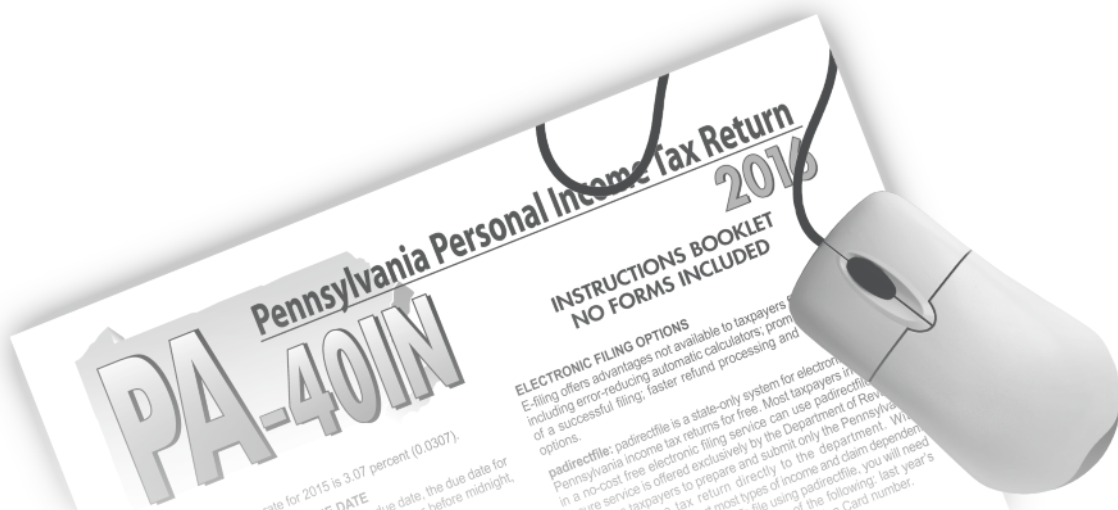


# PERSONAL INDIVIDUAL TAX PREPARATION GUIDE



**pennsylvania**  
DEPARTMENT OF REVENUE



## FOR PERSONAL INCOME TAX RETURNS PA-40



Before reviewing how to assist taxpayers in the preparation of the PA personal income tax return, some key principles must be emphasized.

## CONFIDENTIALITY AND INTEGRITY

As a tax preparer through the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs, you have a special trust from the taxpayers who seek your help. To maintain the integrity of this program and to respect the trust placed in you, tax information must be treated as confidential at all times. Also remember that VITA/TCE tax preparers are prohibited from accepting compensation from taxpayers for preparing PA personal income tax returns.

## QUALITY SERVICE

Quality service to taxpayers is our goal. It is important to check your work for accuracy. Use a calculator to verify mathematical calculations. If you are uncertain of the proper method of reporting any transaction, consult your immediate supervisor.

Your success as a tax preparer largely depends on your ability to establish rapport with taxpayers and interview taxpayers effectively. First, it is important to put the taxpayer at ease. You will ask questions to determine not only tax liability but also benefits and credits. For example, many taxpayers are not aware of the special tax forgiveness provision or the exclusion of a gain realized on the sale of a principal residence. If filing a paper return, you should have the taxpayer sign and date the return upon completion and provide them with the proper address to which the return should be mailed.

## INTERVIEWING TECHNIQUES

### Introductory Stage

It is important to establish a good relationship with the taxpayer. Greet the person you will be helping in a friendly way and introduce yourself. Smile and make eye contact. If anyone has waited for a long time, apologize for the delay. Many people are nervous when it is time to prepare their income tax return, so take a few minutes to chat informally if necessary. Remember, good humor and a readiness to help is the essence of courtesy. If a taxpayer starts complaining,

do not take it personally. Listen to the entire complaint. Do not interrupt as that will only make the taxpayer more upset.

### Questioning Stage

As an interviewer, you must control the conversation and keep the taxpayer from asking unrelated questions. It will be helpful to follow these guidelines:

- Phrase questions very clearly, avoiding multiple questions.
- Repeat questions if necessary. Keep in mind not everyone understands technical tax terms.
- Listen carefully to the taxpayer's responses and be patient.
- To the extent possible, explain the return as it is completed.
- Encourage people to ask questions if they do not understand.
- If you cannot answer a question, say "I do not know but will find out."
- Research difficult questions in available tax books, consult with your immediate supervisor or contact your local Department of Revenue district office.

**NOTE:** Questioning can be effective in determining sources of income. However, it is the taxpayer who is responsible for the accuracy of the information provided. You, as a preparer, are not accountable for any misinformation given by the taxpayer.

### Summary Stage

When the return(s) is/are completed, you will need to give the taxpayer some additional information.

- Have the taxpayer sign and date the return. If filing a paper return and the filing status on the return is Married, Filing Jointly, make sure both taxpayers sign the return. If one taxpayer is not present, remind the taxpayer to have his/her spouse sign the return.
- If there is an overpayment and the taxpayer plans to move, advise the taxpayer to notify the local Department of Revenue district office immediately to have the address updated.

This will ensure the refund is sent to the appropriate address. The post office may not forward refund checks.

- If a balance is due, advise the taxpayer of payment options. Payment may be remitted by check or money order made payable to the PA Department of Revenue. Instruct taxpayers to include the last four digits of their primary Social Security number (SSN) and tax year on the front of the check or money order. If a PA-V form is not available from the software used by the preparer or one is not prepared from the Fill-In PA-V on the department's website, the department advises each taxpayer to use the complete SSN on the check or money order if faster clearing is desired and more accurate posting of the check is preferred. Otherwise, it can take up to four weeks for a check to clear if there is insufficient information such as taxpayer name, address, and tax year on the check. In the event the department cannot determine the correct account for posting of the check, the taxpayer's account will eventually be billed and additional correspondence will need to be addressed by the taxpayer. If your volunteer site e-files returns using special software, the taxpayer may be able to remit the tax payment online. See PAYMENT OPTIONS beginning on Page 74 for additional information.
- If a paper return is being prepared, instruct the taxpayer to mail the return by midnight on the due date, along with any monies due.
- If filing more than one tax return for a taxpayer, advise the taxpayer to mail each return separately.
- Ask if the taxpayer has any questions. Be sure to return all tax materials to the taxpayer, and give the taxpayer a copy of the filed return to keep with his/her records.
- Thank the taxpayer and remember to respect the taxpayer's privacy. Keep all tax information confidential.

## TAX ASSISTANCE GUIDELINES

When assisting a taxpayer with the preparation of a tax return, you should not hesitate to contact your immediate supervisor for guidance. Our main objective is to provide quality service, which can only be achieved by working together.

### FEDERAL/STATE ELECTRONIC FILING (e-file)

Taxpayers may file federal and PA income tax returns electronically, either through a tax preparer or by purchasing software.

VITA/TCE sites that e-file returns using special software should mail Form PA-8453 or PA-8879 to the following address:

PA DEPARTMENT OF REVENUE  
BUREAU OF INDIVIDUAL TAXES  
ELECTRONIC FILING SECTION  
PO BOX 280507  
HARRISBURG PA 17128-0507

These forms should be submitted to the department at the end of the tax preparation season with a note stating they are from a volunteer site. A PA-8453 is not required if a taxpayer signs the federal return with a federal self-select PIN and that PIN is carried over to the PA return. If the practitioner's PIN is being used or someone else other than the taxpayer is entering the taxpayer's PIN on the federal return, PA-8879 must be signed. The PIN does not need to be entered twice and can be carried over from the federal return as long as the taxpayer understands he/she is signing both returns.

The department also allows statements to be filed electronically through the electronic return originators (ERO) with the return. These statements describe why certain income was or was not reported or why a particular paper document is being retained by the ERO (i.e. military orders, stipend, extension form).

Electronic filing provides the following benefits:

- **Accuracy.** Computer programs catch mistakes before they become problems.

- **Acknowledgement.** The department electronically notifies the preparer or ERO that the return was received and accepted.
- **Refunds.** With electronic filing, the taxpayer has the option to receive a refund via direct deposit. This service is not available when filing a paper return.
- **File Now, Pay Later.** A return can be filed anytime before the due date. If tax is owed, payments may be made by authorizing an electronic funds withdrawal. This withdrawal can be scheduled for a later date and may be paid from the taxpayer's checking or savings account. The taxpayer may also choose to remit payment via check or money order with the pre-printed PA-V Payment Voucher, which should be mailed by midnight on the due date of the return.

## ADDITIONAL INFORMATION FOR EROS

The department requires all PA electronic returns to be accepted by the Internal Revenue Service (IRS). Once accepted by the IRS, the ERO does not have to register separately with the PA Department of Revenue.

## ACKNOWLEDGEMENT OF PA ELECTRONIC RETURNS

The Pennsylvania Department of Revenue will acknowledge the receipt of a return. However, the acknowledgement system will now only inform a taxpayer if a return was accepted or rejected. If a return is rejected, the rejection message will identify the reject as a business rule or schema error only. Refer to software instructions or contact the software representative for information regarding responsibilities for accessing and retrieving state acknowledgements.

## ACCEPTED PENNSYLVANIA FORMS/SCHEDULES

The following Pennsylvania forms may be transmitted electronically (refund, equal and balance due, with or without payment), and payment must be made by electronic funds withdrawal, check, money order or credit card.

- Form PA-40 - Pennsylvania Individual Income Tax Return (includes nonresident and Part-Year Resident returns)
- PA Schedule A - Interest
- PA Schedule B - Dividends
- PA Schedule C - Profit or Loss From Business or Profession
- PA Schedule D - Sale, Exchange or Disposition of Property
- PA Schedule D-1 - Computation of Installment Sale Income
- PA Schedule D-71 - Sale or Exchange of Property Prior to June 1, 1971
- PA Schedule E - Rent, Royalty, Patent and Copyright Income or Loss
- PA Schedule F - Farm Income and Expenses
- PA Schedule G-L - Out-of-State Credit, Long Form
- PA Schedule J - Estate & Trust Income
- PA Schedule W-2S - Wage Statement Summary
- PA Schedule SP - Tax Forgiveness Credit
- PA Schedule RK-1- Resident Schedule of PA S Shareholder/Partner Pass-Through Income, Loss and Credits
- PA Schedule NRK-1- Non-Resident Schedule of PA S Shareholder/Partner Pass-Through Income, Loss and Credits
- PA Schedule UE - Allowable Employee Business Expenses
- PA Schedule OC
- PA Schedule O
- PA Schedule P
- PA Schedule T - Gambling and Lottery Winnings
- PA REV-1630 - Underpayment of Estimated Tax by Individuals
- PA REV-1630A - Underpayment of Estimated Tax by Farmers

- PA Schedule 19 - Sale of a Principal Residence
- PA Schedule NRH - Apportioning Income by Nonresident Individuals
- Schedule PA-40X Amended Schedule
- W-2 Forms
- 1099-R Forms
- W-2G Forms

**NOTE:** Federal K-1s are not supported in PA e-File software. However, software packages that offer pdf file attachments can include the federal K-1 and its related supporting statements via pdf file with the return if the income and losses from that K-1 are also input into the return.

## EXCLUSIONS FROM ELECTRONIC FILING

The following documents are excluded from Federal/State electronic filing:

- Non-calendar, fiscal year returns;
- Amended individual income tax returns for years prior to 2010;
- Form PA-40NRC - Nonresident Consolidated Income Tax Returns;
- Form PA-40 KOZ - PA Income Tax Keystone Opportunity Zone Return;
- Returns containing forms/schedules not listed under federal forms; or "Accepted Pennsylvania Forms/Schedules".

**NOTE:** Electronic filing of Form PA-41 is only available through some paid preparers but is not available by department or volunteer tax preparers. Electronic filing of Form PA-20S/PA65 S Corporation/Partnership Information Return is available from most paid preparers but is not available by department employees or volunteer tax preparers.

## CONTACT INFORMATION FOR E-FILE INQUIRIES

The PA Department of Revenue has telephone lines for exclusive use by EROs, transmitters and software

developers participating in the Federal/State e-file program. The operating hours are Monday through Friday, 7:30 a.m. to 5:00 p.m. (except holidays).

**NOTE:** The following phone number is not to be provided to taxpayers.

Help Desk 717-787-4017.

You may forward correspondence for the electronic filing program to the following address:

PA DEPARTMENT OF REVENUE  
BUREAU OF INDIVIDUAL TAXES  
PO BOX 280507  
HARRISBURG PA 17128-0507  
FAX: 717-772-4193 or 717-787-2840

You may also fax information concerning electronically filed returns to the department using the Personal Income Tax Fax Cover Sheet, DEX-93, which is also available from the Department of Revenue's website, **www.revenue.pa.gov**. The fax cover sheet includes the proper fax numbers for providing specific information regarding electronically filed returns. Using the fax cover sheet enables the department to more quickly and accurately attach information to the correct taxpayer's return and further allows for faster turnaround times for processing of taxpayer correspondence.

For a full explanation of the Federal/State e-file program, please review the Pennsylvania Fed/State E-file Handbook, REV-993. This booklet may be downloaded from the Department of Revenue's website, **www.revenue.pa.gov**.

## FORM PA-40 GENERAL INSTRUCTIONS

### Filing Due Date

The due date for filing the PA personal income tax return is the same due date as it is for federal income tax returns. Generally, that date is April 15 or the next business day if the 15th falls on a Saturday, Sunday or holiday. If the IRS determines that Emancipation Day for Washington, DC is a holiday, the due date will be the next business day after the holiday.

### Extension

A taxpayer may request an extension of time to file, however this does not extend the payment deadline.



If the taxpayer anticipates a tax balance due, he/she should submit payment with the extension request.

Extensions may be requested in two ways:

- The taxpayer can submit Form REV-276, Application for Extension of Time to File, postmarked on or before the April 15 due date.
- The taxpayer may submit a copy of a federally approved extension of time to file with his/her state return.

An extension grants an individual an additional six months to file a return. People outside the country are automatically granted a two-month extension to file by June 15.

### Who must file?

Any PA resident, nonresident or part-year resident who:

- Received total PA gross taxable income in excess of \$33 during the tax year, even if no tax is due; and/or
- Incurred a loss from any transaction as an individual, sole proprietor, partner in a partnership or PA S corporation shareholder.

**Minors.** PA law does not exempt a minor from the above requirements to file a PA tax return even if the minor is claimed as a dependent on a federal return. A parent must file a return on behalf of the minor child in such circumstances.

**Decedents.** The executor, administrator or other person responsible for the affairs of a decedent must file a PA tax return on behalf of the decedent if the decedent could not or did not elect to file a joint return with a surviving spouse.

### Determining Residency

An individual may have to pay income tax as a PA resident even if he or she is not considered a PA resident for other purposes. For income tax purposes, one must consider both where he or she is domiciled and where he or she maintained a permanent place of abode during the taxable year.

An individual's domicile is their fixed and permanent home to which they always have the intention of

returning whenever absent, even though they may live elsewhere. An individual can have only one state of domicile at any given time. Below are some factors to consider when determining an individual's place of domicile:

- Where does the taxpayer spend the greatest amount of time during the taxable year?
- Where does the taxpayer maintain a permanent abode for the longest amount of time during the taxable year?
- Where does the taxpayer support his or her spouse and children?
- Where does the taxpayer purchase the necessities of life?
- Where does the taxpayer have doctors, lawyers and accountants?
- Where does the taxpayer house his or her pets?
- Where does the taxpayer have active banking accounts?
- Where does the taxpayer worship regularly?
- Where does the taxpayer participate in social, fraternal or athletic organizations, lodges or country clubs?
- Where does the taxpayer have works of art, expensive furniture, family portraits or heirlooms?
- Where does the taxpayer fulfill local tax obligations?
- Where is the taxpayer employed?
- Where does the taxpayer own real estate fit for year-round living?
- Where does the taxpayer maintain a driver's license and vehicle registration?
- Where does the taxpayer maintain professional licenses?
- Where does the taxpayer maintain union membership?
- Where does the taxpayer declare residency for fishing or hunting licenses, income tax returns or school tuition?

- Where does the taxpayer conduct his or her business?
- Where does the taxpayer receive mail?
- Where does the taxpayer receive unemployment?
- Where does the taxpayer record his or her address for insurance policies, deeds, mortgages, leases, passport, federal and local tax returns, etc.?
- Where was the taxpayer domiciled at birth?
- Where does the taxpayer maintain safe deposit boxes?
- Where does the taxpayer own a cemetery plot?
- Where is the taxpayer listed in the telephone directory?
- Where has the taxpayer obtained a homestead exemption?
- Where does the taxpayer gather for family and social events?
- Where is the taxpayer registered to vote?

In order to establish a new domicile, the following three conditions must be met:

- There must be evidence of a firm and definite present intention to discontinue making the former domicile one's primary base of operations;
- There must be evidence of a firm and definite present intention to make the new domicile one's primary base of operations; and
- There must be evidence of actual physical presence and actual abode (transient, temporary or permanent) in the new location.

If all three requirements are met, the date of the change is the first day of actual physical presence in the new location.

If an individual left their domicile to seek new employment and intended to remain in the other location only if they were to find employment, there is no change in domicile.

Once established in a locality or state, the domicile continues there until a new one is established. It is not

dependent upon continuous physical presence. It is not abandoned by absence or even by presence in a former domicile, no matter how long continued, if, in leaving and during the absence, there is not firm, sincere, unconditional intention of remaining in the other jurisdiction for an indefinite and uncertain period.

For example, temporary absence from a new domicile in a former domicile for the purpose of transacting business or for the sake of health, pleasure, or education, with a definite intention of returning to the new domicile does not affect a person's domiciliary status.

A retired couple with two permanent homes, one inside Pennsylvania and one outside of Pennsylvania, can only have one state of domicile. The state of domicile does not change until there is a move to another state or country with the sincere intention of making a "new" permanent home there and abandoning the previous domicile. The determination as to their state of domicile should be made based on the factors above.

A permanent abode is a house, apartment, dwelling place or other residence an individual maintains as his or her household for an indefinite period, whether he or she owns it or not. An abode is not permanent if it is occupied only during a fixed or limited period of time for a particular purpose. Barracks, bachelor officer's quarters, quarters on ships and other living accommodations provided by one's employer for a definite period do not qualify as permanent dwelling places; nor do college dormitories, fraternity houses, sorority houses and off campus rentals by enrolled college students qualify as a permanent abode.

### **PA Resident**

Residency in Pennsylvania, for tax purposes, may be established in two ways:

**Domicile in Pennsylvania:** If an individual is domiciled in Pennsylvania, he or she is considered a resident unless he or she meets all three of the following conditions:

- He or she did not maintain a permanent abode in Pennsylvania for himself/herself or his/her family;
- He or she did maintain a permanent abode outside Pennsylvania throughout the entire taxable year; and



- He or she did not spend in the aggregate more than 30 days of the taxable year in Pennsylvania.

**Day Test:** If an individual maintains a permanent abode in Pennsylvania and spends a total of 183 days or more of the taxable year in Pennsylvania, even though he or she is not domiciled in the commonwealth, he or she is considered a resident.

### **Nonresident**

An individual is a nonresident for PA tax purposes if he/she is not a resident as defined above.

After determining the location with the greatest connection, it is necessary to see if a new domicile outside of Pennsylvania has been established.

### **Part-Year Resident**

A part-year resident is an individual who moved to or from Pennsylvania during the taxable year with the intent of permanently changing domiciles. A person moving into Pennsylvania, with the intent of residing here permanently, becomes a resident on the first day he or she is actually, physically present in the Commonwealth, regardless of reason or housing arrangement (such as employer provided housing, living with relatives, etc).

### **Persons in the Military or Foreign Service**

Unless there is an intention to change domiciles, a person generally neither acquires a new domicile by entering the armed forces nor loses the domicile that the person had upon entering. A person on military duty is not prohibited, however, from acquiring a new domicile where his or her family is stationed. A person in the military and foreign service, or living in a foreign country for other than a temporary or transitory purpose while a lawful permanent resident or citizen of the country, is treated as a domiciliary of that country if the person:

- Is not an employee of the U.S., its agencies or instrumentalities (including members of the armed forces and career appointees in the U.S. foreign service); and
- Does not hold an appointive office in the executive branch of the government of the U.S.

However, special rules may apply if the employee or officer maintains a permanent place of abode there. An individual who is domiciled in Pennsylvania is considered a nonresident if he or she meets all three of the requirements listed in the prior sections on Pennsylvania residency and domicile.

For tax years 2008 and prior, the spouse of a service member serving in Pennsylvania was taxed on any PA-sourced income that he/she may have earned. Under the Military Spouses Residency Relief Act, income earned by the spouse of a service member shall not be considered taxable income in the state that the service member is stationed if that state is not considered the spouse's state of residence or domicile.

If a service member is a PA resident serving outside of the Commonwealth of Pennsylvania and his/her spouse realizes income in that other state, the spouse's income is only taxable to PA (if the spouse maintains his/her PA residency). A resident credit will not be allowed for taxes paid to the other state. If the spouse receives income subject to employer withholding, he/she should request a refund of that withholding from the other state.

If the service member is a nonresident serving inside the Commonwealth of Pennsylvania and his/her spouse realizes income in PA, that income is not taxable to PA as long as the spouse is considered a resident of another state. If the spouse receives income subject to employer withholding, he/she should request a refund of that withholding. This may be done by filing a PA personal income tax return and only reporting the PA tax that was withheld (shown in Box 17 of the W-2). They must also provide a copy of their spouse's military orders showing they were ordered to service in PA, and a copy of their resident state's driver's license.

### **College Student**

Generally, a child has the same domicile as his or her parents or legal guardian. Becoming a legal adult does not by itself separate a child from the parent or legal guardian's domicile. The child merely acquires the power to establish a separate or new domicile.

### **Minor Child**

The domicile of a minor child is the same as the domicile of the child's parents. If the parents are

separated, the child's domicile is the domicile of the parent with whom the child lives or that of the child's legal guardian.

### **Dual Residency**

A dual resident is an individual who is considered a resident of two states for taxing purposes. If an individual is a dual resident, he or she should report the income that was earned during the taxable year from sources both within and outside of PA on both states tax returns. This individual would then request a resident credit for income sourced to the state of statutory residence in the state that he/she is domiciled in.

