs to access 0% interest small business loans. You can use a Kiva loan for any business purpose, including purchasing inventory, investing in equipment, and hiring staff. For more information, visit <https://borrow.kiva.org/borrow>.