**NOTE:** Special rules apply for PA residents working in states with reciprocal tax agreements with Pennsylvania: Indiana, Maryland, New Jersey, Ohio, Virginia or West Virginia. If a taxpayer is a PA resident and also a resident of a reciprocal state, for income tax purposes he/she may claim the PA resident credit. The reciprocal agreement with these states is not applicable since the taxpayer is subject to tax as a resident in both Pennsylvania and the other state. The taxpayer must file PA Schedule G-L for each state for which a resident credit is being requested and enclose a copy of the resident tax return filed with the other state. This documentation will serve as proof that the other state taxed him/her as a resident in that state and did not allow a credit for tax paid to PA.

For example, Dan is a domiciliary of Pennsylvania for the entire taxable year. He leased an apartment in Maryland and worked 230 days in Maryland. Maryland considers Dan to be a Maryland resident for income tax purposes. He earned \$10,000 in compensation for working in Maryland. Dan must report his compensation as PA-taxable income. Because he is a PA domiciliary, Dan may claim the PA resident credit for taxes paid to Maryland as long as he does not claim a credit on his Maryland return for taxes paid to PA.

### **How Residents are Taxed**

A PA resident is taxed on all taxable income received from sources inside and outside Pennsylvania.

A PA resident may claim a resident credit for any tax imposed by and paid to other states based upon income which is not from Pennsylvania sources and is subject to PA personal income tax. The PA Schedule G-L must be completed to claim this credit.

### **How Nonresidents are Taxed**

Nonresidents are taxed on the following types of income derived from sources within Pennsylvania:

- **Compensation**

Pennsylvania taxes nonresidents on compensation for services performed in Pennsylvania, unless the taxpayer is a resident of one of the reciprocal agreement states.

- **Net Income or Loss from the Operation of a Business, Profession or Farm**

Pennsylvania taxes nonresident owners on all allocated, or apportioned, income from the operation of a business entity in Pennsylvania. If an individual derives income from sources inside and outside Pennsylvania, separate accounts and records that clearly reflect the PA business activity should be maintained. Otherwise, that individual must file PA Schedule NRH to apportion the income.

- **Net Income or Loss from the Sale, Exchange or Disposition of Property**

Pennsylvania taxes nonresidents on the gain from the sale of any real or tangible personal property located in Pennsylvania. Pennsylvania does not tax nonresidents on the gain from the disposition of intangible property nor allow the use of any loss from such a disposition to reduce other PA taxable gains. If a taxpayer sells property in his or her former state before moving into Pennsylvania, no gain or loss on that sale is reportable to PA. However, if the taxpayer moved from Pennsylvania to another state and then sold property or any other tangible property in Pennsylvania, the gain must be reported.

- **Income or Loss from Rents, Royalties, Patents and Copyrights**

Pennsylvania taxes nonresidents on the net income from the use of property located or used in Pennsylvania.

- **Interest on Installment Sales**

Pennsylvania taxes nonresidents on interest from Installment Sales as PA Schedule D-1 Income.

- **Interest on Business Accounts**

Pennsylvania taxes nonresidents on interest on business accounts such as accounts receivable or a business checking account that is included in business income.

- **Mortgage or Security Interests**

Pennsylvania taxes nonresidents on mortgage or security interests on installment sales that are reported as such utilizing PA Schedule D-1. If PA Schedule D-1 is not used and the entire gain is reported in the year sold, interest on an installment sale is not subject to tax.

- **Intangible Personal Property**

Pennsylvania taxes nonresidents on intangible personal property employed in a trade, profession, occupation or business carried on in Pennsylvania. The nonresident taxpayer does not report such a sale on a PA Schedule D, but includes the gain (loss) in determining net income or loss from the operation of a business, profession or farm.

- **Estate or Trust Income**

Pennsylvania taxes nonresident beneficiaries on income from an estate or trust only to the extent the PA-source income to the beneficiaries is taxable to nonresidents.

- **Gambling and Lottery Winnings**

Pennsylvania taxes nonresidents on gambling and Lottery winnings by reason of a wager placed in this commonwealth, the conduct of a game of chance or other gambling activity located in this commonwealth or the redemption of a Lottery prize from a Lottery conducted in this commonwealth, other than noncash prizes of the Pennsylvania Lottery. Nonresidents are not subject to PA taxes on gambling or Lottery winnings, by reason of a wager placed outside this commonwealth, the conduct of a game of chance or other gambling activity is located outside this commonwealth or the redemption of a Lottery prize from a Lottery conducted outside this commonwealth.

**NOTE:** Nonresidents are not subject to PA tax on ordinary interest and dividends from investments or gains realized on the sale, exchange or disposition of

intangible property. Losses on the sale of intangible property may not be used to offset any taxable gain.

### **Apportioning PA Taxable Income**

A nonresident employee who performs services inside and outside Pennsylvania is subject to PA personal income tax on the net compensation for services performed within Pennsylvania. Usually the employer will allocate and separately report on federal Form W-2, Wage and Tax Statement, the PA gross compensation.

If the employer did not report PA gross compensation on the W-2; or reported an incorrect amount as PA gross compensation on the W-2; or the taxpayer incurred unreimbursed employee business expenses in earning or receiving PA gross compensation, PA Schedule NRH, Compensation Apportionment, must be completed.

A separate schedule must be completed for each employer for whom services within and outside Pennsylvania were performed.

If a nonresident taxpayer has income from a business, profession or farm derived from sources both within and outside Pennsylvania and has records and accounts that accurately reflect the income from Pennsylvania, he or she should report as PA taxable income those amounts based on these accounts and records. If the accounts and records do not clearly reflect the PA-source income, the section titled Net Profits from Business or Farm Apportionment Formula on PA Schedule NRH must be completed.

### **EXCEPTION: Residents of a Reciprocal State**

Residents of Indiana, Maryland, New Jersey, Ohio, Virginia or West Virginia are not subject to tax on compensation for services performed inside Pennsylvania on which federal withholding is required, such as wages and salaries. However, if an Ohio resident holds 20 percent or more share interest in a subchapter S corporation and receives wages or salary from that corporation, he or she will be subject to PA income tax on the wages or salary from said subchapter S corporation. This exception does not apply to income reported as compensation such as executor fees on which there is no federal withholding requirement, nor does it apply to any other class of income.

Residents of these states must file Form REV-419, Employee's Nonwithholding Application Certificate, with their PA employers to be exempt from having PA tax withheld. In this situation, the PA employer should withhold and remit tax to the employee's state of residency.

A resident of one of these reciprocal states whose employer withheld PA income tax must file Form PA-40 reflecting no compensation on Line 1a and the PA tax withheld on Line 13. In addition, a signed copy of the other state's resident income tax return (without any supporting documents) along with a copy of the actual W-2 and a statement that the taxpayer was a resident of a reciprocal state must be submitted.

A PA resident working in one of these reciprocal states should request to his or her employer that they withhold PA income tax. If the employer withholds the tax for the reciprocal state, the taxpayer must file for a refund from that state. If the PA resident expects to receive income of \$8,000 or more and the employer does not withhold PA income tax, the individual is required to make quarterly estimated payments. Failure to make these payments will result in an assessment of estimated underpayment penalty.

### **How Part-Year Residents are Taxed**

A part-year resident is subject to PA personal income tax as a resident for the portion of the year they resided in Pennsylvania. The same taxpayer is subject to PA personal income tax as a nonresident for the remaining portion of the year if he or she continues to work in Pennsylvania unless he or she becomes a resident of a reciprocal state.

### **Members of Partnerships and Subchapter S Corporations**

A member of a partnership or a shareholder in a subchapter S corporation must report his or her share of income, whether it was distributed or not. The income or loss from the partnership or subchapter S corporation must be reported in the same class from which the partnership or subchapter S corporation received the income. A line is provided on PA Schedules A, B, D, E and J specifically for partnership or subchapter S corporation income. Ordinary business income, farm income, dividends, interest and rental income should be added to any similar class of income

and included on the appropriate line of Form PA-40. Composite returns can be filed on behalf of the nonresident shareholders or partners. Sometimes an individual partner or shareholder pays an expense of a partnership or subchapter S corporation, such as interest expense. In this case, the individual may deduct the expense from his/her income only if the partnership agreement or articles of incorporation require that the member or shareholder pay the business or rental expenses out of his or her personal assets. These expenses must be noted on a separate attachment and do not relate to any existing schedule.

Do not add health care benefits to the PA wages of shareholder-employees of PA S corporations as long as the plan is non-discriminatory, even though such benefits must be added to federal wages.

Each partner in a business, profession or farm must attach to Form PA-40 a copy of the PA RK-1 for residents or PA NRK-1 for nonresidents. A separate PA RK-1/PA NRK-1 must be submitted for each partnership in which the taxpayer is a member. If a partnership fails to provide such forms, the taxpayer must attach a copy of the federal Schedule K-1 and classify the income or loss according to PA instructions for that class.

Each shareholder in a PA S corporation must attach to Form PA-40 a copy of PA-20S/PA-65 RK-1 for residents or PA-20S/PA-65 NRK-1 for nonresidents. A separate PA-20S/PA-65 RK-1/NRK-1 must be submitted for each PA S corporation in which the taxpayer is a shareholder.

A PA return must be filed even if the PA-20S/PA-65 RK-1 or PA-20S/PA-65 NRK-1 shows a loss.

### **Members of the Armed Forces and Nonmilitary Persons on Federal Active Service**

For PA personal income tax purposes, armed forces include the Army, Navy, Air Force, Marine Corps and Coast Guard. They do not include the Merchant Marines, Public Health Service or National Oceanic and Atmospheric Administration, except if/when any of these are incorporated into the armed forces in times of war or emergency. Further, civilian employees for the Department of Defense, such as teachers and subcontractor employees, are not considered members of the armed forces.



**Resident Members of the Armed Forces**

Compensation earned by residents of Pennsylvania in the armed forces serving on federal active duty outside Pennsylvania is not taxable as compensation in Pennsylvania. This includes housing allowances and a reserve unit's two-week summer training. Military pay -- including housing allowances received by a PA resident while not on federal active duty or not on federal active duty training -- is fully taxable regardless of where the military service is performed. For example, all income received for inactive duty while attending weekend drills is taxable. Also, compensation earned by a PA resident for military service on active duty in Pennsylvania is subject to personal income tax. Under Act 182 of 2006, PA residents called to active military duty for disaster relief of emergency management assistance inside or outside of Pennsylvania are exempt from taxation on the compensation paid to them by either the U.S. government or the commonwealth. The taxpayer has the burden of establishing that income received for military service outside the commonwealth was earned while on federal active duty. The Department of Revenue will accept as proof the authority section of the military orders directing the taxpayer to federal active duty outside the commonwealth. If authority for the active duty is based upon a federal statute, such as 32 U.S.C. §§ 316, 502, 503, 504 or 505, federal active duty will be presumed and the income is excludable from taxable compensation. To exclude income from serving on active duty in the military outside of the commonwealth, residents must file a PA personal income tax return and include their military W-2 Forms and copies of their orders as evidence of active duty military pay earned outside Pennsylvania. If PA tax was withheld for active duty service outside the commonwealth, the taxpayer will be given a full refund of their withholding. If a portion of the military service is active and a portion inactive, the taxpayer should provide documentation that gives a detailed breakdown of active duty pay while outside of the commonwealth, combat zone pay (if applicable) and all other military compensation. The sum of these items must equal the reportable wages shown in Box 16 of the individual's military W-2 Form. In addition, the documentation must state the dates during which each component of compensation was received and

must include a copy of the individual's military orders ordering him or her to a combat zone and/or placing him or her on active duty as a member of the U.S. armed forces at a military facility outside the commonwealth during the year. A W-2 Form that identifies income as active duty pay is not sufficient because it does not explain where the active duty occurred. The taxpayer may reduce the amount of reportable military compensation on Line 1a of his or her Form PA-40 by the sum of the compensation received as combat zone pay and/or active duty pay received as a member of the U.S. armed forces outside the commonwealth. If authority for active duty is based upon a PA statute, such as 51 P.S. §§ 508 or 3102, state active duty will be presumed and the income received is taxable.

**Nonresident Members of the Armed Forces**

Nonresident military personnel who are serving on federal active duty in Pennsylvania in compliance with military or naval orders are exempt from PA personal income tax on their military pay and housing allowances because of federal law. They and their family members are, however, subject to tax on any other PA-source income normally taxable to nonresidents. This includes non-active duty pay such as weekend drills.

**National Guardsmen and U.S. Reservists**

National Guardsmen and U.S. Reservists ordered to active duty for training at a two-week summer encampment pursuant to Title 10 or Title 73 of the U.S. Code are presumed to be on federal active duty. Military pay received for such service is excludable from taxable compensation provided the active duty training is performed outside the commonwealth. In addition, scholarships or remuneration received by cadets and midshipmen at U.S. military academies is not taxable because none of these academies are within Pennsylvania and such individuals are on federal active duty.

When a civilian employer either makes up the difference in a National Guard member's or U.S. Reservist's regular wages or continues full pay for the Guardsman or Reservist during the term of active duty, the differential or full pay continuation is considered taxable compensation. The Heroes Earnings Assistance and Relief Tax Act (HEART) of

2008 is an exception to this. If the differential pay is earned while in a combat zone or hazardous duty zone, the income is not taxable.

A full-time member of the PA National Guard is taxed on all of the following components of military compensation:

- Inactive state duty pay received for services both within and outside the commonwealth;
- Inactive federal duty pay received for services as a member of the U.S. armed forces both within and outside the commonwealth;
- Active federal duty pay received for services within the commonwealth, unless called to active military duty for disaster relief of emergency management assistance; and
- Active state duty pay received for services both within and outside the commonwealth, unless called to active military duty for disaster relief of emergency management assistance.

#### **Nonmilitary Persons on Federal Active Service**

A PA resident on federal active duty outside Pennsylvania is subject to tax on his or her compensation.

**NOTE:** A PA resident in the U.S. foreign service is not on active duty for PA purposes, and his or her compensation is subject to tax.

#### **Members of the Merchant Marines, Employees of the U.S. Public Health Service and National Oceanic and Atmospheric Administration**

PA residents serving in the Merchant Marines, the U.S. Public Health Service, the National Oceanic and Atmospheric Administration or contractors working in foreign countries, are subject to tax on compensation whether earned within or outside PA unless the U.S. President declares them by Executive Order to be military service during times of war or national emergency. Also included in this category are those individuals who are employed by the Department of Defense as school teachers. They are not covered under the Soldiers' and Sailors' Civil Relief Act as they are civilian employees of the Department of Defense and not members of the armed forces.

#### **Military Spouses Residency Relief Act**

The Military Spouses Residency Relief Act (MSRRA) affects the treatment of residency and income for spouses of military personnel for state and local tax purposes for tax year 2009 and after.

The MSRRA permits a service member's nonmilitary spouse to retain status as an out-of-state resident and source any nonmilitary compensation to the state of residence under the following circumstances:

- The service member must be in Pennsylvania in compliance with military orders.
- The service member's spouse must be in Pennsylvania solely to be with his/her spouse.
- The service member's spouse must have the same domicile (legal residence) as the service member.

Conversely, if a Pennsylvania resident service member is serving outside Pennsylvania and his/her nonmilitary spouse earns income in that other state – and the spouse claims relief under the MSRRA – the spouse's income is only taxable to Pennsylvania.

#### **I. Domicile/Legal Residence**

A person generally does not acquire a new domicile or legal residence by entering the armed forces. Until a service member intentionally changes his/her domicile, a service member's domicile is the state he/she called home when he/she entered the military. This is the state where the service member files income tax returns (if that state has an income tax) and where the service member intends to return upon leaving the military.

Under MSRRA, a service member's spouse neither loses nor acquires domicile or residency by being absent or present in any U.S. tax jurisdiction solely to be with a service member complying with military orders.

#### **II. Nonmilitary Spouses and Pennsylvania Income Taxation**

For tax years beginning on or after Jan. 1, 2009, compensation or other income earned in Pennsylvania for services rendered by a service member's nonmilitary spouse is not taxable by Pennsylvania, when:



- The nonmilitary spouse and service member have the same out-of-state domicile;
- The spouse is in Pennsylvania solely to be with the service member (see note below); and
- The service member is in Pennsylvania complying with military orders.

However, a nonmilitary spouse's other income from Pennsylvania sources is subject to Pennsylvania personal income tax to the extent it is earned, received or acquired from sources within the commonwealth as follows:

- By reason of ownership or disposition of an interest in real or tangible personal property in Pennsylvania;
- In connection with a trade or business in Pennsylvania; and/or
- From intangible personal property employed in a trade, profession, occupation or business carried on in Pennsylvania.

A qualifying nonmilitary spouse must have moved to Pennsylvania from another state, be in Pennsylvania solely to accompany his/her active duty service member spouse stationed in Pennsylvania in accordance with military orders, and have the same state of residency as the service member.

Taxpayers claiming relief under MSRRA and a refund of Pennsylvania income tax withheld, in addition to a standard personal income tax return and appropriate schedules, must provide the following:

- A copy of the service member's current military orders showing the order to serve in Pennsylvania;
- A copy of the service member's military identification card;
- A copy of the nonmilitary spouse's driver's license from the resident state;
- A copy of the nonmilitary spouse's W-2, issued by the employer;
- A copy of the nonmilitary spouse's tax return filed for the resident state;

- A copy of the nonmilitary spouse's military ID card, identifying the card-holder as the spouse; and
- A copy of the service member's federal Department of Defense Form 2058, State of Legal Residence Certificate (see note below).

Taxpayers filing electronically should fax these documents within two to three days of e-filing to 717-772-4193, noting the taxpayer's name and Social Security number on each document. Those filing paper returns should write "MSRRA" across the top of Page 1 of the PA-40.

Spouses of service members who meet these requirements and who either had Pennsylvania income tax withheld from wages or made other Pennsylvania income tax payments for the tax year may receive refunds of such taxes paid by filing a Pennsylvania personal income tax return, PA-40. The nonmilitary spouse should report zero wages on Line 1 of his/her Pennsylvania personal income tax return, and include the total Pennsylvania taxes withheld (Box 17 of Form W-2) on Line 14.

**NOTE:** A nonmilitary spouse working in Pennsylvania but living in a neighboring state in which the military spouse is stationed, may also be eligible if the military spouse is required to be there per military orders and all other requirements are met for state of domicile and reason for being in the location with the military service person.

### **III. Discontinuation of Pennsylvania Income Tax Withholding**

The nonmilitary spouse of a service member whose wages/salary is exempt from Pennsylvania personal income tax under MSRRA should file a Pennsylvania Form REV-419, Employee's Nonwithholding Application Certificate, with his/her Pennsylvania employer, claiming exemption from Pennsylvania income tax withholding.

### **IV. Taxation of Service Members' Military and Nonmilitary Pay**

MSRRA does not exempt from Pennsylvania personal income tax nonmilitary income earned by a service member. However, a nonresident service member's active duty military income continues to be exempt from Pennsylvania personal income tax.

### Combat Zones

Combat zone pay received by a U.S. service member is not taxable for PA personal income tax purposes (see Title 72 P.S. § 7301(d)(vii)), nor is it considered poverty income for purposes of the special tax forgiveness provisions (see Title 72 P.S. § 7301(o.2)(vii)).

For PA personal income tax purposes, combat zones are areas designated by the U.S. President. PA National Guard members and U.S. Reservists are U.S. service members while they are serving in a combat zone for purposes of this exclusion. The \$500 combat zone pay exclusion limit for military officers contained in the Internal Revenue Code is not in the state taxing statute. Refer to [www.irs.gov](http://www.irs.gov) for a listing of current combat zones.

PA residents serving in combat zones or qualified hazardous duty areas designated by the U.S. President are given the same additional time to file their PA personal income tax returns and make payments as allowed for federal income tax purposes. The deadline is automatically extended to 180 days from the last day of service or the last day of continuous hospitalization for injuries incurred in one of these areas. Print "Combat Zone" at the top of the return and mail it along with the military orders to:

REGARDING COMBAT ZONE  
PA DEPARTMENT OF REVENUE  
BUREAU OF INDIVIDUAL TAXES  
PO BOX 280600  
HARRISBURG PA 17128-0600

If the return is filed electronically, a copy of the military orders must still be submitted. Print "Combat Zone" at the top of the orders and fax them to 717-772-4193 or mail them to:

REGARDING COMBAT ZONE  
PA DEPARTMENT OF REVENUE  
ELECTRONIC FILING SECTION  
PO BOX 280507  
HARRISBURG PA 17128-0507

### Retirement Income

Retired or retainer pay of a member or former member of a uniform service calculated under Chapter 71 of Title 10, U.S. Code (as amended) is not taxable for PA personal income tax purposes.

### Taxable Income Classes

PA personal income tax is levied at a flat rate on eight separate classes of income:

- Compensation
- Interest
- Dividends and Capital Gains Distributions
- Net Income or Loss from the Operation of a Business, Profession or Farm
- Net Gains or Loss from Sale, Exchange or Disposition of Property
- Net Income or Loss from Rents, Royalties, Patents or Copyrights
- Estate or Trust Income
- Gambling and Lottery Winnings

### Gains and Losses

A gain in one class of taxable income cannot be offset against a loss in any other class of taxable income, nor may gains or losses be carried back or forward to another tax year. If a taxpayer has a net loss in any income class, enter the amount of the loss on the appropriate line on Form PA-40; use the actual dollar figure and fill in the oval indicating loss for that category. A completed schedule must be submitted even if the taxpayer incurred a loss in a class of income. A spouse may only offset losses against his or her own profit/gain/income. A spouse may not offset a loss against the other spouse's profit or gain. However, if both spouses jointly own a business which incurred a loss, they may each take their share of the loss against their other business gains.

### Joint Income

If two or more persons, such as a taxpayer and spouse, own income-producing property -- including real estate, savings accounts or stock -- as joint tenants, tenants by the entirety or tenants in common, each person must report his/her proportional share of income from the property, even if only one Social Security number and name appears on the statement. Generally, such income is divided equally between the owners.

In the case where a taxpayer and spouse and a third party own real estate, such as parents and a son or daughter, the taxpayer and spouse are jointly liable for one-half of any gain on the sale, and the child is liable for the other half (unless the deed stipulates that the property is held as tenants in common). However, for any other property, such as bank accounts, each individual person is considered an equal owner. In the case of ownership by a taxpayer and spouse and a child appearing as owners on a bank account, each would be liable for one-third of the interest earned.

## INSTRUCTIONS FOR PREPARING FORM PA-40

If filling out a paper Form PA-40, be sure to fill in all requested information by typing or printing legibly.

Only taxpayers who request a PA-40 book will have a book mailed to them.

The Department of Revenue uses electronic data imaging to enter tax returns into its computer system. Follow these instructions for entering Social Security numbers, names, addresses and amounts to help ensure personal income tax returns are processed accurately and quickly.

- Print in black ink.
- Use UPPER CASE (CAPITAL) letters.
- Print one number or letter in each box.
- Leave a blank box between whole words.
- Print the taxpayer's name – last, first, middle initial and suffix on the correct lines.
- Print the taxpayer's correct address.
- Print the taxpayer's apartment number, suite number, room number, rural route, floor, etc on the first line.
- Print the taxpayer's PO Box on the second line.
- Fill in all appropriate ovals completely.
- Show money amounts in whole dollars. Eliminate any amount less than \$0.50 and increase any amount between \$0.50 and \$0.99 to the next highest dollar.

- Prepare a copy for the taxpayer's records before submitting.

If the name, address or city begins with Mc, Van, O', etc, do not enter a space or a punctuation mark.

There are two lines to enter the address. Use the postal format of apartment number, suite, room number, rural route, box number, floor, etc. on the first line and the street address on the second line. If there is only a street address, it may be entered on either line.

There are ovals present for "Extension", "Amended Return", "Residency Status", "Filing Status", "Farmers" and losses in certain income categories. If any of these apply, the oval(s) must be filled in completely. Do not use an X or a check mark. Also note that Form PA-40 is two-sided. Do not forget to complete both sides.

### Social Security Number

The taxpayer's correct Social Security number (SSN) must be verified and matched against the state copy of the Wage and Tax Statement, the W-2 Form. If a W-2 Form has an incorrect SSN, the taxpayer must obtain a corrected W-2 Form (Form W-2C) from his or her employer.

Returns completed for married taxpayers, even if filing Married, Filing Separately, must include the SSN of both spouses.

**NOTE:** By law (42 U.S.C. Sec. 405(c)(2)(C)(i); 61 Pa. Code Sec. 117.16) the PA Department of Revenue has the authority to use the SSN to administer PA tax laws to identify taxpayers and their incomes. PA law does prohibit the commonwealth from disclosing information individuals provide on income tax returns, including SSNs, except for official purposes.

### Name

The complete name of the taxpayer must be entered. If completing a joint return, the spouse's first name must also be included. If a taxpayer and spouse use different last names, the person entering his or her name as the spouse must enter the last name he or she is using in the blocks designated as "Spouse's Last Name". Do not enter anything in these blocks if the taxpayer and spouse use the same last name. If filing a joint return with a deceased taxpayer, the surviving spouse enters his/her name first. If both

taxpayer and spouse are deceased and filing a joint return, enter the name of the primary taxpayer from the previous tax year first.

### **Address**

The address must be the current mailing address of the taxpayer. If using a military address, the APO or FPO address should be used.

If filing for a taxpayer who is using an address that is out of the country, the format established by the U.S. Postal Service must be followed. The proper format is to enter the name(s) in the spaces provided. The house number and street, apartment number and street or postal delivery location is to be entered in the spaces for the first line of the address. The city, state/province and foreign postal code (the equivalent of ZIP code) should be entered on the second line of the address. The name of the country should be entered in the spaces provided for City or Post Office on the Form PA-40. Do not enter any information in the state or ZIP Code spaces.

### **Daytime Telephone Number**

Provide a telephone number where the taxpayer can be reached during the day.

### **School Code and School District Name**

The five-digit code and name of the school district where the taxpayer lived on Dec. 31 of the tax year must be entered. If the taxpayer was a nonresident of Pennsylvania on the last day of the tax year, enter 99999 in the school code area. If the taxpayer died during the tax year, enter the information applicable at the time of death. This information must be entered. Using an incorrect school code may affect the school district's funding. Failure to enter this information may delay the processing of the return and delay the issuance of any refund.

Some examples of what to consider when entering the school code on a return are as follows:

- Any military personnel should use the school code for the domicile of his/her spouse (if the spouse lives in Pennsylvania), parents (if entering the military while domiciled in Pennsylvania), or the code for the school district in which he/she lives while on federal active military duty while stationed in Pennsylvania (if a PA resident).

- A person residing in a nursing home or other care facility who plans to return to his/her principal residence after a temporary stay in such facilities should enter the school code for the physical address of his/her principal residence and not the nursing home or care facility.
- A person who resides in a nursing home or care facility on a permanent basis and has made the decision to do so (assuming mentally capable to make this decision) should use the school code for the physical address of the nursing home or care facility.
- A PA resident attending college inside or outside Pennsylvania should use the school code for the physical address of the domicile or primary residence of his/her parents.
- A nonresident or part-year resident who did not reside in the state as of Dec. 31 of the tax year should enter 99999 in the school code field.
- A part-year resident who resided in Pennsylvania as of Dec. 31 of the tax year should enter the school code of the physical address of his/her domicile or primary residence on Dec. 31.
- A person who uses a mailing address other than the physical address of the domicile or principal residence should enter the school code for the physical address of his/her domicile or primary residence.
- A person who works outside Pennsylvania, but maintains a permanent place of abode inside PA during absences from Pennsylvania or a person who plans to return to Pennsylvania after a temporary relocation to another state or country and is still considered a PA resident, should use the school code for the physical address of his/her permanent place of abode or the school code of his/her physical address prior to moving out of Pennsylvania.

### **Extension**

If an extension of time to file has been requested, this oval must be filled in. If tax is owed, a copy of the federal extension should be submitted with the taxpayer's return if a PA extension was not filed.

An extension of time to file does not extend the payment deadline. Any tax reasonably expected to be due must be paid with Form REV-276, Application for Extension of Time to File, by the April 15 due date. If at least 90 percent of the total tax liability was paid in four quarterly estimated installment payments by the due date of each installment payment and all additional tax was paid with the extension on or before the April 15 due date, an underpayment of tax penalty will not be charged. However, interest will be imposed if the total tax balance is not paid by the April 15 due date.

For federal extensions where additional money is due with the filing of the PA-40, enclose a copy of the extension granted by the Internal Revenue Service (IRS). Do not place this document in front of the return. No extension will be granted for more than six months unless the taxpayer continues to reside outside the U.S. Persons working out of the country are granted an automatic two-month extension of time to file until June 15.

**NOTE:** Do not include a copy of Form REV-276 when filing the return, as the department codes the taxpayer's account upon receipt of PA extension requests.

### Amended Return

If filing an amended return, this oval must be filled in. In addition, please write "Amended Return" across the top of the return. It is very important that if an amended return is being filed, you use a return that is for the same tax year that is being amended. Failure to do so will result in the amended return being processed for the wrong tax year. Crossing out the tax year and writing in the year intended to be amended will not suffice. Pennsylvania does not have a separate return specifically for amending a tax year. However, beginning with tax year 2008 returns, the department now has Schedule PA-40X that also must be used when amending a return. Schedule PA-40X provides a comparison of amounts from original and amended returns on a line by line basis, calculates the refund or balance due in a separate worksheet and provides a separate area to provide a description or reason for the changes to the original return.

### Residency Status

If the taxpayer was a resident for the taxable year, fill in the "R", Pennsylvania Resident oval in the residency status section. If the taxpayer was a nonresident of Pennsylvania during the taxable year, fill in the "N", Nonresident oval. If the taxpayer was a part-year resident, fill in the "P", Part-Year Resident oval and indicate the length of time he or she was a resident of PA during the taxable year.

### Filing Status

**Single (S)** – You must file as single if:

- On Dec. 31 of the tax year you were not married; or
- During the tax year, you divorced or became a widow or widower and did not remarry and/or could not or did not elect to file a joint return with a deceased spouse.

**Married, Filing Jointly (J)** – You and your spouse, even if living apart or if one of you is deceased, can file a joint return for convenience. The executor(s) of the estate(s) of the taxpayer and spouse may also elect to file jointly. To file jointly, you must meet ALL of the following conditions:

- Your taxable years end on the same date (not including returns with a deceased taxpayer and/or spouse);
- You and your spouse elect to have the same residency period (earliest starting date if you moved into PA and latest ending date if you moved out of PA) if you are part-year residents;
- Neither of you is individually claiming one or more of the credits on PA Schedule OC;
- Your deceased spouse's estate has not elected to file a separate return on his or her behalf; and
- Neither of you is individually liable for the payment of child or spousal support, or another liability to the PA Department of Human Services.



**NOTE:** Married taxpayers who file joint PA personal income tax returns are jointly and individually responsible for the taxes and any interest or penalties due on joint returns, even if they later divorce. Any taxpayer who filed a joint PA personal income tax return with his/her spouse can request relief from joint liability through the department's Taxpayers' Rights Advocate. Three types of relief from joint liability are available: innocent spouse relief, separation of liability and equitable relief. Each type of relief has different requirements. For more information, see Spousal Relief from Joint Liability, Form REV-971, available on the department's website. Any questions concerning this program should be referred to the Office of Taxpayers' Rights Advocate by e-mailing [pataxadvocate@pa.gov](mailto:pataxadvocate@pa.gov); faxing 717-787-8264; or calling 717-772-9347.

**Married, Filing Separately (M)** – You and your spouse have the option to file separate returns. However, you and your spouse must file separate returns if:

- Your taxable years end on different dates;
- Your taxable years begin on different dates for part-year residents;
- Either of you is claiming one or more of the credits on PA Schedule OC;
- Either of you is individually liable for the payment of spousal/child support, or another liability to the PA Department of Human Services;
- Either of you is individually liable for a court-ordered obligation to the Administrative Office of Pennsylvania Courts; or
- One of you is a PA resident and the other is not. However, you can file jointly if you both elect to file as PA residents and meet all other requirements for filing jointly.

**NOTE:** You must include your spouse's SSN even if filing Married, Filing Separately.

**Final Return (F)** – Use this filing status if you lived in Pennsylvania during the tax year, but permanently moved away or if for any other

reason, you will not have any PA taxable income (or loss) in the following tax year. Provide the reason, such as you moved to another state.

**Deceased (D)** – Use this status if the taxpayer, spouse or both died during the tax year. Enter the date(s) of death.

**NOTE:** For tax years beginning on or after Jan. 1, 2013, a joint return can be filed by the surviving spouse and decedent when a spouse or taxpayer dies during the tax year if:

1. The decedent did not previously file a return for the tax year; and
2. The personal representative, executor or administrator has not been appointed by the time the return is made, signed and filed; or
3. The fiduciary of the decedent consents to the filing of and signs the joint return.

Also for tax years beginning after Jan. 1, 2013, the executor(s) of the estate(s) of the taxpayer and spouse (if both die during the same tax year) may also elect to file a joint return on behalf of the taxpayer and spouse if:

1. The personal representatives, executors or administrators consent to filing a joint return; and
2. The joint return is signed by both fiduciaries.

A surviving spouse must file a separate return if the fiduciary of the estate does not agree to a joint return or if a fiduciary of the decedent is appointed after the filing of the joint return and the fiduciary supersedes the joint return filing by filing a separate return on behalf of the decedent. In cases where a joint return has already been filed by the spouse and a fiduciary has been appointed who wants to file a separate return on behalf of the decedent, a separate return for the surviving spouse must be filed within 90 days of the filing of the decedent's separate return by the fiduciary. If the surviving spouse's separate return is filed within 90 days, the separate return shall be considered to be filed on the date the original joint return was filed. Otherwise, the surviving spouse's return shall be considered to be filed on the date the department receives it.



**IMPORTANT:**

- If a joint return is filed and the taxpayer, spouse or both are deceased, complete the married filing joint oval, the deceased oval and the spouse and/or taxpayer ovals as well as the date(s) of death. The surviving spouse should complete the name and Social Security number section of the return as the primary taxpayer on the return.
- If a separate return must be filed by the surviving spouse and a joint return was not previously filed, the surviving spouse's filing status should be single and no information should be included in the deceased filing status area. If a separate return must be filed by the surviving spouse after having filed a joint return, the surviving spouse should also complete the amended return oval and include Schedule PA-40X.
- If a separate return is filed by the decedent's fiduciary, the fiduciary should complete the deceased and taxpayer ovals and include the date of death.
- If both taxpayers die during the tax year and the fiduciaries do not elect to file a joint return, complete the taxpayer deceased oval and include the date of death on the separate returns for each.
- If a decedent was not married when he or she died, the fiduciary should complete the deceased taxpayer oval and include the date of death.

**CAUTION:** Do not list the deceased taxpayer's name and Social Security number as the primary taxpayer unless both the taxpayer and spouse die during the tax year and a joint return is filed on their behalf.

**Farmers**

This oval should be filled in if at least two-thirds of an individual's gross income is from farming.

**Pro-Forma Returns for Taxable Bankruptcy Estates**

Please see the instructions for the PA-41 Fiduciary Income Tax Return for additional information

regarding the preparation of a pro-forma PA-40 Personal Income Tax Return for a taxable bankruptcy estate.

**Occupation**

Enter the primary occupation of the taxpayer and his or her spouse.

**CLASSES OF INCOME****LINE 1a, GROSS COMPENSATION**

Compensation for PA personal income tax purposes is remuneration received for services rendered by an individual whether directly or through an agent and whether in cash or in property. Compensation paid in any medium other than cash is valued at its fair market value. The term compensation may include cash, foreign currency, check or other negotiable instruments, freely transferable readily marketable obligations or other cash equivalents, property interests, below-market-rate loans and discharge of liabilities.

Income items that are always taxable as compensation include:

- Salaries
- Wages
- Tips received directly by the employee or through his or her employer
- Gratuities
- Commissions
- Bonuses
- Incentive payments
- Vacation/holiday pay
- Termination/severance pay
- Payments for unused vacation or sick leave
- Payment incentives for early retirement
- Reimbursements and allowances in excess of allowable business expenses
- Damage awards to the extent that they represent lost profits, age discrimination or sex discrimination

- Directors' fees (unless one's profession is being an outside board director, in which case income would be taxable as business income on PA Schedule C)
- Jury fees
- Witness fees (unless testifying as an expert in a field which is considered one's line of business, in which case income would be taxable as business income on PA Schedule C)
- Eligible reimbursed moving expenses in excess of allowable expenses on PA Schedule UE
- Honoraria (unless one's profession is being a professional speaker, in which case income would be taxable as business income on PA Schedule C)
- Fellowships if the recipient is required to provide a substantial service such as advanced research or teaching
- Tuition assistance or educational benefits unless the training or education is either 1) required by law or regulation; or 2) required of the employee by the employer in order for the employee to retain the skills necessary for his/her present position. If the course, degree program or training is designed to enable the employee to enter a new field or profession or to obtain a promotion, the reimbursement is taxable
- Executor or administrator fees (unless one's profession is being an executor or administrator, in which case income would be taxable as business income on PA Schedule C)
- Covenant not-to-compete or payments received as consideration for refraining from the performance of services
- Proceeds from an employee stock ownership plan to extent of excess computed under the cost-recovery method
- Cash allowances for rent, utilities or other expenses received by ministers
- Reimbursements made by an employer for dependent care, legal services or other personal services

- National Service Education Awards
- Income from Peace Corps, VISTA Job Corps and Americorp
- Distributions from a pension plan for any reason other than death, disability or retirement, to the extent the distribution exceeds the taxpayer's contributions
- Employee contributions to an eligible PA retirement plan
- Premature withdrawals from an IRA or 401K to the extent not previously taxed, unless rolled over

Income items that are never taxable as compensation include:

- Federal active-duty pay earned outside PA
- GI Bill benefits including tuition and living expenses
- Alimony
- Child support
- Income in respect of a decedent
- Inheritance
- Social Security
- Railroad retirement benefits
- Public assistance
- Unemployment compensation
- Occupational Disease Act benefits (if included on W-2 Form, attach explanation)
- Meals and lodging provided to an employee by the employer
- Personal use of employer-owned or leased property and/or services, at no cost or at a reduced cost. These amounts are not taxable fringe benefits for PA personal income tax.
- Employer-provided parking facilities. These amounts are nontaxable fringe benefits for PA personal income tax.

- Employer-provided professional services paid for directly by the employer. These amounts are nontaxable fringe benefits for PA personal income tax.
- Premiums paid by an employer for group term life insurance (no limit)
- Rental value of parsonage owned by the congregation and required to be occupied by the cleric
- Foster care
- Amounts received for permanent loss of body function, disfigurement or reimbursed medical expense
- Disability payments paid by employer arising under occupational disease acts or other legislation
- Strike benefits
- Life insurance proceeds or settlements
- Employee contributions to a nonqualified deferred compensation plan
- Distributions from eligible PA retirement plans after retirement age

**NOTE:** There are significant differences between PA personal income tax and federal income tax regulations. Certain income items not taxable for federal purposes are taxable for PA purposes, and vice versa.

### **W-2 Forms/PA Schedule W-2S, Part A**

In January and February, every taxpayer should receive a W-2 Form from each employer he/she works for during the preceding tax year. This form will show the amount of employee compensation received and taxes withheld during the tax year. In many cases, the taxpayer has the option of either submitting a copy of the W-2 form(s) with the tax return or completing and submitting Part A of PA Schedule W-2S, Wage Statement Summary. This information must be submitted with the tax return to serve as evidence of compensation paid and taxes withheld by an employer. Part A of Schedule W-2S has enough room for the entry of 10 W-2 forms. If the taxpayer worked for more than 10 employers in any given tax year,

he/she should attach additional PA Schedule W-2S forms. While this form may be used in place of submitting W-2 form(s), the department requires the form to be submitted in certain circumstances. The W-2 form must be submitted with the return under the following circumstances:

- The PA compensation entered on Line 1a of the PA-40 is not the same as Box 16 on the Form W-2 (you believe that the PA compensation or withholding is incorrect);
- The employer provided a handwritten Form W-2;
- The employer reported an incorrect amount on Form W-2. A written statement from the employer must also be submitted;
- The employer withheld PA income tax from wages at a rate that is more than the tax rate of 3.07 percent;
- The taxpayer is a resident of a reciprocal compensation agreement state and the employer withheld PA income tax;
- The Medicare wages in Box 5 on Form W-2 are greater than PA wages in Box 16. In this case, complete and include with the return the PA-40 W-2 Reconciliation Worksheet;
- The taxpayer is a PA resident working in another state or country and did not have PA income tax withheld by their employer;
- A distribution from a nonqualified deferred compensation plan is included in Box 1 of the Form W-2; and/or
- The Form W-2 shows income earned or tax withheld for another state.

The department reserves the right to request a copy of the actual W-2(s). When calculating PA compensation from a W-2 Form, it is important to use the state wages from Box 16 of the W-2, not the federal wages. This is a common mistake. The state amount is often higher because Pennsylvania taxes the employee's contribution into his/ her retirement

plan at the time contributed, where the federal taxing authority does not.

If the taxpayer was not furnished with or was unable to obtain a W-2 Form, he/she must provide a copy of federal Substitute W-2, Form 4852, or copies of evidence of compensation paid and tax withheld such as pay stubs and a statement identifying the employer and the reason no W-2 Form is available.

Any additional compensation not reflected on a W-2 Form must be substantiated with an explanation as to its source.

### **PA W-2 Reconciliation Worksheet**

The PA-40 W-2 RW, PA W-2 Reconciliation Worksheet, must be completed by taxpayers when Medicare wages are greater than PA Wages and the information included on the W-2 is not sufficient for the department to reconcile the two amounts. For example, a W-2 that includes Medicare wages of \$25,000 and PA wages of \$23,000 would be required to complete the W-2 RW if no amounts are included on the W-2 that would explain the difference.

The worksheet is also required when a W-2 does not adequately identify the amounts needed to reconcile the wages or amounts are missing from the W-2 to reconcile the wages. For example, a W-2 includes Medicare wages of \$30,000 and PA Wages are \$29,000. The federal wages on the W-2 are also \$29,000 and Box 12 of the W-2 includes a Code H amount of \$1,000 but no other amounts are included on the W-2. Normally, the federal wages plus the Code H amount would result in the PA wages. However, PA wages are the same as federal wages and less than Medicare wages. Since no other amounts are included on the W-2 in this example, the W-2 reconciliation is required to be included to provide the difference.

### **1099 Forms/PA Schedule W-2S, Part B**

A taxpayer who receives miscellaneous and/or non-employee compensation, such as pensions, retirement plan distributions, executor fees, jury duty pay, etc., during the tax year will receive a federal Form 1099-R, 1099-MISC and other statements. Copies of all 1099-R, 1099-MISC and other statements must be submitted with an individual's tax return if he/she files a paper return. 1099-MISC forms need

not be submitted if the income is being reported in another category of income such as Net Income or Loss from the Operation of a Business, Profession or Farm. Part B of PA Schedule W-2S may be completed and submitted when reporting miscellaneous and/or non-employee compensation, however federal Form 1099-R, 1099-MISC and other statements must still be submitted. Part B of PA Schedule W-2S has enough room for the entry of 10 1099 forms. If the taxpayer has more than 10 1099 forms in any given tax year, he/she should attach additional PA Schedule W-2S forms. All 1099 forms, whether or not they show taxable income, must be submitted and/or included in Part B of PA Schedule W-2S.

Instructions for completing Part B of PA Schedule W-2S are as follows:

#### **Column A.** Taxpayer or Spouse

Enter a T if the payment or distribution was to the primary taxpayer shown first on the PA-40 or S if the payment or distribution was to the spouse.

#### **Column B.** Type

Enter the letter designation for the type of payment from the list of payment types shown at the bottom of PA Schedule W-2S, Wage Statement Summary. If the taxpayer does not know the type of payment listed on form 1099-R, he/she may need to contact the payer for more information regarding the distribution to properly report the type of payment. For distributions from an IRA, the box next to Box 7 on the 1099-R will have an X entered to indicate a distribution from a Traditional IRA, SEP IRA or Simple IRA. Distributions from Roth IRAs will have Code J or T included in Box 7 of the 1099-R. Distributions from qualified deferred compensation plans should be listed on Form W-2.

#### **Column C.** Payer's Name

Enter the payer's name.

#### **Column D.** 1099R Code

If the payment being reported is from federal Form 1099-R, enter the distribution code listed in Box 7 of the 1099-R.

#### **Column E.** Total Federal Amount

Enter the total amount of payment from federal Form 1099-MISC or from another document and/or any distribution from federal Form 1099-R Box 1. If the

payment is from federal Form 1099-MISC or from another document other than a 1099-R, enter the same amount in Column G.

**Column F. Adjusted Plan Basis**

If the distribution code in Column D is 1, 2, J, L, S or U from the 1099-R, enter the amount of the adjusted basis in the plan. The adjusted basis in the plan or IRA is generally equal to the sum of the contributions to the plan or IRA minus the sum of prior distributions which were previously treated as nontaxable as a recovery of such contributions.

**Column G. PA Compensation**

If Code 1, 2, 8, 9, J, L, S or U from a 1099-R is entered in Column D, subtract the amount in Column F from Column E and enter the resulting amount (but not less than zero) here. If any other 1099-R code is entered in Column D, enter a zero in Column G, meaning there is no PA taxable compensation from these codes. If the distribution code in Column D is a 7, 7D or 4D (1D, 2D or 3D also) and the payment type listed in Column B is K or L, these types of payments are not taxable as compensation, but are taxable as interest income to the extent there is income included in federal gross income. Although not taxable as compensation, they must be included to allow for reconciliation with amounts reported for federal income tax purposes.

**Column H. PA Tax Withheld**

If the payer withheld PA state income tax from the distribution or payment, enter the amount withheld from that distribution or payment.

**Filing Tips:**

- A taxpayer with a distribution Code 2 on Form(s) 1099-R must determine if he/ she received the distribution from an eligible employer-sponsored retirement or pension or retirement plan eligible for PA tax purposes. Additionally, the taxpayer must have been eligible by meeting the age or service conditions of the plan. If these conditions are met, the taxpayer should input the same amount in Column F as was reported in Column E. Otherwise, the cost or adjusted basis of the plan must be included.

- A taxpayer with distribution Code 1 or 2 on Form(s) 1099-R from a retirement plan from the State Employees' Retirement System (SERS), the Pennsylvania School Employees' Retirement System (PSERS), the Pennsylvania Municipal Employees' Retirement System (PMERS) or the U.S. Civil Service Commission Retirement Disability Plan should input the same amount in Column F as was reported in Column E.
- A taxpayer with a conversion of a traditional IRA to a Roth IRA (or vice versa) with distribution Code 1 in Box 7 of the 1099-R may be eligible to report the amount as nontaxable income when a direct transfer from trustee to trustee occurs and/or the when the entire distribution from the original IRA account (including taxes withheld) is paid into the Roth IRA within 60 days of the date of the distribution. In such cases, input the same amount in Column F as reported in Column E. If the distribution is not a direct transfer from trustee to trustee, or if the entire distribution is not paid into the new IRA, as a result of the conversion of the original IRA account, the distribution must be reported as two separate distributions on PA Schedule W-2S. The distributions will be reported on separate lines of Column E with the net amount converted into the new IRA (gross distribution from Box 1 of the Form 1099-R less amounts not repaid into the new IRA account) being reported as the first distribution and amounts not repaid into the new IRA account reported as the second distribution. The amount reported in Column E for the first distribution will not be taxable (input the same amount in Column F as reported in Column E). The amount reported in Column E for the second distribution may be taxable since Column F will reflect the cost or adjusted basis of the IRA.
- A taxpayer with distributions from an annuity purchased from a commercial insurance or mutual company, an endowment contract or a charitable gift annuity having a distribution Code D along with Codes 1, 2, 3, 4 or 7 in Box 7 of the 1099-R must record the distributions on PA Schedule W-2S and also report the amount of



income taxable for federal income tax purposes as PA-taxable interest income. When recording the distribution on PA Schedule W-2S, input the same amount in Column F as reported in Column E. Report the federal taxable amount of any annuities or endowments on Line 11 of PA Schedule A. Report the federal taxable amount of any charitable gift annuities on Line 12 of PA Schedule A.

- A taxpayer with a distribution from an Employee Stock Ownership Plan (ESOP) should enter the amount of the distribution in Column G if the stock in the ESOP has not been allocated to the participants. Use payment type M in Column B and the description "Non-Allocated ESOP Stock Dividend" in the space to describe the payment. If the distribution is a non-allocated ESOP stock dividend, the full amount of the distribution is taxable as compensation. If the stock has been allocated to the participants, input the same amount in Column F as reported in Column E, and enter payment type M in Column B and the description "Allocated ESOP Stock Dividend" to describe the payment. Allocated ESOP stock dividends are taxable as dividend income for PA purposes. Enter the name of the company and amount of the distribution on Line 8 of PA Schedule B with "Allocated ESOP Stock Dividend" as the description.
- A taxpayer with distributions of excess contributions and earnings on the excess contributions (distribution Code 8 in Box 7 of the 1099-R) must determine if the contributions being returned are from taxpayer contributions/deferrals or employer contributions. In cases where the excess contributions being returned are taxpayer contributions/deferrals, only the amount of excess contributions should be entered in Column F. Earnings on the excess contributions should not be included in the adjusted basis of previously taxed contributions. In cases where the excess contributions and earnings being returned are employer contributions, no entry should be made in Column F. In either case, a letter from the employer/plan administrator is required to provide whether

or not the contributions being returned are taxpayer contributions/deferrals and a breakdown between the excess contributions and the earnings on the excess contributions when the excess contributions and earnings are from employee contributions/deferrals.

- A taxpayer with a distribution Code 4 only (Code D not included) on Form(s) 1099-R should also include the amount in Box 1 in eligibility income for Schedule SP, Special Tax Forgiveness purposes. The amount should be included in Part C, Eligibility Income, of Schedule SP on Line 4, Insurance proceeds and inheritances.
- A taxpayer who received retirement benefits as the beneficiary from a qualified joint survivor annuity reporting the distributions to the taxpayer using Code 7 instead of Code 4 in Box 7 of federal Form 1099-R should also include the amount in Box 1 as eligibility income for Schedule SP, Special Tax Forgiveness purposes. The amount should be included in Part C, Eligibility Income, of Schedule SP on Line 4, Insurance proceeds and inheritances.
- Taxpayers with military pay for active duty outside PA should complete PA Schedule W-2S and include the W-2 in Part A of PA Schedule W-2S. If any income is earned by a PA resident while on active duty status within PA, that income should be included in the "PA compensation from Box 16" column. Do not include compensation earned while on active duty outside PA or if a nonresident on active duty within PA. If any PA income tax is withheld from the military pay, include the amount of tax withheld in the "PA income tax withheld from Box 17" column. See Pages 12 through 14 for more information.
- A taxpayer with a distribution from an ESOP within a 401(k) (also known as a KSOP) should use payment type I in Column B and enter the total amount of the distribution in Column E. If the federal Form 1099-R includes a distribution Code 7 in Box 7, enter the total amount of the distribution in Column F. If the federal Form 1099-R includes a distribution Code 1 in Box 7, use the cost recovery method to determine



the taxable amount of the distribution. The taxpayer's basis in any stock distributions from a KSOP with distribution Code 7 on federal Form 1099-R is the total distribution less any cash and/or tax paid included with the distribution. The taxpayer's basis in any stock distributions from a KSOP with distribution Code 1 on federal Form 1099-R is the ratio of the current value of the stock included in the distribution to the total distribution times the adjusted basis determined using the cost recovery method.

### Stock Options

Incentive, statutory stock and nonstatutory stock options are taxable as compensation on the earliest of the following dates:

- Date of exercise of the option, unless there are substantial restrictions;
- Date that substantial restrictions on the option lapse; or
- Date of sale of the option.

The difference between the fair market value of the stock on the date of exercise or lapse as applicable and the amount paid by the employee to obtain the option, if any, is the amount subject to PA tax when sold before lapse or exercise.

Pennsylvania's Tax Reform Code, unlike the Internal Revenue Code (IRC), does not contain provisions that distinguish between or among various types of stock options. There is no distinction drawn between qualified and nonqualified (sometimes referred to as "statutory" and "non-statutory") stock options. Moreover, there are no PA provisions that distinguish between qualified stock options and those options granted under employee stock purchase plans.

For PA personal income tax purposes, a stock option is compensation in the form of intangible property. By regulation, a qualified stock option is taxable and subject to withholding on the date of exercise if the employer is required to withhold tax from the wages of its employee. The difference between the fair market value of the stock on the date of exercise and the amount paid by the employee to obtain the option, if any, is the amount subject to PA tax. A

non-qualified stock option is taxable when it has a readily ascertainable fair market value or when it is no longer subject to a substantial risk of forfeiture.

### Clergy

If a member of the clergy is considered a common law employee, the cleric's occupancy of a parsonage owned by the congregation and provided for the convenience of the congregation is not taxable as compensation. All housing allowances provided to clergy are taxable as compensation.

If a member of the clergy is not a common law employee and is a sole proprietor who offers his services in a market place (i.e. to a nonexclusive, indefinite number of individuals or congregations), income is considered to be derived from a business or profession and is reported on PA Schedule C.

### Summary:

- Where the employer provides housing for the clergy, the value of the housing is not taxable.
- Where the employer pays the costs of housing directly and not as a reimbursement to the clergy, the direct costs are not taxable.
- Where the employer pays a housing allowance to the clergy for living in provided housing on the employer's property, the payments are taxable – cash is always taxable.
- Where the employer pays a housing allowance to the clergy for living in housing that the clergy obtains, the housing allowance is fully taxable as PA compensation, and the clergy may be able to deduct directly related business expenses for any business use portion of this residence on PA Schedule UE.

### Executor Fees

Executor fees are taxable as compensation. This includes executor's fees paid to nonresident executors and administrators for estates in Pennsylvania. It is presumed that these fees are received for services performed in Pennsylvania by the executor and/or his or her agent (such as an attorney) and the burden of proof falls upon the taxpayer to prove otherwise. Any apportionment must be reported on PA Schedule NRH.

An executor or executrix for an estate in Pennsylvania would be required to visit Pennsylvania to complete his or her duties. The fact that the executor or executrix may use an agent to do the duties does not take away the fact that they had a presence in Pennsylvania and are subject to tax on that income. The only apportionment to be done is to exclude that portion of the executor fee that represents the services performed outside of Pennsylvania for the convenience of the estate and by necessity out of Pennsylvania. An example would be an appearance in court outside of Pennsylvania involving the estate. The remainder of the fee would be taxable as compensation for Pennsylvania purposes by nonresident executors. Apportionment can only be done by the number of days required out of Pennsylvania over total days spent working on the estate, including the time of the agent. The executor or executrix may be able to receive some credit from another state for the income taxed by both states.

### **Household Employees**

Household employees include babysitters, caretakers, nannies, health aides, private nurses, housekeepers, cleaning people, drivers, yard workers and any person hired to do any sort of household work, as long as the employer retains the right to control the details of how the work is done. This differs from house workers obtained through an agency or self-employed workers who retain control of how the work is done. Generally, a self-employed worker provides his or her own tools and offers services to the public as an independent business. These individuals must file and report his/her income through the appropriate business schedule.

Since household employees are not subject to federal income tax withholding (although they may be subject to Social Security withholding), they are not subject to PA income tax withholding.

### **Statutory Employee**

For federal employment tax purposes, a statutory employee is defined as an individual that performs services for remuneration for any person:

- As an agent-driver or commission-driver engaged in distributing meat products, vegetable products, fruit products, bakery products,

beverages (other than milk) or laundry or dry-cleaning services, for his principal;

- As a full-time life insurance salesman;
- As a home worker performing work, according to specifications furnished by the person for whom the services are performed, on materials or goods furnished by such person which are required to be returned to such person or a person designated by him; or
- As a traveling or city salesman, other than as an agent-driver or commission driver, engaged on a full-time basis in the solicitation on behalf of, and the transmission to, his principal (except for sideline sales activities on behalf of some other person) of orders from wholesalers, retailers, contractors or operators of hotels, restaurants or other similar establishments for merchandise for resale or supplies for use in their business operations. If the contract of service contemplates that substantially all of such services are to be performed personally by such individual; except that an individual shall not be included in the term employee under the provisions of this paragraph if such individual has a substantial investment in facilities used in connection with the performance of such services (other than in facilities for transportation), or if the services are in the nature of a single transaction, not part of a continuing relationship with the person for whom the services are performed.

Statutory employees that receive a W-2 must report the income as compensation on Line 1 of the return. Expenses attributable to the income must be shown on PA Schedule UE. Income reported to a statutory employee on federal Form 1099-MISC should be included on PA Schedule C, along with corresponding expenses, and be reported on Line 4 of the return. For statutory employees that receive income using both types of income reporting documents, the expenses may be apportioned between PA Schedule UE and PA Schedule C using the percentage of income received by document type to the total income received from both.

### **Scholarships/Fellowships and Stipends**

Generally, a scholarship or fellowship award made on the basis of need or academic achievement is not

taxable if awarded to encourage or allow the recipient to further his or her educational development. If the recipient is required to apply his skill and training to advance creative work or some other project, the scholarship may be taxable.

In order to substantiate that a scholarship or fellowship is not taxable, include a letter with an original signature of the department head or other official detailing the description of the program under which the award was received. A form letter is not acceptable.

Stipends paid to medical interns and residents pursuant to internships or residency programs that conform to "Essentials of an Approved Internship" or "Essentials of an Approved Residency" as established by the American Medical Association are taxable.

Fellowship awards and stipends do not constitute taxable compensation for services if the recipient is required to apply his skill and training to advance research, creative work, or some other project or activity, and the recipient can show that:

- The benefits resulting from the services of the recipient are so minimal, given the actual services performed or expected to be performed, that they constitute no realistic basis for compensation by the institution sponsoring the fellowship or stipend;
- The activities of the recipient are so closely and directly supervised and immediately controlled by regular faculty members so as to constitute a burden on the institution which would offset any benefit it receives from the recipient's activities; or
- The recipient is a candidate for a degree and the same activities are required for all candidates for that degree as a condition for receiving such a degree.

The recipient must substantiate one of the above with a letter featuring an original signature of the department head or other official.

## CANCELLATION OF DEBT

Insolvent individuals not filing for bankruptcy recognize cancellation of debt as income. The reportable amount is the lesser of:

- The amount of indebtedness forgiven or discharged; or
- The taxpayer's net worth as calculated using generally accepted accounting principals (GAAP) immediately after the cancellation.

If an insolvent individual is not rendered solvent by the cancellation of debt, no income is recognized.

Solvent individuals would report the amount of indebtedness forgiven or discharged as income.

Income from cancellation of debt will be reported depending upon the class of income from which the debt is incurred or related. If the cancellation of debt is personal debt, ie credit card debt or from a principal residence mortgage, and no business or rental expenses on PA Schedule UE, PA Schedule C, PA Schedule E or PA Schedule F were deducted related to the debt, no income is reported for PA personal income tax purposes.

In the case of a principal residence mortgage, cancellation of a debt may be taxable if the taxpayer does not qualify for the exemption of the gain on the sale of a principal residence or if mortgage interest was used as a PA Schedule UE, PA Schedule C or PA Schedule F expense for a home office expense deduction in the current or prior tax year. The percentage use method will determine the amount to be included in income.

For credit card debt, the portion of the debt remaining related to any business expenses deducted will be considered income based upon a first-in-first-paid methodology.

If any business or rental expenses were deducted, income must be allocated to the respective class where the deduction occurred. If PA Schedule UE expenses are related to the deduction, the income is included as compensation on Part B of Schedule W-2S. If the expenses are related to PA Schedule C or PA Schedule F, the income is included on Line 4 of the PA-40 return. If the expenses are related to PA Schedule E, the income is reported as other income on PA Schedule E.

The basis of an insolvent debtor's property must be reduced, but not below its fair market value. Basis

reductions for amounts canceled shall be allocated in any manner that has the effect of reducing the difference between the fair market value and the adjusted basis of the properties.

### **Individuals Who File for Bankruptcy**

Unless the case is dismissed, an individual bankruptcy filed under Chapter 7, 11 or 12 of the Bankruptcy Act leads to the creation of a bankruptcy estate, and no income shall be considered to have been realized by reason of discharge of indebtedness under bankruptcy laws.

If cancellation of debt is excluded from income based on the insolvency or bankruptcy exclusions, the taxpayer must reduce his or her tax attributes, including his or her adjusted basis in property.

Income from cancellation of debt is taxable to Pennsylvania when:

- Under GAAP, the debt forgiven was considered a liability
- Where the debt forgiven constitutes a quid pro quo or incentive that would be taxable under PA personal income tax regulations if it had been paid to the debtor in cash or in property

### **Class of Income**

- If debt forgiveness relates to an employee/ employer relationship, it is reported as compensation.
- If debt forgiveness relates to business, profession or farm income, it is reported in that class.
- If debt forgiveness relates to the sale, discontinuation or abandonment of a business or segment thereof, it is reported as gain on the sale of property.
- If the debt forgiveness relates to rent, royalty, patent or copyright income, it is reported in that class.

For more detailed rules on cancellation of debt, please refer to Personal Income Tax Bulletins 2009-2 through 2009-6 on the department's website.

## **NON-EMPLOYEE COMPENSATION**

Reimbursable expenses, even if not reimbursed, may not be deducted.

Unreimbursable expenses incurred for realizing non-employee compensation (e.g. executor fees, administrator fees, etc.) may be claimed on PA Schedule UE as long as:

- The agreement contemplates that a portion of the director/executor's fee is intended to reimburse the director/executor for his or her actual expenses; and
- The expenses are ordinary, actual, reasonable and necessary (i.e. no commuting or personal expenses may be deducted).

## **CAFETERIA PLANS**

Cafeteria plans are federal plans pursuant to Internal Revenue Code (IRC) Section 125 under which employers sponsor benefit packages that offer employees choices between cash and qualified benefits. If the employees choose cash, the cash amounts are included in taxable compensation. If the employees choose qualified benefits, the values of the benefits are not included in gross income. Qualifying benefits include:

- Accident coverage
- Health coverage
- Group-term life insurance coverage
- Dependent care programs
- Certain employer payments for educational expenses
- On-site athletic facilities provided and operated by the employer
- A profit-sharing or stock bonus plan or rural cooperative plan as defined in IRC Section 401(k)(7) that includes a qualified cash or deferred arrangement as defined in IRC Section 401(k)(2).

If a taxpayer's employer maintains a federally qualified cafeteria plan pursuant to IRC Section 125,



certain amounts deducted from the taxpayer's salary (e.g., health/accident insurance) are not subject to PA personal income tax to the extent excluded for federal purposes.

Employer-provided flex dollars that an employee must use to pay for PA-exempt benefits, such as health insurance or life insurance, are excludable from income taxation. Employee contributions to a qualified IRC Section 125 plan for coverage for hospitalization, sickness, disability or death, supplemental unemployment benefits or strike benefits -- like employer contributions -- are exempt, but only to the extent they are exempt for federal income tax purposes. If an employer has an employee benefit plan that is not a qualified IRC Section 125 plan, employee contributions, even for the same kinds of coverage, are not excludable from PA taxable compensation.

Employee payments and contributions for other benefits, including dependent care and contributions to an IRC Section 401 plan, are not excludable from PA taxable compensation. If the employer's plan provides life insurance coverage that includes coverage for an employee's dependent child and the employee pays a portion of the premium for that coverage, that portion of the employee's payment is not excludable.

For PA personal income tax purposes, all benefits other than for death, disability, hospitalization and sickness are taxable.

## DEFERRED COMPENSATION

Compensation includes distributions from non-qualified deferred compensation plans attributable to an elective deferral of income, regardless of whether the distribution is paid during employment or retirement. PA's constructive receipt rules (with certain exceptions noted below) are the same as the federal constructive receipt rules in determining when compensation is received by a taxpayer. These rules apply to taxable years 2005 and after.

Following the federal constructive receipt rule, deferrals to nonqualified deferred compensation plans are not includible in compensation. However, the monies distributed from these plans do become taxable when paid, either while still working or after having retired. The deferred compensation is taxable

for work performed in Pennsylvania regardless of the residency of the person receiving the compensation when it is paid, unless the taxpayer is a nonresident at the time of receipt and chooses a payment schedule of more than 10 years.

If distributions were made that were previously taxed under a nonqualified deferred compensation plan attributable to elective deferrals, the PA-40 W-2RW, Reconciliation Worksheet must be completed and included with the return. This form is available through one of the forms ordering services.

## SICK AND DISABILITY PAY

Compensation does not include periodic payments for periods of sickness or disability paid by or on behalf of the employer unless the payments are for regular wages. This exclusion from compensation also includes any amount received if pain and suffering, emotional distress or other non-economic element is a factor in determining the amount of payment. However, any amount that qualifies as payment of regular wages is subject to tax.

Determining if a payment is considered payment of regular wages:

- No payments made by a third-party insurer for periods of sickness or disability are considered payment of regular wages.
- In addition, payments of any plan where the following occurs are not considered payment of regular wages:
  - The periodic payments have no direct relationship to the employee's usual rate of compensation.
  - The payments are calculated based on the nature of the sickness or disability without regard to the employee's job classification.
  - The amount of the payments is reduced by payment from Worker's Compensation Acts, Occupational Disease Acts, Social Security Disability or similar legislation.
  - The payments exceed the employee's usual compensation for the period.



- Payments made under the following circumstances are benefits subject to withholding and income tax:
  - Amounts received during a period of sickness or disability for services performed during another period, to which the individual would have been entitled regardless of whether he/she was sick or disabled. In other words, this would be in the nature of payment for work performed prior to the period of illness or disability.
  - Payments for unused sick leave.
  - Payments in lieu of regular wages for a period during which an employee is absent from work due to injury or sickness, when the payment amounts are determined by time the employee is absent from work and the employee's regular rate of compensation, regardless of the nature of the injury or illness. These payments are made by an employer who has no legal or moral duty to make payments beyond an agreement between the employer and the employees. Further, they were not related to the actual employment (i.e. Worker's Compensation) and are of temporary, non-chronic and short duration with no permanent impact.
  - Payments made without regard to the nature of the injury or illness.

## RETIREMENT PLANS

Payments or distributions from retirement plans – including simplified employee pension (SEP) plans, Keogh plans, federally qualified tax sheltered annuities, 457 plans, 401(k) plans and other retirement plans – are not taxable if they meet the following requirements:

- The plan is formalized in writing and communicated to the participants;
- The plan establishes eligibility requirements for separation from service by retirement on the basis of old age, infirmity, long-continued service or a combination of old age or infirmity and long-continued service or distributions are

subject to IRC Sec. 72(t) penalty if distributed prematurely;

- The plan must make provisions for payments to be made at regularly recurring intervals after separation from service by retirement, and which continue at least until death. An option for a lump-sum payment or payments does not disqualify the retirement nature of the plan as long as the above provision is also provided;
  - The plan does not permit the distribution of program benefits to any employee until termination of employment except for:
    - Incidental disability benefits paid at regularly recurring intervals during the period of disability by reason of said disability (this may not be in the form of a lump sum payment); or
    - The return of the employee's previously taxed contributions and income or gains thereon in the case of a contributory retirement benefit plan.
- NOTE:** A lump-sum distribution from an employer-sponsored retirement plan made prior to the normal retirement age or length of service requirement under the plan for disability is taxable to the extent it was not previously taxed. Payments made to the participant's estate or designated beneficiary as a consequence of the participant's death are not taxable.

Program benefits from SEP plans, Keogh plans, federally qualified tax sheltered annuity programs and tax deferred custodial accounts cannot be paid before death, disability, separation from service, unforeseeable emergency or the attainment of age 59 ½, without being subject to substantial penalty when so paid.

- If it is a premature withdrawal, the taxable portion would be determined as any other annuity.
- Rollovers from an IRA or qualifying retirement program into another IRA or qualifying retirement program -- unless taxable for federal purposes -- are not taxable.

- Non-employee benefit annuities, e.g., insurance company annuities are not taxable compensation, but interest income.
- Insurance policies surrendered are not taxable compensation, but interest income.
- A subsequent beneficiary receiving the benefits of a retirement plan does not change the nontaxable character of the income.

**NOTE:** All distributions from the State Employees' Retirement System (SERS), Public School Employees' Retirement System (PSERS), the Pennsylvania Municipal Employees' Retirement System (PMERS) and U.S. Civil Service Commission Retirement Disability Plans are exempt from PA income tax regardless of the coding on Form 1099-R. Payments received by a member or former member of a uniform service that are taxable as calculated under Chapter 71 of Title 10, U.S. Code, as amended, are also exempt.

## INDIVIDUAL RETIREMENT ARRANGEMENTS AND ROTH INDIVIDUAL RETIREMENT PLANS

### Contributions

No exclusion is provided for contributions to an individual retirement arrangement except:

- Direct employer contributions; and/or
- Amounts rolled over from another IRA or from a qualifying old age or retirement benefit program where the transferred amounts are not includable as income for federal income tax purposes.

### Undistributed Income on IRA Assets

Undistributed income on assets held is not includable in income.

### Withdrawals from IRAs

Amounts withdrawn from an IRA are includable in income to the extent that contributions and income earned on such contributions were not taxed previously except:

- Payments, including lump sum distributions, made on or after reaching the age of 59 ½ years;

- Payments paid to the estate or designated beneficiary of the participant by reason of the participant's death; or
- Payments rolled over into another IRA or into a qualifying old age or retirement benefit program where the transferred amounts are not includable in income for federal income tax purposes.
- Traditional IRA Rollover

You do not have to pay PA tax on the difference between the amount distributed from your traditional IRA and your previous contributions:

1. If you rolled over the entire withdrawal directly (trustee to trustee) from one traditional IRA to another traditional IRA, or
2. If you withdrew from the traditional IRA and within 60 days invested the entire (100 percent) amount you received into another traditional IRA.

**NOTE:** Withdrawals from an IRA for disability are taxable on a cost recovery basis.

**CAUTION:** If federal tax is withheld from a rollover distribution, the amount of federal tax withheld must also be reimbursed into the new IRA account in order for the rollover to be considered nontaxable for PA PIT purposes.

### Distribution of an IRA or Retirement Plan Incidental to Divorce

Note that divestiture of an IRA (or any other retirement plan) pursuant to a divorce is taxable to the extent it has not previously been taxed. In Pennsylvania, a distribution from a retirement or pension plan to a spouse or ex-spouse of a plan participant – pursuant to orders of state divorce courts incident to annulment, divorce or separation – that would have been taxable to the plan participant had it been made directly thereto, is taxable to the participant and not to the spouse or ex-spouse.

### General Rules for Roth IRAs

Most of the personal income tax rules that apply to individual retirement accounts, annuities or simplified employee pensions also apply to Roth IRAs. For example:

- An exclusion is allowed for payments made by employers directly to Roth IRA trustees or issuers for the benefit of employees.
- No exclusion or deduction is allowed for contributions to a Roth IRA made by, on behalf of or attributable to an employee or self-employed person, directly or indirectly, whether through payroll deduction, salary reduction agreement or otherwise.
- Income on assets held in a Roth IRA is not taxable.
- Distributions are includable in income to the extent that contributions were not previously included, if they were made before the individual for whom the account is maintained obtains age 59 ½ or retires from service. Further, such distributions are includable as income if the plan makes no provision for payments at regularly recurring intervals continuing at least until the participant's death.
- The cost recovery method is used to determine the portion of a distribution to be included in income.

### Special Rules for Transfers to Roth IRAs

For federal tax purposes, amounts rolled over into Roth IRAs from traditional IRAs are considered income. Similarly, the conversion of a traditional IRA to a Roth IRA is generally taxable for federal income tax purposes.

For Pennsylvania personal income tax purposes, the following rules apply:

- Amounts rolled over into IRAs from non-IRA individual retirement plans are generally considered income in the distribution year to the extent the distributions exceed contributions to the plan.
- Amounts rolled over into an individual's IRA from a federally qualified retirement plan (other than an individual retirement plan) are generally considered income for the distribution year to the extent the distributions exceed contributions to the plan. However, when a plan allows the distribution to be paid directly to another

federally qualified retirement plan maintained for the same owner's benefit – as a direct trustee-to-trustee transfer to the IRA – the distribution is not considered taxable income. Similarly, when the distribution is paid into the IRA no later than the 60th day after the day on which the IRA owner receives payment, the distribution is not considered taxable income.

### Special Rules for Converting Traditional IRAs to Roth IRAs

The conversion of a traditional IRA to a Roth IRA is generally not taxable. That is, monies transferred from a traditional IRA to a Roth IRA via conversion (whether by a trustee-to-trustee transfer or a roll-over within 60 days) are generally not subject to Pennsylvania personal income tax. However, any amounts transferred from the traditional IRA that are not put into the Roth IRA, be it by federal income tax withholding or otherwise, are subject to Pennsylvania personal income tax. In such a situation, basis is allocated pro-rata between the taxable distribution and the non-taxable conversion. If there is a partial rollover/conversion, the basis in the traditional IRA must be allocated pro-rata between the traditional IRA and the Roth IRA.

## ANNUITIES

If you received a distribution from an annuity that is not an employer-sponsored retirement plan or received distributions from Life Insurance or Endowment Contracts (Code D also included in Box 7 of Form 1099-R), the distributions are taxable when you begin receiving payments if they are taxable for federal income tax purposes. You are required to report the amount taxable for federal income tax purposes as interest income for PA PIT purposes.

### 1099-R

Per the following guidelines, all Forms 1099-R must be submitted if a Form PA-40 is required to be filed, whether the distribution is taxable or not. In addition, the information must be entered on Part B of Form PA-40 W-2S.

Federal Form 1099-R is used to report income received from pensions, annuities, profit sharing

plans, IRAs, insurance contracts, etc. The form designates the taxable amount for IRS purposes but not for PA. You have to apply PA rules to determine what portion if any is taxable for PA.

The following guide should be followed in submitting copies of Form 1099-R:

- **PA-40 Paper Returns:** When filing a paper return, all 1099-R and 1099-MISC Forms must be submitted. When completing Part 2 of the W-2S, all 1099 MISC Forms not reported on PA Schedule C and all 1099-R Forms must be entered. The code appearing in Box 7 of 1099-R must be entered in Column D of Part B of PA Schedule W-2S. If the income is not taxable to Pennsylvania, enter "0" in Column G of this schedule.
- **e-file:** When using e-file, follow the paper return requirements for completing PA Schedule W-2S. However, copies of 1099-R Forms need not be submitted unless the return is a state-only return or the 1099-R includes Pennsylvania tax withholding.

If the code in Box 7 of Form 1099-R is 1, 2, 8, 9, J, L, S or U, there may be taxable income. This is determined by subtracting the amount of the adjusted basis in the plan (Column F, Part B of PA Schedule W-2S) from the total federal amount (Column E, Part B of PA Schedule W-2S). The adjusted basis is generally the taxpayer's actual contributions to the plan, less any prior distributions. The taxpayer must provide this information. The maximum allowable basis cannot be greater than the total federal amount.

If the code in Box 7 of Form 1099-R is 6 or F, there may be taxable income to report on PA Schedule D. Refer to the PA Personal Income Tax Guide for information regarding these codes.

**REMINDER:** All distributions from SERS, PSERS, PMERS and U.S. Civil Service Commission Retirement Disability plans, regardless of the distribution code in Box 7 of Form 1099-R, are not subject to tax. These still must be shown on Part B of PA Schedule W-2S, and "0" must be entered in Column G.

The codes in Box 7 of the 1099-R can be any of the following:		Taxable for PA
A	May qualify for special averaging over 10 years	n/a
B	Designated Roth account distribution	(h)
D	Annuity payments from nonqualified annuities and distributions from life insurance contracts	Yes (b)
E	Distributions under Employee Plans Compliance Resolution System	No
F	Charitable gift annuity	Yes (b)
G	Direct rollover to IRA or other qualified plan	No
H	Direct rollover of a designated Roth account distribution to a Roth IRA	No
J	Early Distribution from a Roth IRA	(c)
K	Distribution of IRA assets not having a readily available FMV	(g)
L	Loan treated as distributions	(d)
N	Re-characterized IRA contributions	No
P	Excess contribution plus earnings	(a)
Q	Qualified distributions from a Roth IRA	No
R	Re-characterized IRA contributions	No
S	Early distribution from SIMPLE IRA	Yes (d)
T	Roth IRA distribution, exception applies	(c)

*Codes for 1099-R continued on Page 34*

*Codes for 1099-R continued from Page 33*

The codes in Box 7 of the 1099-R can be any of the following:		Taxable for PA
U	Dividends distributed from an Employee Stock Option Plan (ESOP) under Section 404(K)	Yes
W	Charges or payment for purchasing qualified long-term care insurance	Yes (b)
1	Early distribution, no known exception (under 59½)	Yes (d)
2	Early distribution, exception applies no penalty (under 59½)	Yes (e)
3	Disability	(i)
4	Death benefit	(i)
5	Prohibited transaction	Yes
6	Section 1035 exchange	No
7	Normal distribution	(f)
8	Excess contributions, plus earnings	(a)
9	PS 56 costs	No

- (a) - Taxable to the extent there are any earnings on the excess contributions or the employer did not include the contributions in taxable compensation. Otherwise, not taxable.
- (b) - Taxable as interest income on PA Schedule A to the extent of the amount included in federal taxable income.
- (c) - Not taxable to the extent taxpayer is over 59½. Taxable if taxpayer is under 59½ using cost recovery method to determine amount taxable.
- (d) - Taxable to the extent distributions exceed contributions as determined using the cost recovery method.
- (e) - Not taxable if a distribution from an eligible plan for Pennsylvania tax purposes. Otherwise, taxable to the extent distributions exceed contributions as determined using the cost recovery method.
- (f) - Not taxable if a distribution from an employer-sponsored retirement program or from a traditional or Roth IRA. However, if the distribution is from an annuity or endowment contract purchased from a life insurance or mutual thrift insurance company, the distribution is taxable as interest income to the extent of the amount included in federal taxable income.
- (g) - Taxable to the extent included with Codes 1 or 2 and to the extent they are taxable.
- (h) - Taxable to the extent included with Codes 1, 2, 8, L, P and/or U and to the extent one of those codes is taxable.
- (i) - Not taxable if not included with Code D. If Code D is included, taxable as interest income on PA Schedule A to the extent of the amount included in federal-taxable income.



## LINE 1b, PA-40 SCHEDULE UE

Pennsylvania's income tax law allows a deduction of allowable employee business expenses for which the taxpayer was not reimbursed. It is not necessary for these expenses to be required by the employer as a condition of employment. For example, purchases by teachers for materials to be used in the classroom that fall under the conditions of ordinary, necessary, reasonable, actually incurred and directly related to performing the duties of the occupation or employment are allowable expenses for PA purposes, even though they may not be required as a condition of employment or continued employment.

Unlike the federal allowance, there is no monetary cap as long as the expenses fulfill the above conditions and can be substantiated. You may only deduct those expenses actually paid while performing the duties of your employment. You may not deduct expenses based upon federal per-diem allowances.

Deductions that may be claimed on Schedule UE:

- Union dues/agency fees/initiation fees
- Work clothes not suitable for street wear that are required to be purchased. This includes cleaning, altering and repairs of such clothes.
- Small tools and supplies
- Professional license fees, malpractice insurance and fidelity bond premiums (where required by law or employer)
- Travel and mileage expenses including vehicle expenses (using the actual or mileage rate method), transportation, parking fees, and tolls. A taxpayer may not claim depreciation on any vehicle on which the standard mileage rate method is used.
- Meals and entertainment expenses, however, meals while not in an overnight travel status or while working late and federal per-diem rates for meals and incidental expenses are not allowable.
- Moving Expenses, provided the transfer is from one permanent workplace to another and the new workplace is 35 miles or more further from

the old residence than the old workplace (the 35 mile rule is waived for military personnel and their families). Expenses are limited to those incurred in moving family, self and household goods from point of departure to point of arrival, including lodging the night of arrival.

- Educational expenses, if required by law or employer to maintain or improve skills in present job
- Office work area expense

**CAUTION:** Certain utilities, which are not subject to sales and use tax when purchased exclusively for residential use, become subject to sales and use tax when used for commercial purposes. If you are including electricity, natural gas, fuel oil, or kerosene in your calculation of home office expense, you should report use tax due on the prorated expense amount on Line 25 of the PA-40.

- Miscellaneous expenses such as:
  - Breakage fees
  - Cash shortages
  - Costs incurred to pay readers for blind employees
  - Business gifts
  - W-2 fees that must be paid back to the employer (e.g. jury duty where employer continues full wages and requires repayment of monies received for jury duty)
- Reimbursements received that are not on a W-2 must be deducted from expenses claimed on Schedule UE.

Deductions that may not be claimed on Schedule UE:

- Personal, living and family expenses
- Dues to fraternal organizations, professional societies, chambers of commerce and recreational clubs

- Dues and subscription costs to publications, even when the publications are related to your trade or profession
- Political candidate or campaign contributions
- Charitable contributions
- Commuting expenses
- Cost of meals while working late, unless while traveling overnight on business
- Occupational privilege taxes or assessments and other local, county, state, federal and foreign taxes
- Childcare or elder care expenses
- Life, disability and health insurance premiums
- Contributions to deferred compensation plans and other pension plans
- Legal fees (except to recover back wages), fines, penalties and bad debts
- Bribes, kickbacks and other illegal payments
- Job hunting or other employment pursuit expenses
- Malpractice insurance premiums, except when required by law or by the employer as a condition of employment
- Moving expenses for selling or purchasing a house; breaking a lease; house hunting; securing temporary lodging prior to moving; seeking new employment; moving for your own convenience; relocating to a new job or workplace less than 35 miles farther than your old commute from home to work; or moving anywhere other than within or into Pennsylvania
- Educational expenses, except when required by law or the employer
- Capital expenditures
- Expenses calculated at federal per-diem rates.

The department will no longer accept expenses reported on federal Forms 2106 or 2106-EZ to be

used for reporting any expense other than vehicle expenses. If commuting miles between different jobs for different employers are included in the amounts for federal Forms 2106 or 2106-EZ, the commuting miles must be removed from the calculation.

Taxpayers may wish to provide a copy of a letter from their employer verifying the expenses are required to be incurred to perform the duties of their position and the method of any reimbursement by their employer for those expenses. Form REV-757, Employer Letter Template, may be completed by the employer for such purposes. In lieu of an employer letter, taxpayers may provide a copy of their employer's employee expense reimbursement policy. In addition, Form REV-775, Personal Income Tax Employee Business Expense Affidavit, may be submitted if an employer will not provide the taxpayers with a letter and the expense policy is not available.

A separate PA Schedule UE must be completed for each taxpayer and for each employer and occupation. Taxpayer's who are tradesmen may complete one PA Schedule UE if they are working out of a union hall. Tradesmen may only include mileage for job locations that are more than 35 miles from the closer of the union hall or personal residence to the jobsite. The total amount of unreimbursed expenses must be entered on Line 1B of the PA-40.

If a taxpayer receives a fixed mileage allowance or per diem living expense not included in the PA taxable income in Box 16 of the W-2 form, the expenses associated with the reimbursements may not be claimed on a PA Schedule UE. Neither can an employee deduct expenses if he/she was reimbursed by the employer for the exact amount of the expenses.

**EXAMPLE:** James is regional manager for a chain of retail stores and is required by his employer to drive his personal vehicle and visit each retail location within his region at least one time per month. James' employer reimburses him at a rate of \$0.40 per mile and provides a lunch per diem of \$8.00 per travel day. James is not permitted to deduct a mileage expense on his PA Schedule UE for the difference between the federal allowance and his employer's reimbursement

or an expense for meals while traveling to visit the retail locations within his region unless his employer includes the reimbursements in his PA compensation.

### **LINE 1c, PA-40 TAXABLE COMPENSATION**

Subtract the expenses shown from the total compensation and report the difference on this line. This represents taxable compensation.

Nonresidents must complete Schedule NRH, Nonresident Income Apportionment Schedule, if compensation was received from sources within and outside Pennsylvania if:

- The employer did not accurately apportion income on the W-2; or
- The taxpayer is claiming any unreimbursed business expense.

### **LINE 2, PA-40 INTEREST SCHEDULE A**

Interest income must be reported on Form PA-40. However, interest from business accounts, working capital interests and accounts receivable are included on the appropriate business schedule as part of gross income. Interest received from an installment sale is included on PA Schedule D-1 and carried over to PA Schedule D. If the interest is on a rental security deposit, it is used in determining the net income or loss on PA Schedule E.

The requirements for when PA-40 Schedule A must be completed have been revised. If the total PA-taxable interest income (taxpayer, spouse and/or joint) is equal to the amount reported on the federal return and there are no amounts for Lines 2 through 15 of the schedule (not including Lines 4 and 10), interest income must be reported on Line 2 of the PA-40, but Schedule A does not have to be completed. If there are adjustment amounts for any of the Lines 2 through 15 of the schedule (not including Lines 4 and 10), PA Schedule A must be completed and submitted with the PA-40, Personal Income Tax Return.

A taxpayer and spouse must complete and submit separate schedules to report their income if any

amounts are reported on Lines 2 through 15 for either the taxpayer or the spouse. However, if all the income is earned on a joint basis, one schedule may be completed. Complete the oval to indicate whether the income included on the schedule is from the taxpayer, spouse or joint. When reporting the interest income on a separate PA Schedule A, a taxpayer and spouse must show their separate share of the interest income from joint income on each PA Schedule A. Do not include three schedules with the joint income reported on one schedule and taxpayer and spouse income reported on separate schedules. Unless the interest income for both taxpayer and spouse do not include any amounts for Lines 2 through 15 (not including Lines 4 and 10), both taxpayer and spouse must complete and submit a separate Schedule A. See the PA-40 Schedule A instructions for additional information.

PA taxable interest income includes but is not limited to interest income from savings and loan associations, credit unions, bank deposits, bonds, certificates of deposit, interest-bearing checking accounts, state, federal, local and foreign tax refunds, mortgages, obligations of other states and investments. Generally, federal Form 1099, issued by financial institutions, will indicate the interest received or credited from or by such institutions. Interest received on the following obligations is subject to tax, as the interest on these obligations is only guaranteed by the federal government. This list is not an exclusive list.

- Agricultural Credit Insurance Fund (Agricultural Credit)
- Bonneville Power Administration (Pacific Northwest Transmission)
- Electric and Hybrid Vehicle Development Fund
- Export-Import Banks
- Federal Financing Bank
- Federal Home Loan Mortgage Corporation (Freddie Mac)
- Federal National Mortgage Association (Fannie Mae)
- Federal Ship Financing Fund (Merchant Marine Act)

- Geothermal Resources Development Fund (Geothermal Research)
- Government National Mortgage Association (Ginnie Mae)
- Merchant Marine Obligations (Maritime Administration)
- U.S. Housing Authority - Low-Rent Housing
- Pension Benefit Guarantee Corporation
- Rural Development Insurance Fund
- Rural Housing Insurance Fund
- Rural Telephone Bank
- Securities Investor Protection Corporation (Securities Investor Production Fund)
- Small Business Administration
- Synthetic Fuels Corporation
- U.S. Railway Association

Burial fund earnings are taxable income for PA residents when the funeral home holds the account in the name of the taxpayer to pay the future funeral expenses of the taxpayer. Irrevocable burial funds are not taxable to the taxpayer. The funeral home reports the income as the custodian of the account on PA-41.

Interest income on dividends from insurance companies, whether disbursed or not, are taxable as interest income.

Undistributed unearned income accruing on IRA, Keogh Accounts pension trusts, or nonqualified deferred compensation plans is not includable in income.

## **ANNUITIES, LIFE INSURANCE AND ENDOWMENT CONTRACTS**

Distributions from non-recognized private annuities purchased by the taxpayer, including retirement annuities not part of an employer-sponsored retirement program, are reported as interest income. This includes an amount from a life insurance and/or endowment contract if required to report an amount for federal income tax purposes. The form indicates an

amount for contributions and an amount for earnings. Report the amount of earnings reported for federal income tax purposes as interest income on Line 11 of PA-40 Schedule A.

**Charitable Gift Annuities:** If a taxpayer is receiving periodic payments from a charitable organization to which he/she established a gift annuity, there is taxable income. The amount reported is the gross amount reported for federal income tax purposes (including both the ordinary income and capital gains income).

**Exchange of Life Insurance Contracts:** The taxability of life insurance contracts (e.g. where one company takes over another) follows the requirements of Section 1035 of the Internal Revenue Code. Under these rules, if there is no cash involved, the exchange is tax-free. If the exchange involves cash, it is reported as income on Line 10 of Schedule D.

## **DISTRIBUTIONS FROM IRC SECTION 529 QUALIFIED TUITION ACCOUNT PROGRAMS AND HEALTH/MEDICAL SAVINGS ACCOUNTS**

Distributions from IRC Section 529 qualified tuition account programs are not taxable unless they are not used for educational purposes. Distributions not used for educational purposes are reported, as interest income on Line 14 of PA Schedule A. Any distributions from health or medical savings accounts not used for medical expenses that are included in federal taxable income are taxable as interest income on Line 13 of PA-40 Schedule A.

## **PENNSYLVANIA ABLE SAVINGS PROGRAM FUND ACCOUNTS - QUALIFIED IRC SECTION 529A ACCOUNTS**

Earnings on contributions to an account established under the ABLE (Achieving a Better Life Experience) Savings Program Fund with the Pennsylvania Treasury Department are exempt from taxation.

Distributions from IRC Section 529A accounts are also exempt when used for qualified disability

expenses of eligible individuals. Withdrawals for other than the above purposes are subject to tax. The cost recovery method is used to determine the amount subject to tax. Report the amount subject to tax on Line 3 of PA Schedule A as an Other addition adjustment.

## UNIFORM GIFTS TO MINORS ACT

Interest, dividends or any other income earned by accounts set up under the Uniform Gifts to Minors Act must be reported on the tax return of the child.

**NOTE:** PA tax law does not allow for any deduction for contributions to accounts set up under this act.

## IMPUTED INTEREST

Imputed interest is taxable for Pennsylvania. Imputed interest is the implied interest on an obligation where the instrument does not provide for interest or the interest rate is below the applicable federal rate. For example, on an original issue discount bond (OID), a stripped bond or a certificate of deposit (CD) maturing several years from now where interest is received at maturity, the imputed or accrued interest (discount on OID) is reported each year for Pennsylvania personal income tax purposes. Pennsylvania follows the federal rules for imputed and accrued interest.

## TAX-EXEMPT INTEREST

Interest received from direct obligations of the Commonwealth of Pennsylvania, its political subdivisions and authorities, or the U.S. Government is not taxable income and should not be reported. Interest from Series E, F, G, H, EE and HH bonds; federal treasury bills and notes; Certificates of Accrual Treasury Securities (CATS); and Treasury Investment Growth Certificates (TIGERS) is not taxable. See the section on imputed interest for CATS and TIGERS that are zero coupon bonds, issued at a discount (a/k/a stripped bonds).

The tax-exempt portion of the stripped coupon or stripped bond OID is the excess of the stated redemption price at maturity (or in the case of a coupon, the amount payable on the due date of the coupon), over an issue price that would produce a

yield to maturity as of the purchase date. The tax-exempt portion is equal to the lower of the coupon rate of the tax-exempt obligation from which the coupons were separated, or the yield to maturity (on the basis of the purchase price) of the stripped coupon or stripped bond. The taxpayer can elect to use the original yield to maturity instead of the coupon rate for these purposes.

Interest on obligations issued by the following federal instrumentalities are also not taxable:

- Banks for Cooperatives
- Federal District Banks For Cooperatives
- Central Banks for Cooperatives
- Commodity Credit Corporation
- Farm Credit System Capital Corporation: Consolidated Obligations
- Farm Credit System Joint Stock Banks
- Farm Credit System Land Banks and Land Bank Associations
- Federal Deposit Insurance Corporation
- Federal Farm Credit Banks
- Federal Financing Bank 12
- Federal Home Loan Banks
- Federal Crop Insurance Corporation
- Federal Land Bank Associations
- Financing Corporation
- General Insurance Fund:
  - Armed Services Mortgage Insurance
  - National Defense Housing Insurance
  - Rehabilitation and Neighborhood Conservation Housing Insurance
  - Rental Housing Insurance Fund
  - Rental Housing Insurance Fund Mortgage Insurance
  - War Housing Insurance Law



- Insurance of Loans for Manufacturer of Houses
- Mortgage Insurance Benefits
- Government of Guam 48
- Government of Puerto Rico
- Government of the Northern Mariana Islands and covenant to establish a Commonwealth of the Northern Mariana Islands in a political union with the U.S.
- Government of Virgin Islands
- Public Building Trust Participation Certificates
- Mutual Mortgage Insurance Fund
- National Credit Union Administration Central Liquidity Facility
- Production Credit Associations
- Public Housing Agencies
- Resolution Funding Corporation (REFCORP)
- Student Loan Marketing Association (Sallie Mae)
- Tennessee Valley Authority
- U.S. Postal Service
- U.S. Treasury Notes, Bonds, Bills, Certificates and Savings Bonds

Interest received from obligations of other states or municipalities located in other states or foreign countries is taxable income.

## **DISTRIBUTIONS FROM MONEY MARKET AND MUTUAL FUNDS AND OTHER INVESTMENT COMPANIES**

Taxable distributions from the earnings and profits of money market or mutual funds and investment trusts and companies must be reported as dividend income and are not considered interest income.

## **FORFEITED INTEREST PENALTY**

Forfeited interest penalty incurred for premature redemption or withdrawal of a time savings account

or certificate of deposit may be offset against interest income from the source instrument. If the penalty exceeds the interest income, the excess may be taken as a loss on PA Schedule D, provided there is a gain from which the (loss) can be offset.

## **EXCHANGE OF LIFE INSURANCE ANNUITY CONTRACTS**

The taxability of an exchange of life insurance annuity contract follows the requirements of Section 1035 of the Internal Revenue Code. Under these rules, if there is no cash involved, the exchange is tax-free and need not be reported. However, if the exchange involves a cash payment, the amount of the cash received will be taxable as interest income. This applies to those exchanges which occur in tax years beginning Jan. 1, 2005, and later.

## **PA-40 SCHEDULE A INSTRUCTIONS**

Line 1: Enter the amount of interest income reported on Line 8a of your federal Form 1040, or Form 1040A, or Line 2 of federal Form 1040EZ.

Line 2: Enter the total amount of tax-exempt interest income included in Line 8b of federal Form 1040, or Form 1040A. Do not include exempt-interest dividends in this amount.

Line 3: Enter any other adjustments for items that increase PA interest income and provide a description of the amounts. Examples of deductions from federal interest income that must be added back include, but are not limited to: self-charged interest; amortization of bond premium; nominee interest; or expenses incurred to realize interest income. If you are not required to file a federal return, also enter on this line the amount of any interest income reported to you in Box 1 of all federal Forms 1099-INT, Interest Income, as well as all other federally taxable interest income received, including, but not limited to, U.S. government interest or interest from federal Schedule K-1s.

- Line 4: Add the amounts on Lines 1, 2 and 3 and enter the amount.
- Line 5: Enter the total amount of interest income included in the amounts reported in Line 1 of federal Schedule B from federal Schedule(s) K-1.
- Line 6: Enter the amount of tax-exempt interest from direct obligations of the Commonwealth of Pennsylvania and/or direct obligations of political subdivisions of Pennsylvania. Include on this line any interest income from obligations issued by the commonwealth, a public authority, commission, board or other agency created by the commonwealth or political subdivision of the commonwealth.
- Line 7: Enter the amount of any interest income from direct obligations of the U.S. Government (U.S. Treasury Bonds, Notes, Bills, Certificates and Savings Bonds). Do not include amounts from U.S. obligations reported on federal Schedule K-1(s) or on Line 3 of federal Schedule B in this amount.
- Line 8: Enter any other adjustments that decrease PA interest income and provide a description of the amounts. Examples include but are not limited to: interest income earned while a nonresident; interest on installment obligations that are included as gain on the sale of property for PA purposes; forfeited interest penalty; interest income from an irrevocable federal grantor trust that is required to file a PA-41 Fiduciary Income Tax Return; and amortization of bond premium. An example of the description for interest income earned while a nonresident would be "Non-Residency Period Interest". Do not include expenses incurred to realize interest income.
- Line 9: Add the amounts on Lines 5, 6, 7 and 8 and enter the amount.
- Line 10: Subtract Line 9 from Line 4 and enter the amount.
- Line 11: Enter amounts reported on Form 1099-R with Box 7 Codes 1, 2, 3 or 7 that also include Code D.
- Line 12: Enter the amount of charitable gift annuity income taxable for federal income tax purposes.
- Line 13: Enter the amount of any distributions from IRC Section 529 plans that are for non-educational purposes. The cost recovery method must be used to determine the taxable amount for contributions made in tax years 2005 and earlier. The total amount of distributions that were claimed as deductions for tax years 2006 and later is taxable. If any contribution after 2005 exceeded the deduction limit for the tax year, the cost recovery method may be used for the excess contribution.
- Line 14: Enter the amount of any distributions from Health/Medical Savings accounts included as Other income on Line 21 of federal Form 1040.
- Line 15: Enter the amount of interest income from PA S corporations and partnerships. Include the amounts reported from all PA Schedule(s) RK-1, or federal Schedule(s) K-1 if an RK-1 is not provided.
- Line 16: Add the amounts on Lines 10, 11, 12, 13, 14 and 15 and enter the amount.
- NOTE:** If a separate PA Schedule A is prepared for a taxpayer and spouse, include only the taxpayer or spouse share of the income for each line.

### **LINE 3, PA-40 DIVIDENDS SCHEDULE B**

Dividend income must be reported on Form PA-40.

The requirements for when PA-40 Schedule B must be completed have been revised. If the total PA-taxable dividend and capital gains distributions income (taxpayer, spouse and/or joint) does not include any amounts for Lines 2 through 9 of PA Schedule B (not including Line 6), dividend income must be reported on Line 3 of the PA-40, but Schedule B does not have

to be completed. If there are any amounts (taxpayer, spouse and/or joint) for any of the Lines 2 through 9 of PA Schedule B, PA Schedule B must be completed and submitted with the PA-40, Personal Income Tax Return.

A taxpayer and spouse must complete and submit separate schedules to report their income if any amounts are reported on Lines 2 through 9 for either the taxpayer or spouse. However, if all the income is earned on a joint basis, one schedule may be completed. Complete the oval to indicate whether the income included on the schedule is from the taxpayer, spouse or joint. When reporting the dividend income on a separate PA Schedule B, a taxpayer and spouse must show their separate share of dividend income from any jointly owned stock on each PA Schedule B. Do not include three schedules with the joint income reported on one schedule and taxpayer and spouse income reported on separate schedules. Unless the dividend income for both taxpayer and spouse do not include any amounts for Lines 2 through 9 (not including subtotal Line 6), both taxpayer and spouse must complete and submit a separate Schedule B. See the PA-40 Schedule B instructions for additional information.

All dividend income is reported on this line. A resident shareholder must report as taxable dividend income, for the taxable year in which it is received or credited, any distribution by a business corporation or business association out of its earnings and profits without regard to the manner in which the business derived the income. For PA tax purposes, a business association is an unincorporated business enterprise organized in a manner similar to a business corporation. Business corporations or business associations include business trusts, agricultural cooperatives, electric cooperatives, federally qualified real estate investment companies, mutual funds and other federally regulated investment companies.

## CAPITAL GAINS DISTRIBUTIONS

Capital gains distributions received from mutual funds or other regulated investment companies are taxable as dividend income on Line 9 of PA Schedule B. Report the amount from Box 2a of your 1099-DIV as PA-taxable dividend income even though you

report such distributions as capital gains on federal Schedule D.

## DIVIDEND INCOME DOES NOT INCLUDE:

- Dividends distributed by a corporation to its stockholders in the form of stock, if the distribution is not treated as income for federal income tax purposes. If the stock distribution is not taxable, the tax basis of the old stock is adjusted to reflect the additional shares.
  - Distributions designated "return of capital" by utility companies or other corporations. Such distributions serve to reduce the basis of stock in the corporation. Once a taxpayer's basis is reduced to zero, any further distributions are taxed as gain from the sale or disposition of property.
  - Dividends paid by savings and loan associations, mutual savings banks, cooperative banks and credit unions on deposits or withdrawals from accounts must be reported as interest.
  - PA exempt-interest dividends paid after Jan. 1, 1993. Ordinary dividends paid by a mutual fund or a registered investment company and designated as exempt-interest dividends for PA purposes in a written notice. Exclude that portion of the total dividends designated as being from exempt PA and federal obligations.
- IMPORTANT:** The amount designated as capital gain is fully taxable as dividend income for PA purposes.
- Dividends paid by mutual insurance companies are a return of premium only. Dividends paid by companies other than mutual insurance companies are taxable dividends.
  - Undistributed capital gains made by a regulated investment company. Any gain derived from the sale, exchange or disposition of the underlying shares in the fund or trust will be a taxable gain for PA personal income tax purposes. Any loss incurred from the sale, exchange or disposition of the underlying shares is recognized, but may

only be offset against a shareholder's taxable gain for the taxable year.

## PA-40 SCHEDULE B INSTRUCTIONS

- Line 1: Enter the amount of dividend income reported on Line 9a of your federal Form 1040, or Form 1040A.
- Line 2: Enter the total amount of dividend income reported on Line 5 of federal Schedule B from federal Schedule(s) K-1.
- Line 3: Enter the total amount of any tax-exempt dividends from direct obligations of the Commonwealth of Pennsylvania, direct obligations of political subdivisions of Pennsylvania and/or direct obligations of the U.S. Government (U.S. Treasury Bonds, Notes, Bills, Certificates and Savings Bonds) included in any tax exempt fund or money market fund dividends.
- Line 4: Enter any other adjustments that decrease PA dividend income and provide a description of the amounts. Examples include, but are not limited to: dividend income for a part-year resident taxpayer during the period the taxpayer was a nonresident; nominee capital gains distributions; and dividend income from an irrevocable federal grantor trust that is required to file a PA-41 Fiduciary Income Tax Return. Do not include expenses incurred to realize dividend income.
- Line 5: Add the amounts on Lines 1, 2, 3 and 4 and enter the amount.
- Line 6: Subtract Line 5 from Line 1 and enter the amount.
- Line 7: Enter the total amount of any exempt-interest dividends reported in Box 10 of federal Form 1099-DIV, Dividends and Distributions, or the amount of exempt-interest dividends included in Line 8b of your federal return.
- Line 8: Enter any other adjustments that increase PA dividend income and provide a

description of the amounts. Examples include but are not limited to: excessive salary paid to a shareholder; nominee capital gain distributions; distributions from non-PA S corporations; tax-exempt interest dividends reported in Box 10 of Form 1099-DIV; and expenses incurred to realize dividend income. If you are not required to file a federal return, enter on this line the amount of dividend income reported to you in Box 1 of all federal Forms 1099-DIV, Dividends and Distributions, as well as any other federally taxable dividend income received by you from all sources including, but not limited to, dividends from federal Schedule K-1s.

- Line 9: Enter the amount of capital gains distributions included as capital gains on federal Schedule D.
- Line 10: Enter the amount of dividend income from PA S corporations and partnerships. Include the amounts reported from all PA Schedule(s) RK-1, or federal Schedule(s) K-1 if an RK-1 is not provided.
- Line 11: Add Lines 6, 7, 8, 9 and 10 and enter the amount.

**NOTE:** If a separate PA Schedule B is prepared for a taxpayer and spouse, include only the taxpayer or spouse share of the income for each line.

## LINE 4, PA-40 NET PROFITS FROM A BUSINESS, PROFESSION OR FARM SCHEDULES C AND F

All net profit or loss from a business, profession, farm, partnership, PA S corporation or limited liability company must be reported on Form PA-40/PA-40NRC. If a net loss occurs, enter the actual dollar figure of the loss on Line 4 of the Form PA-40 and fill in the oval to indicate loss.

Sole proprietors who had income, profits or losses from a business or profession other than a farm, must complete and file PA Schedule C. Sole proprietors who had income or losses from a farm must complete and file PA Schedule F.

All business income and expenses for a sole proprietorship or disregarded single-member limited liability company must be reported on PA Schedule C, regardless of the amount of income and expenses.

If a taxpayer had more than one business or farm, or if a taxpayer and spouse each had separate businesses, submit a separate PA Schedule C or PA Schedule F for each business or farm.

A taxpayer's share of ordinary gain/loss from operations derived from partnerships, Pennsylvania S corporations or other entities must be shown separately and added or deducted accordingly. Schedule RK-1 or Schedule NRK-1 must be included.

Business or farm income or loss from partnerships, S corporations and limited liability companies is also reported to taxpayers on PA Schedules RK-1 or NRK-1 or the federal Schedule K-1. Include the income or loss from Line 1 of the PA Schedule RK-1 or NRK-1. If a partnership or limited liability company, also include the amount of any guaranteed payments shown on Line 12 of the PA Schedule K-1 or Line 10 of the PA Schedule NRK-1 when the payments are for services generated from business or farm income. Report the income or loss from Line 1 from the federal Schedule K-1 along with any guaranteed payments.

If income came from more than one business, farm, partnership, S corporation or limited liability company, include a schedule showing the amounts of income or loss reported for each entity and report the total on Line 4 of the PA-40.

Taxpayer and spouse income and losses must be determined separately. Taxpayer income may be offset with taxpayer losses within a class of income. However, taxpayer income may not be offset with spousal losses within a class of income and vice versa.

**CAUTION:** Certain utilities, which are not subject to sales and use tax when purchased exclusively for residential use, become subject to sales and use tax when used for commercial purposes. Commercial purposes include business property owned by an individual and used for business purposes such as an in-home office or a business operated from an individual's principal residence. Exceptions include

properties with separate metering for businesses where the business area utilities are metered and paid for under commercial purposes and the principal residence portion property is metered and paid for by the individual owner or where the property is metered and billed under a mixed use method by the utility company. If you are including electricity, natural gas, fuel oil or kerosene in your calculation of utilities expense and the property is not listed as commercial property with the utility company, as a commercial entity with the fuel oil or kerosene supplier or as a mixed use property, use tax should be reported on the related expense amounts for these utility expenses on Line 25 of the PA-40.

A PA Schedule C or F differs from a federal Schedule C or F. The following adjustments should be made to the federal Schedule C or F income:

- **Deferred income not reported for federal purposes.** PA personal income tax law does not permit a business or farm to defer income to a different taxable year or period. If under federal law an election permitted the delay of receipts, this amount must be added.
- **Working capital interest and dividend income that was not reported.** This includes investments to generate funding for business operations. Report such interest and dividend income. If such interest and dividend income was reported on PA Schedule A or B, it must be reduced accordingly.  
**NOTE:** When invested for business purposes, include otherwise PA-exempt interest and dividend income. Income from exempt PA investments, such as direct U.S. and Commonwealth of Pennsylvania obligations does not retain its PA exempt character when used in business or farm operations.
- **Gains from the sale of business assets that were reported on federal Schedule D or another schedule.** A sale of a business asset in the ordinary course of operating a business or farm is reported as business or farm income on PA Schedule C or F. However, the asset sold must be replaced to qualify for this treatment to be allowed. A sale of a business segment can



also be treated as business income if a similar business segment is purchased to replace the segment sold. Abandonment of property or sales of any other business assets or segments not replaced are reported on PA Schedule D. In many instances, the sale of an asset is partially reported as business income for federal purposes and part as Schedule D. To report the gain properly for PA PIT purposes, an adjustment must be made to either include or exclude the income from business income for PA purposes or to include or exclude the gain from PA Schedule D depending on whether the asset sold was replaced or not.

**NOTE:** When invested and sold for business purposes, include otherwise PA-exempt gains. Income from the sale of PA-exempt investments, such as direct U.S. and Commonwealth of Pennsylvania obligations, does not retain its PA nontaxable character when used in business or farm operations.

- **Gain on the involuntary conversions (such as IRC Section 1033) not reported for federal purposes.** Gains on the sale of business property resulting from an involuntary conversion (destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) that are not reported for federal income tax purposes under IRC Section 1033 are not required to be reported for PA personal income tax purposes on transactions occurring after Sept. 11, 2016. PA personal income tax law does not contain this provision. Report any taxable gain realized from such a transaction when the asset was employed in the operation of the business or farm.
- **Gain from the sale of business property where PA basis is different than federal basis.** Since PA personal income tax law does not follow federal rules, basis is usually different for PA personal income tax purposes. Rely on the books and records to determine the gain using the PA basis, and increase the business or farm income. If the use of PA basis results in a loss or reduces the federal amount, submit a PA Schedule C or F. Remember: A sale or abandonment of

a business or segment thereof is a PA Schedule D transaction. If such a sale was reported as a business transaction and not on PA Schedule D, adjust the PA Schedule C or PA Schedule F and PA Schedule D accordingly.

- **Taxes.** Taxes based on gross or net income, federal income taxes and one-half of the self-employment taxes that the IRS allows cannot be deducted. Nor can taxes paid to other states or foreign countries based on income be deducted. In addition estate taxes and inheritance, legacy, succession and gift taxes are not deductible. Assessments for betterment and improvements cannot be deducted. The Philadelphia business privilege tax is an allowable deduction on the schedule, but only if not already deducted on the federal schedule. Single-member limited liability companies (LLCs) that file as sole proprietors and LLC's that file as partnerships and PA S corporations may deduct the PA capital stock/foreign franchise tax paid. Other federal, state and local taxes are allowable deductions.
- **Bonus depreciation.** PA personal income tax law does not follow any federal allowance for additional or bonus depreciation expenses. Add as income the difference between the bonus depreciation and the depreciation that should have been taken for PA personal income tax purposes, based on the generally accepted depreciation method consistently used for the business or farm. Subtract as an additional depreciation expense any PA allowable depreciation as a result of the change in depreciable basis for taxable years after the year in which bonus depreciation is used for federal purposes.
- **Other depreciation expenses deducted for federal purposes that Pennsylvania does not allow.** Add as income the difference between the federally elected depreciation and the depreciation taken for PA personal income tax purposes, based on the generally accepted depreciation method consistently used for the business or farm. The department allows Accelerated Cost Recovery System (ACRS), Modified Accelerated Cost Recovery System (MACRS),

and Section 179 of the IRC as amended to Jan. 1, 1997, but not any other accelerated method, including "bonus depreciation," IRC Section 168(k). Straight-line depreciation must be used for PA purposes whenever PA basis differs from federal basis. If bonus depreciation, federal Section 179 limits or any other adjustments to basis result in differences in basis between the federal and state basis, straight-line depreciation must be used for PA purposes.

- **Income from cancellation of debt.** If the federal income included for cancellation of debt is related to a specific expense deducted for PA purposes, the cancellation of debt income is still included for PA PIT purposes. Otherwise, the amount is not included. For example, if a business credit card (on which vehicle and other supplies or miscellaneous expenses are incurred) is not able to be paid and the debt is forgiven or cancelled, the amount of the debt forgiven is included in PA income.
- **Increases in income associated with IRC Section 481(a) "spread" adjustments that Pennsylvania does not permit.** Because PA law imposes the personal income tax annually, do not report income over a number of tax years, even if doing so under a federal election. Reduce your PA taxable income in future years by the income that could not be deferred to those years under PA personal income tax law.
- **Income from obligations of other states and organizations that is not exempt for PA purposes.** Include otherwise federally exempt interest income, dividend income and gains. PA law does not exclude income from the obligations of other states.
- **Do not take the deduction for the one-half of the self-employment taxes federal law allows.**
- **Business meals and entertainment expenses:** Pennsylvania allows 100 percent of customary and reasonable amounts expensed as opposed to the federal limit of 50 percent.

- **Sales tax on acquired property may be expensed currently rather than added to the basis of the property as required by the IRS.** If sales tax is expensed, the basis of that property will differ from the federal basis. If sales tax is expensed for PA purposes, depreciation must be adjusted accordingly; a taxpayer cannot expense sales tax and still take depreciation on the sales tax. If the sales tax is expensed for PA purposes, straight-line depreciation must be used to determine the depreciation expense on the property.
- **Charitable contributions made from the business funds for charitable purposes and publicly acknowledged by the charity are allowable for Pennsylvania.**
- **Any generally acceptable amortization method may be used.**
- **Depletion, is an allowable deduction against income.** Cost depletion may be used but percentage depletion may not.
- **Intangible Drillings Costs.** The direct expensing of intangible drilling costs under IRC Section 59(e)(2) is not allowable for PA PIT purposes. Taxpayers that directly incur intangible drilling and development costs (IDCs) may elect to currently expense up to one-third of the IDCs in tax years beginning after Dec. 31, 2013. The remainder of the IDCs may be amortized over 10 years. If a taxpayer does not elect to currently expense his/her IDCs, he/she may amortize the IDCs over 10 years. For tax years beginning prior to Jan. 1, 2014, IDCs must be amortized over the life of the well.  
**IMPORTANT:** Any election to expense up to one-third of the IDCs must be made by the taxpayer incurring the IDCs. A partner or shareholder may not make an election to expense IDCs passed through from a partnership or S corporation.
- **Other increases/decreases for PA personal income tax purposes.** Itemize other income/expense that must be reported for PA personal income tax purposes, even if not reported for

federal income tax purposes. Itemize expenses deducted for federal income tax purposes that PA personal income tax law does not permit. Submit a statement if you need more space.

- **Federal safe harbor business use of a residence deduction.** Pennsylvania does not recognize the federal safe harbor method for determining the allowable deduction for business use of a residence for Pennsylvania personal income tax purposes. Only actual expenses for a home office or the business use of a home may be deducted.
- **Business Start-up Expenditures.** Taxpayers who are in their initial year of business may directly expense business start-up expenditures up to \$5,000 in the same manner as IRC Section 195(b)(1)(A) for tax years beginning after Dec. 31, 2013. Start-up expenditures in excess of \$5,000 are amortized over 180 months. For tax years beginning prior to Jan. 1, 2014, business start-up expenditures must be amortized over 180 months.

Interest earned on deposits, balances or accounts receivable would be part of business income as well as gain loss on sale of business assets and trade-ins. Income such as earnings on investments held or other income/loss not derived in the ordinary course of business must be recorded on the appropriate schedules as described below:

- Gain/Loss on sale or disposition of the business or a portion thereof PA Schedule D
- Rent or Royalty Income/Loss PA Schedule E
- Interest/Dividends PA Schedules A and B

## **CROP DAMAGE INSURANCE / DROUGHT RELIEF GRANTS**

Drought relief grants from Pennsylvania and the federal government is part of gross income on PA Schedule F. The same applies to crop damage insurance, as it replaces the gross receipts of the farmer. Crop damage payments received as a result of an oil and gas well lease for well pads or temporary right of ways are reported all in the same year as the

amount is received and may not be spread out over the life of the lease or periods for which they are paid.

## **PENNSYLVANIA S CORPORATIONS**

The Department of Revenue recognizes all federal subchapter S corporations for reporting income on Line 4. However, if a corporation's shareholders have elected not to be a PA S corporation by filing Form REV-976, Election Not to be Taxed as a Pennsylvania S Corporation, the distributed earnings and profits are taxable as dividends. Amounts received in excess of the earnings and profits should be reported on PA Schedule D. All federal subchapter S corporations with a PA resident shareholder are required to file a PA-20S/PA-65, PA S Corporation/Partnership Information Return. Unless nexus is established with Pennsylvania, all others are not required to file.

### **Reporting income on Form PA-40 NRC.**

Nonresident taxpayers who are owners in one pass-through entity who have no PA source income or loss from any other source may elect to combine their income and file a PA-40 NRC, Nonresident Consolidated Income Tax Return. In such cases the pass-through entity files the PA-40 NRC on behalf of those owners who elect to be included. The income or loss as shown on Lines 1 through 5 and Line 10 of the PA Schedule NRK-1s for these owners should be reported on the PA-40 NRC along with any credits from Lines 6 and 7. The nonresident owners included on the PA-40 NRC must elect to be included in the filing of the consolidated return and records to show this election must be maintained by the pass-through entity. See the instructions beginning on Page 77 for additional information.

## **LINE 5, PA-40 SALE OR EXCHANGE OF PROPERTY SCHEDULE D**

Net gain or income from the sale, exchange or other disposition of any kind of property is taxable under PA law. This includes gain from the sale or disposition of real estate, tangible personal property and intangible personal property such as stock or other ownership interests in business enterprises, bonds and contracts of insurance with refundable accumulated reserves payable upon lapse or surrender.

**Summary Transactions:** Taxpayers with numerous PA Schedule D transactions may enter summary information in the gross sales price and cost or adjusted basis columns to report the net gain or loss on the sale, exchange or disposition of property in lieu of entering each transaction. The property sold must be listed on an exchange if a summary statement or brokerage statement is attached as a PDF file to the return or is faxed in to the department's e-File Services unit at 717-772-4193 or 717-787-2840. If faxed, it is recommended that the department's DEX-93, Personal Income Tax Fax Cover Sheet, be used. In such cases, please enter "VARIOUS" in the date acquired and date sold columns on PA Schedule D. If the property is not listed on an exchange, a transaction may not be included in a summary statement and must be listed separately on PA Schedule D.

**Annuities:** The investment contributions in a taxable retirement annuity that is employer sponsored or part of an employer's program cannot be excluded or deducted from income even if intended for retirement. This income is reported as compensation on Line 1. If this is a non-employer sponsored life insurance or endowment contract the income is reported as interest rather than as a sale, exchange or disposition of property.

The assignment of a court award is not taxable unless all rights to payments are given up. Court awards of damages are taxable to the extent that they represent back wages, recovered net profits, rents or another form of taxable income in the year received. This rule applies irrespective of whether they are payable in lump sum form or over time.

**Condemnations:** Condemnation of property is not taxable for federal purposes. It is a taxable disposition of property for PA purposes. The disposition occurs when the condemnation is filed with the Prothonotary's Office. Relief may consist of payments for the value of the property as well as relocation costs. Only the actual payment for the value of the property itself is taxable for PA purposes. The taxable income would be the gross sales price less the adjusted basis of the property. For SP purposes, the additional amounts received (relocation costs) are not part of eligibility

income. However, if the property is income-producing property, all monies received are included in the gross sales price on the sale of property.

**Carryover Losses:** PA law has no provision for carryover losses to another year. All losses are to be reported in the year that the transaction is completed.

**FEMA:** Generally FEMA money is not taxable. However if the monies were not fully reinvested into the damaged property, the excess would be taxable on Schedule D. To the extent FEMA money was not used to restore the property, it would be offset by basis reduction. Such cases will be reviewed on a case-by-case basis and referred to the Department of Revenue's Office of Chief Counsel.

**Class Action Life Insurance Settlements:** Life insurance settlements for class action cases where stock is given to the policy holder with the company's option for cash settlement upon selling the stock, is reportable as sale of property. The sale of the policy (if canceled) uses the cost recovery basis to determine the gain/loss. If the policy is not sold or canceled, the payments received would adjust the basis of the policy. The stock received would have a basis of zero, so that when it is sold, the net sales price is the reportable gain.

**Conversion of Mutual Insurance Company to Stock Insurance Company:** Demutualization is the conversion of a mutual insurance company to a stock insurance company. By virtue of owning a policy from a mutual insurance company, the policyholder is a part owner of that entity. The policyholder is entitled to receive compensation for giving up membership interests under their policy with the mutual insurance company. Upon conversion to a stock insurance company, the policyholder exchanged his/her ownership in the mutual insurance company for stock or the cash equivalent. The policy itself is not changed by the demutualization.

Where the cash equivalent is received, the policyholder has a disposition of intangible personal property reportable on a PA Schedule D. The gross amount received is the sales price, and the cost basis is zero.



If stock is received, no gain is reported until the subsequent sale of said stock occurs. At that point, the sales price is calculated as usual, and the cost basis is zero.

**Easements and Rights of Ways:** Easements and rights of way represent transfers of property and therefore are reportable on PA Schedule D. The seller must establish the original value of the ceded property in determining the basis.

**Oil and Gas Pipeline or Well Access Easements and Right of Ways:** Payments received for permanent right of ways and easements as well as express easements (15 years or longer in length) are considered a sale of a portion of the landowner's property. The percentage of square footage of the land included in the permanent easement or right of way to the total square footage of the entire property (pro-rata method) multiplied by the total adjusted basis of the land (or any other reasonable method for determining basis of the property) should be used in determining the gain or loss on the property. If any method other than the pro-rata method is used, approval for use of the alternative method must be obtained from the Department of Revenue's Office of Chief Counsel prior to filing the return.

**The redemption at maturity of a certificate of deposit:** Such would not be a gain on sale reportable on Schedule D, rather it is interest income reportable on Schedule A.

Pennsylvania does follow IRS rules on:

- Transfers to controlled corporations
- Exchanges in corporate reorganizations
- Transfer of property incident to divorce: There is no adjustment of the value to the party receiving the property. When the acquiring party disposes of the property, the original cost basis will be used. The relinquishing party will report no gain or loss on the sale or disposition of the property.
- The gain on the sale, exchange or disposition of property resulting from an involuntary (destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or

imminence thereof) that are not reported for federal income tax purposes under IRC Section 1033 are not required to be reported for PA personal income tax purposes on transactions occurring after Sept. 11, 2016.

Pennsylvania does not follow IRS rules on:

- Like-kind exchanges (Section 1031 IRC): For PA purposes, the sales price will be the fair market value of any property acquired plus any additional consideration. Beginning with the 1998 taxable year, a transfer of an interest in a partnership in exchange for an interest in another partnership is afforded non-recognition treatment, so long as the transaction is not taxable for federal purposes. There is no basis adjustment. This non-recognition provision applies to liquidations in connection with an exchange and, made pursuant to a statutory merger, consolidation or division. A partnership is an unincorporated entity treated as a partnership for federal income tax purposes.
- Involuntary conversions: The loss is limited to the smaller of that calculated by using the value immediately prior to the conversion or the value immediately after the conversion taking into account any insurance proceeds or other consideration.
- Wash sales (selling and then immediately repurchasing the same item): Each transaction is considered separately and independently of any subsequent transaction.
- Deemed sales are not recognized for PA income tax purposes.
- Bona fide sales to related persons: The gain or loss is calculated by using the actual cost basis and actual adjusted sales price with no special rules.
- Interest paid when purchasing stock on a margin or any item over time: The interest paid cannot be deducted or included as part of the cost. This interest is the cost of borrowing money, not part of the cost of the item.



## BASIS RULES

- The basis of property received as a result of an inheritance is the fair market value of the property as of the date of death of the decedent.
- There is no stepped-up basis for property acquired as a surviving joint tenant with right of survivorship for state purposes. Property acquired by inheritance of intestate succession does produce a stepped-up basis for state purposes however.
- Basis does not have to be reduced for state purposes merely because the taxpayer utilized a federal tax credit in conjunction with the depreciable asset.

## SALE OF PRINCIPAL RESIDENCE

Generally, the gain on the sale of a principal residence occurring on or after Jan. 1, 1998, is exempt from PA tax. Likewise, no loss may be taken because such a transaction is not entered into for profit or gain. There is no requirement for any schedule to be filed for informational purposes on an exempt sale of such a residence. However, if there is any portion of the sale that does not qualify for exemption, PA Schedule 19 must be submitted along with the PA Schedule D.

A residence is a house, lodging or other place of habitation, including a trailer or condominium that has independent or self-contained cooking, sleeping and sanitation facilities.

A principal residence, in order to qualify for exclusion, must meet the following conditions:

- It was owned by the taxpayer for two of the last five years prior to the date of sale;
- It was physically occupied and personally used the most during two of the last five years prior to the date of sale. Moving furniture and personal belongings into a residence does not qualify as use. Even if the taxpayer's family physically occupied the residence, it is not the taxpayer's principal residence if he or she did not occupy it;
- If the taxpayer has sold a principal residence and claimed the exemption within two years of the

date of sale of a second principal residence, the second sale must be reported unless the sale is the result of a change in personal circumstances beyond one's control such as a change in employment or health;

- The principal residence was never used for other than residential purposes and was not subject to a depreciation deduction whether taken or not;
- It was sold on or after Jan. 1, 1998.

**NOTE:** If the property is jointly owned, only one spouse fulfills the qualifications and a joint return is filed, the entire transaction is exempt. However, if the taxpayer and spouse file separately, only the spouse who fulfills all the qualifications may claim the exemption. The other spouse would be subject to tax on his or her half of the gain. This exclusion also applies to installment sales.

If the owner has died, the exclusion may not be claimed unless the decedent closed the sale before death. However, a surviving spouse may claim the exclusion if the decedent satisfied both the ownership and use conditions before his or her death, and the spouse has not remarried. The exclusion may not be taken on a fiduciary return, PA-41, by the estate.

If a portion of the principal residence was used for purposes other than residential purposes and is eligible for claiming depreciation expenses, the portion of the gain attributable solely to residential purposes may be excluded. Examples would include a duplex with one-half as rental, an office in the home and a residence above a retail store or a farm. The gain attributable to nonresidential purposes does not qualify for the exclusion.

PA-19 worksheet and instructions should be used to properly apportion the percentage of a mixed-use property not eligible for the exclusion. If the sale of property is taxable, submit a copy of PA-19 with Schedule D.

If a residence was rented for a couple of months, it is not necessarily disqualified from the exclusion. For example, rent paid by the buyer to live in the seller's home prior to the disposition, does not violate any of the requirements for excluding the gain from the

disposition of a principal residence. The exclusion is allowable as long as the seller is not holding it for the post-conversion appreciation in value and the property is therefore, not depreciable.

When a taxpayer-seller of a principal residence vacates, offers the residence for sale and offers the property for rent pending such sale to preserve its value, it will not be disqualified for the exclusion, as the property is not being held for the production of income and is not subject to depreciation allowance. The property would only be disqualified if the rental were for the production of income and subject to depreciation and/or the taxpayer held the property for the purpose of seeking profit based on a post-conversion appreciation in value.

The gain or loss on any residence or portion of a residence not eligible for the exclusion is reported on PA Schedule D. If other than a principal residence, gain or loss is reported in the Line 1 section of Schedule D. If a principal residence, gain or loss is reported in the Line 7 section of Schedule D. A loss may not be claimed on the sale of a principal residence.

## HOLOCAUST SETTLEMENTS

Awards or settlements received in reparation for the seizure, theft, requisition or involuntary conversion of the income of victims of Nazi persecution constitute proceeds from the disposition of property.

## FARMLAND PRESERVATION AND SALE OF TIMBER

Income received from placement of farmland into the Farmland Preservation Program as established by Act 146 of 1988 should be used as an adjustment to the basis of the property. In the event remuneration exceeds the basis, the excess proceeds are reported as a capital gain.

If the sale of timber was not part of a business, the sale should be reported on Schedule D. The gain is the difference between the amount realized and the basis in the timber. If there was a specific purchase of seedlings that were planted years ago and they have been harvested, use the cost of the seedlings as the tax basis in the timber. Otherwise, a proration must

be calculated to determine the basis. The following procedure must be followed to calculate the gain:

- What is the gross amount of the sale? (e.g. \$7,600)
- What is the fair market value of the land before the timber was harvested? This must be obtained by the taxpayer. (e.g. \$76,000)
- Take the fair market value of the land prior to the timber being harvested and divide it into the amount received. In this example, it would be 10 percent; \$76,000 divided into \$7,600.
- Apply this percentage to the original basis of the land. For example, assume the original cost to be \$25,000. Multiply this by the percentage above, 10 percent, to achieve the basis of the timber. In this example, it would be \$2,500.
- The gain would be calculated by subtracting the cost basis above from the gross amount of the sale. In this case it would be \$7,600 - \$2,500, for a taxable gain of \$5,100.

**NOTE:** The sale of Christmas trees and other ornamental trees is considered farming income.

## DEPRECIATION

**Depreciation Recapture:** Depreciation is the expensing of the cost of a depreciable asset employed in the operation of a business or in the production of rents or royalties over its useful life. The depreciation method chosen must be a method of accounting that reflects the consistent application of generally accepted accounting principals in a particular trade or business. It shall be presumed to clearly reflect income if the method is used for federal income tax purposes. Such accounting methods can be employed in calculating net profits (losses) unless they are inconsistent with Department regulations. Generally this method is the straight-line method of depreciation which evenly divides the basis in the asset by its useful life. The Department of Revenue permits as a convenience the use of the federal income tax depreciation method such as MACRS, which is an accelerated method. PA personal income tax does not permit taxpayers to deduct any bonus

depreciation allowable for federal income tax purposes. Although the depreciation method used for federal purposes and Pennsylvania purposes is generally the same, if the Pennsylvania basis of the property being depreciated is different than the federal basis for any reason, Pennsylvania requires the use of the straight-line method.

PA's rule for the adjustment of basis for depreciation expense requires that a minimum amount of depreciation must be recognized as an adjustment to basis by the taxpayer on depreciable property in the amount of depreciation that would be allowed under the straight-line method. To the extent the taxpayer uses a different method to calculate depreciation and receives a tax benefit for some amount of depreciation expense greater than straight-line, that increased amount must be recognized as the adjustment to basis. If, however, the taxpayer did not receive a tax benefit of the amount in excess of the straight-line amount, that excess does not have to be recognized as an adjustment to basis. The taxpayer must reduce the basis by at least the straight-line depreciation expense even if he/she received no tax benefit.

For purposes of calculating the basis in assets for PA tax purposes, the taxpayer must aggregate all taxable years under a single method of depreciation and should not use different depreciation methods from year to year.

For federal and PA purposes, when calculating the income for each year, the taxpayer must consistently use the same depreciation method over the life of the asset. When analyzing the gain (loss) on sale, liquidation or other disposition, the taxpayer must adjust the basis in the asset downward by the greater of: 1) the total state benefit received over all the years the asset was held by the taxpayer (i.e. reductions in PA taxable income or the income tax of another state) under whatever method was used, which could be the accelerated (MACRS) method of depreciation; or 2) the total deductions for all years the asset was held by the taxpayer that would be allowable under the straight-line method, irrespective of whether a state tax benefit was received.

### **Bonus Depreciation and Other Depreciation Differences between Pennsylvania and the IRS:**

Allowable depreciation is limited to those that follow generally accepted accounting principals or those allowed under the IRC Sections 179 and 168(k) as they existed as of 1986. Therefore, Pennsylvania does not allow the additional first-year or bonus depreciation as part of any changes to federal tax law. Pennsylvania also does permit the additional Section 179 deduction limits allowable as a result of changes to federal tax laws. The maximum deduction using IRC Section 179 is \$25,000 and the maximum investment an property before a dollar-for-dollar education in allowable Section 179 expense for PA purposes is \$200,000.

### **REPOSSESSION OF PROPERTY**

If property is sold on a deferred payment contract and the seller repossesses the property upon default of the buyer in a subsequent tax year, the seller must adjust his basis upward in the property repossessed by the amount of gain previously reported.

Debt forgiveness pursuant to an obligation to provide payment is taxable if property is given as consideration.

### **CAPITAL GAINS DISTRIBUTIONS**

Capital gains distributions received from mutual funds or other regulated investment companies are taxable as dividends and are reported on Line 3 of Form PA-40.

### **TAX-EXEMPT OBLIGATIONS**

Net gains or interest from the sale or disposition (not redemption) of the following obligations are exempt from tax. These obligations include:

- Direct obligations of the U.S. Government, such as federal Treasury bills and Treasury notes originally issued before Feb. 1, 1994
- Direct obligations of certain agencies, instrumentalities or territories of the federal government originally issued before Feb. 1, 1994
- Direct obligations of the Commonwealth of Pennsylvania and its political subdivisions or authorities originally issued before Feb. 1, 1994

Losses incurred from the disposition of the above obligations may not be used to reduce other gains.

Under PA law, if any of the obligations described above were originally issued on or after Feb. 1, 1994, any gain or loss realized on the sale, exchange or disposition of such obligations must be reported. Gains are taxable, and losses may be used to offset other gains.

Net gain or income from the sale of obligations of other states or foreign countries is subject to tax.

## RETURN OF CAPITAL DISTRIBUTIONS

A resident shareholder must report as taxable gain for the tax year in which it is received or credited the excess of the fair market value of any return of capital distribution over the adjusted basis of the stock on Line 4 of the PA Schedule D. A return of capital distribution is any distribution that is not made or credited by a business corporation or association out of its earnings and profits.

The basis of stock shares held by a resident shareholder shall be decreased (but not below zero) by any distribution that is not taxable dividend income. Once the basis is reduced to zero the distribution is taxable.

## SPECIFIC INSTRUCTIONS FOR PA SCHEDULE D-71

PA Schedule D-71 is used for property other than personal residences acquired before June 1, 1971.

Generally, gain or loss on the sale or other disposition of property is calculated by subtracting the adjusted basis of a property from the value of cash and property realized on its sale or disposition. Special tax provisions, however, apply with respect to the calculation of gain on property acquired before June 1, 1971. Gain on property acquired before June 1, 1971, is calculated by subtracting the adjusted basis of the property or the alternative basis of the property, whichever is greater, from the value of cash or property received on its sale or disposition. Also, no gain or loss is realized on the sale or disposition of property acquired prior to June 1, 1971, if the value of the cash or property received is greater than the

property's adjusted basis but less than its alternative basis.

These special tax provisions apply if the property sold or otherwise disposed of was acquired before June 1, 1971. These provisions also apply if the acquired property was sold or disposed of by gift, and the donor acquired the property before June 1, 1971.

Part 1: Used for all property sold other than installment sales

Part 1a : Description of the property sold

Part 1b: Cost Method

A = Bona fide appraisal - reflecting the value of the property as of 6-1-71 must have appraisal attached.

S = Listed Security - generally the opening price as of 6-1-71. If there have been splits, the number of shares as of 6-1-71 must be determined. The same applies if the stock has been purchased over a period of time.

P = Proration - percentage of gain/loss attributed to period after 6-1-71

X = Deemed Value - In cases where it is impossible to establish a value as of 6-1-71 by any of the above methods, a taxpayer may claim a deemed value for that date. The taxpayer must be able to justify the value used and be able to prove why none of the above methods can be used. Two examples where this type of value may be employed are where a home owner has built a vacation home over a period of years spanning the period before and after 6-1-71, or where a corporation is a family-held business and the stock is not traded.

Part 1c: Date sold goes above the dotted line and the date acquired below (use settlement date for securities and closing date for real estate)



Part 1d: Gross sales price less expense of sale. Expense of sale includes closing costs such as brokerage fees, commissions, points, survey(s), loan fees, transfer tax stamps, legal fees, title registration, termite inspection, advertising, and repairs directly related to the sale.

Non-selling expenses such as real estate taxes, interest, assessments, insurance and mortgage prepayment penalty are not deducted.

Part 1e: Costs

Adjusted costs = actual cost + any capital improvements - any depreciation/amortization  
 Inheritance = fair market value as of date of death  
 Gift = Use donor's adjusted base

Alternative basis = used only for property acquired prior to 6-1-71

Determined as follows for the proration method:

Sales Price x number of months before 6-1-71 + total number of months held

Cost x number of months after 6-1-71 = Prorated basis (P) total number of months held

Prorated basis + capital improvements after 6-1-71 - depreciation/amortization after 6-1-71

Part 1f: Gain or loss Subtract column E from Column D and enter gain or loss

### Five Rules Regarding Gain/Loss on Property Purchased Prior to June 1, 1971:

#### Income Producing Property

- If loss on adjusted basis, use adjusted cost.
- If gain on adjusted basis and gain on alternative basis, use the smaller gain.
- If gain on adjusted basis and loss on alternative basis, use 0, no gain or loss.

### Non-income Producing Property

- If adjusted basis is a loss, ignore alternative basis; use 0, no gain or loss.
- If gain on adjusted basis and gain on alternative basis, use the smaller gain

Line 2 = Subtotal the total gains and losses calculated under Part 1 and enter on PA Schedule D, Line 5.

### CALCULATION OF INSTALLMENT SALE INCOME PA SCHEDULE D-1

If the sale results in a loss, the installment method cannot be used, and the sale must be reported on PA Schedule D.

When real or tangible personal property is sold at a gain and any portion of the payments are received in a tax year after the year of sale, it is an installment sale. The taxpayer has the option to either report the entire proceeds in the year of the sale or report on the installment method. The installment sales method is not permitted for the sale of intangible personal property or transactions, the object of which is the lending of money or the rendering of services. An installment sale election cannot be revoked once made. If the installment method of reporting is elected, the taxpayer must use a Schedule D-1 to report the sale. Any interest received from the installment obligation is also reported as installment sale gain instead of interest income.

**NOTE:** If the property was acquired prior to June 1, 1971, the taxpayer must also obtain Schedule D-71 to determine the adjusted basis or alternative basis. Example: Lawrence Glenn sold his hunting cabin on Sept. 12 of the current year. He purchased it on Aug. 5, 1989. The purchase price was \$10,000, and he made improvements of \$500 for an adjusted basis of \$10,500. He sold the cabin for \$15,000, and closing costs were \$775 for net proceeds of \$14,225. It was sold on the installment plan with payments totaling \$4,383 the first year, of which \$4,100 was principal. For the second year he collected \$7,124, of which \$5,251 was principal.

Since Lawrence Glenn chose the installment sale method to report this sale, he must use Schedule D-1.



For the year of the sale, the Schedule D-1 shows a net profit in Part 1 of \$3,725 (\$14,225 - \$10,500) and Part 2 shows the calculation of the taxable part of installment sale for the first year. First the proportional gain ratio must be determined by dividing net profit by the gross sales price. In this example, it is 0.249 ( $\$3,725 \div \$15,000$ ). Apply the ratio to the principal payments received during the year ( $\$4,100 \times 0.249 = \$1,021$ ). Add to this figure interest payments received during the year, \$283 ( $\$4,383 - \$4,100$ ). The resulting figure is the taxable gain of \$1,304.

For the following year, Part 1 does not have to be completed on Schedule D-1. Part 2 starts with the same ratio as in the prior year, 0.249. This is applied to the principal payments received in the second year ( $\$5,251 \times 0.249 = \$1,308$ ). Add to this figure interest payments received during the second year, \$1,873 ( $\$7,124 - \$5,251$ ). The resulting figure is the taxable gain of \$3,181 ( $\$1,308 + \$1,873$ ).

Subsequent years would be done the same as the second year. If Mr. Glenn had decided not to use the installment method, PA Schedule D would be utilized and the entire amount of gain would be reported in the first year. Each year's interest on the installment sale would then be reported as interest income on PA Schedule A instead of gains. If Mr. Glenn was a nonresident and reported the entire gain in the year of sale, he would not report any interest income to Pennsylvania.

## LINE 6, PA-40 RENTS, ROYALTIES, PATENTS AND COPYRIGHTS PA SCHEDULE E

Rental income is income received for the use of real or personal tangible property subject to depreciation. Royalties are income received upon the extraction of coal, oil, gas or other minerals subject to depletion allowances or for the use of a patent or copyright. If the property is located in another state or country you must include the complete address of the property in the address field. For oil and gas royalties, enter the name of the oil and gas producer paying the royalties for each 1099-MISC received. For all other patent, copyright, or similar property or any other tangible personal rental property, enter the type of property and source of the income.

The department no longer accepts Page 1 of federal Schedule E in lieu of PA Schedule E. The following adjustment to federal income and expenses must be taken into account when using PA Schedule E.

- Passive rental/royalty loss must be claimed in full rather than carried over to future years as the federal Government allows.
- Oil and gas royalty payments received from mineral rights located under a farm are not considered farm income and should be reported on PA Schedule E.
- Depreciation expense on sales tax the taxpayer elected to currently expense for PA income tax purposes cannot be claimed (same as for PA Schedule C/F).
- Taxpayer's share of gain or loss from partnerships, PA S corporations or other entities must be shown separately.

**CAUTION:** Certain utilities, which are not subject to sales and use tax when purchased exclusively for residential use, become subject to sales and use tax when used for commercial purposes. Commercial purposes includes rental property owned by an individual and held out for rent by another individual or business. Exceptions include properties with separate metering for rental units and common areas where the common area utilities is included as used for commercial purposes and the rental unit property is residential rental property when the utilities are paid for by the tenants. If you are including electricity, natural gas, fuel oil, or kerosene in your calculation of utilities expense and the property is not listed as commercial property with the utility company or as a commercial entity with the fuel oil or kerosene supplier, you should report use tax due on the related expense amounts for these utility expenses on Line 25 of the PA-40.

### Not for Profit Rental

If a property is rented or leased without the intent to realize a profit, expenses are limited to income. Generally, Pennsylvania follows IRC Section 280A and any gain represented from income in excess of

expenses must be reported, but no loss will be allowed.

## DEPLETION

The Department of Revenue does not allow percentage depletion. The only recognized and allowable depletion is cost depletion.

## LEASE WITH OPTION TO BUY

A lease with an option to buy may be a purchase contract. If the payments received under the contract are payments of the purchase price, they are not includable in income as rental income. Such income should be reported on PA Schedule D.

## SELLING MINERAL INTEREST, PATENTS OR COPYRIGHTS

If a taxpayer gives up all rights to mineral interests, patents or copyrights, the amounts received are considered payments for the sale or exchange of property and should be reported on Schedule D.

## PROPERTY DAMAGE PAYMENTS

A property damage reimbursement resulting from the construction of temporary structures such as staging areas is taxable as rental income on PA Schedule E. Most contracts require the lessor to mitigate damage and restore the property to its original condition, thus no "damage" actually occurs. Payments received for the granting of a permanent right of way or an express easement of 15 years or more should be reported on PA Schedule D as a gain of the sale or disposition of property. Otherwise, payments received for temporary access to another property for a temporary easement or right of way are included as rental income. Report the amount of royalty income from oil and gas leases separately from any rental income for the same property. When reporting royalty income, use the gross amount reported to you on federal Form 1099-MISC.

## REPORTING MINERAL RIGHTS LEASE AND ROYALTY INCOME

Taxpayers who receive an upfront payment for the lease of oil or gas mineral rights and in subsequent

years receive royalty payments for the production of oil or gas from producing wells should report the income on PA Schedule E.

Report the amount of royalty income from oil and gas leases separately from any rental income for the same property. When reporting royalty income, use the gross amount reported to you on federal Form 1099-MISC.

## OIL AND GAS ROYALTY EXPENSES

Royalty income is derived from subsurface mineral or oil and gas rights. As a result, the expenses that relate to surface rights, such as real estate taxes and insurance are not allowable against royalty income. Mortgage interest is only allowable if the interest relates directly to the financing of the separately enumerated mineral or oil and gas rights. Expenses that relate directly to the production of royalty income, such as production costs payments and costs related to the negotiation or verification of the lease, are allowable. Direct reductions to payments from the lessor, such as production costs, transmission costs or gathering fees, are allowable and should be itemized under Line 17, Other Expenses. Expenses incurred by a landowner to restore a property damaged by staging areas, rights of way or structures are allowable expenses. However, expenses incurred by a landowner to improve the property or increase its value are not allowable.

**NOTE:** Depletion, specifically percentage depletion, is not an allowable expense for PA personal income tax purposes. Although cost depletion may be allowable, it requires that the landowner has clearly identifiable costs incurred with the acquisition of the mineral or oil and gas rights. These specific costs are not included within the general acquisition costs of the surface and must be separately enumerated in a purchase agreement in order to clearly identify the depletable amount of oil and gas rights from the property.

## LINE 7, PA-40 ESTATES OR TRUSTS

Distributions of trust corpus to a beneficiary are not taxable. Income received by the trust or estate on its assets that is currently distributable or, in fact, is

paid or credited to a beneficiary of the trust or estate is taxable to the beneficiary. If the taxpayer is a beneficiary of one or more trusts or estates, PA Schedule J must be completed to report the estate or trust income.

The taxpayer should have received PA Schedule RK-1 or NRK-1 indicating the taxable amount of estate or trust income. If the estate or trust did not file a PA return and did not provide a PA RK-1 or NRK-1, the taxpayer must report the amount shown on federal Schedule K-1, adjusted to reflect PA requirements. Note that only positive income figures may be used; negative figures are to be disregarded. If the income reported is from a PA Schedule RK-1 or NRK-1, this should be noted on Schedule J, and PA RK-1 or NRK-1 need not be submitted. However, if the figure is from federal Schedule K-1, a copy of the schedule must be included.

If the taxpayer is a nonresident, income from estates or trusts which is taxable to Pennsylvania includes PA business income, sale of PA assets and rent/royalty income from PA sources. It does not include interest or dividends from PA sources.

### **Revocable Trust**

If such a trust is established, report the income/loss constructively received in each PA income class in which income was earned, received or realized. Do not report the amounts on PA Schedule J. If submitting supporting schedules and statements showing the name of the trust, clearly write "Revocable" on the schedule.

However, the person (settlor) who established the revocable trust (including grantor trusts that are revocable) does not file PA-41 if, under the governing instrument, he/she retains authority to:

- Completely revoke the trust without the declaration of new uses or the consent of any other party; and
- Revest in him/herself the legal title to the corpus of the trust, without the consent of any other party. In this case, the settlor reports the income/loss in the appropriate income class or classes on PA-40.

### **Grantor Trust**

Generally, a grantor trust files PA-41. The beneficiaries of the trust, including the grantor if he/she receives income from the trust, report the income as beneficiaries on PA Schedule J.

## **LINE 8, PA-40 GAMBLING AND LOTTERY WINNINGS**

Enter the amount of gambling and lottery winnings.

Pennsylvania Lottery cash prizes paid on or after Jan. 1, 2016, are now subject to PA tax.

Any cash prize won by a PA resident or nonresident on a lottery ticket purchased in Pennsylvania is taxable for PA PIT purposes if the cash prize payment is made on or after Jan. 1, 2016. If a taxpayer is a PA resident and purchased a Powerball or Mega Millions ticket in another state, any prize won is PA-taxable income regardless of the date the prize is paid.

Cash prizes paid on or after Jan. 1, 2016 includes payments on annuities for prizes won in a previous tax year. Cash prizes paid on or after Jan 1, 2016 also includes any federal income tax, PA sales tax and any other fees and taxes paid on the value of a noncash prize on behalf of the prize winner.

For PA personal income tax purposes, a Lottery is any enterprise which involves a prize, a random determination of the winnings, consideration and some form of an entry. The entry may involve a purchase, attendance at an event, submitting an entry, signing an entry form or other similar actions. Taxable winnings, whether in cash or property, are awarded in games of chance and lotteries that require the participant to make some form of consideration, e.g., raffles, fish bowls, bingo, etc. If no consideration is given, it is not gambling and not taxable. Consideration could be money, services or an incentive to perform an activity by the entrant (which would not necessarily otherwise be done), such as mailing in an entry, telephoning or visiting a place of business or website.

As of Jan. 1, 2016, nonresidents of Pennsylvania are liable for PA income tax on PA-source winnings other than noncash winnings from the Pennsylvania Lottery. This includes racetrack winnings and slot machine

winnings in addition to all other forms of games of chance mentioned above.

The Department of Revenue requires PA Schedule T be completed for the reporting of gambling and lottery winnings. For PA residents, winnings from PA casinos and out-of-state casinos are taxable and must be reported on Schedule T. Nonresidents are only required to report PA-source winnings. Spouses must report gambling activities separately on separate Schedules T, and the losses of one spouse cannot be used to offset the winnings of the other.

### Losses

Pennsylvania Lottery tickets purchased on or after Jan. 1, 2016, may be used to offset other gambling and lottery winnings. You may offset other gambling and lottery losses against gambling and lottery winnings, e.g., cost of each bingo game or raffle ticket.

### Expenses

No expenses attributable to gambling and lottery income are deductible, e.g., travel, parking, postage, entry fees.

## K-1 INCOME

The IRS and TaxAide expanded the scope of income that VITA/TCE volunteers deal with to include certain K-1 income. This K-1 income includes:

- Interest income, including tax-exempt interest
- Dividend income
- Net short-term and net long-term capital gains and losses

K-1s are schedules for individual shareholders, partners or beneficiaries that show their distributed portions of income that passed through the entities to them at the individual level.

K-1s are received by any individual who is a shareholder in a corporation, a partner in a partnership or a beneficiary receiving a share of income through a trust. The individual owns a percentage of ownership in the corporation or partnership. When dealing with trusts, the individual, also referred to as the beneficiary, receives a certain percentage of income through the trust.

## Types of K-1s

- Federal Schedule K-1

**Form 1120S:** Given to taxpayers who are shareholders in a corporation

If there is a Code A in Box 16 of the K-1, review the statement that accompanies federal Schedule K-1 to determine the source of the tax-exempt interest. Refer to the list of tax-exempt interest in your Personal Income Tax Preparation Guide to see whether or not the amount in Box 16 should be included in interest income.

**Form 1065:** Given to taxpayers who are partners in a partnership

If there is a Code A in Box 18 of the K-1, review the statement that accompanies federal Schedule K-1 to determine the source of the tax-exempt interest. Refer to the list of tax-exempt interest in your Personal Income Tax Preparation Guide to see whether or not the amount in Box 18 should be included in interest income.

**Form 1041:** Given to taxpayers who are beneficiaries of a trust

Federal Schedule K-1 can be utilized when preparing returns for resident taxpayer.

Do not use federal Schedule K-1 for nonresident taxpayers; a nonresident taxpayer is only required to report PA-source income and the federal Schedule K-1 includes income earned from sources inside and outside of PA.

**PA Schedule RK-1:** Resident K-1 given to PA resident taxpayers who are shareholders in a corporation, partners in a partnership, or beneficiaries of a trust

**PA Schedule NRK-1:** Nonresident K-1 given to nonresident taxpayers who are shareholders in a PA corporation, partners in a PA partnership, or beneficiaries of a PA trust. Must use this K-1 if filing return for a nonresident; will only show taxpayer's PA-source income from the corporation, partnership, or trust.



## REPORT K-1 INCOME ON APPROPRIATE SCHEDULE

- Interest income from a K-1 should be reported on Schedule A (Line 7).
- Dividend income from a K-1 should be reported on Schedule B (Line 4).
- Net short-term/long-term capital gains or losses from a K-1 should be reported on Schedule D (Line 6).

**NOTE:** For trust K-1s, all positive income figures should be added together (without deducting any net losses from the combination of short/long-term capital gains) and reported as trust income on PA Schedule J, Income from Estates or Trusts, and on Line 7 of the PA return.

## LINE 9, TOTAL PA TAXABLE INCOME

Add Lines 1c, 2, 3, 4, 5, 6, 7 and 8 on Form PA-40.

**REMEMBER:** A loss in one class cannot offset a gain incurred in another class of income.

## LINE 10, PA-40 CONTRIBUTIONS TO MEDICAL SAVINGS ACCOUNTS, HEALTH SAVINGS ACCOUNTS AND IRS SECTION 529 TUITION ACCOUNT PROGRAMS

Pennsylvania allows contributions to health savings accounts, IRS Section 529 Tuition Savings Accounts and medical savings accounts to be claimed as deductions. If claiming a deduction for any of these contributions, one of the four followings codes must be entered in the space provided to identify the deduction being claimed.

- M** – Medical savings account
- H** – Health savings account
- T** – Tuition savings account
- C** – Combined deduction from two or all three of the above

In addition, PA Schedule O must be completed. In no case may the total of the deductions exceed the taxable income reported on Line 9 of Form PA-40.

In claiming the medical savings account and/or health savings account deduction, Pennsylvania follows federal rules. One must make a contribution to a medical savings account or health savings account for federal purposes. The taxpayer may then take the same deduction on Line 10. If married filing separate returns, only one spouse may take this deduction. Pennsylvania also follows federal rules concerning withdrawals from these accounts. The amount reported on Line 10 should be the same amount reported on the federal income tax return.

**NOTE:** PA law does not impose an additional 15 percent tax for nonmedical withdrawals. However, any amount included as income for federal income tax purposes as a result of a nonmedical withdrawal is included as interest income for PA income tax purposes.

If claiming a deduction for IRC Section 529 tuition account contributions, the limitation is on a per beneficiary, per taxpayer, per year basis, up to the amount of taxable income (if less than the \$14,000 per beneficiary, per taxpayer limit). A taxpayer and spouse would each be able to contribute \$14,000 to a qualified tuition plan for their child, provided each had income of \$14,000 (\$28,000 total income) separately included on their joint return. If a second beneficiary had an account, they could donate another \$14,000 each to that beneficiary as long as they each had income of \$28,000 (or \$56,000 total income) separately included on their joint return.

Contributions to a medical savings account are allowed up to the level allowed for federal income tax purposes. The amount comes from Line 36 of Form 1040, and a copy of the first page of the Form 1040 must be included with the PA-40 return to verify this amount.

Contributions to health savings accounts are also deductible to the extent they are allowed for federal income tax purposes. This amount comes from Line 25 of Form 1040, and a copy of the first page of the Form 1040 must be included with the PA-40 return to verify this amount.

**NOTE:** No deduction can be made for the rollover from one IRC Section 529 plan into another or for the changing of a beneficiary within account.



**LINE 11, PA-40 NET TAXABLE INCOME**

Subtract Line 10 from Line 9.

**LINE 12, PA-40 PA TAX LIABILITY**

Multiply net PA taxable income by the current tax rate and enter the result.

**CREDITS****LINE 13, PA-40 TOTAL PA INCOME TAXES WITHHELD**

Enter total PA tax withheld from PA Schedule W-2S or from Box 17 of Federal Form(s) W-2. Include the PA tax withheld from PA Schedule T or from Box 14 of Federal Form(s) W-2G. Also include any PA tax withheld from Box 10 of Federal Form(s) 1099-R. If any PA tax was withheld from nonresident partners or shareholders, the tax withheld should be shown on Line 17 of Form PA-40.

If an employee expects to be entitled to 100 percent Tax Forgiveness in the current year and was entitled to 100 percent Tax Forgiveness the preceding year, he/she should obtain an Employee's Nonwithholding Application Certificate, Form REV-419, from the employer so that PA income tax withholding may be suspended. This form must be filed each year. When applicable, it must be revoked within 10 days of the date any PA income tax liability will be incurred during the current year.

**NOTES:** When required, a PA income tax return must be filed even if a taxpayer is exempted from withholding.

If tax withheld materially differs from the current tax rate, the taxpayer should be advised to obtain verification from a financial officer on company letterhead of tax actually withheld. If figures appear to have been altered, similar verification should be obtained.

PA personal income tax withholding is required for all Pennsylvania Lottery cash prizes greater than \$5,000 paid after July 12, 2016. In addition, many of the casinos in Pennsylvania offer voluntary withholding of PA personal income tax. If there is PA tax withheld included in Box 15 of federal Form(s) W-2G, report the withholding on Line 7 of PA Schedule T.

**FILING TIP:** A copy of federal Form(s) W-2 must be included with a return if the tax was withheld at a rate greater than 3.07 percent. Copies of any federal Form(s) W-2G or 1099-R that include PA personal income tax withholding must also be included with the return.

**LINES 14, 15, 16, 17, 18; PA-40 PA ESTIMATED TAX PAYMENTS FOR PA-40****Line 14. Credit from Prior Year PA Income Tax Return**

Enter on Line 14 the credit on current year estimated tax claimed from an overpayment on the taxpayer's immediate prior return.

**Line 15. Estimated Installment Payments**

Enter the amount of estimated tax payments for the current year.

**FILING TIP:** If a taxpayer and spouse made separate estimated installment payments, they should each file separate returns claiming only their own payments. If a taxpayer and spouse made joint estimated payments, they should file a joint return. Filing in this manner will avoid processing delays. If joint estimated payments were made and the taxpayer and spouse decide to file Married, Filing Separately, they should complete and submit REV-459B, Consent to Transfer, Adjust or Correct PA Estimated Personal Income Tax Account. A taxpayer and spouse can tell the department which payments to post under each name and Social Security number. Both spouses must sign this form.

**NOTE:** For married couples with a joint estimated account who are filing separately, the department may delay processing until it receives both tax returns.

**Line 16. Payment Made with Request for Extension**

This line reflects payment made with a request for an extension of time to file.

**Line 17. Tax Withheld as Reported on PA Schedule NRK-1**

Nonresident tax withheld from PA Schedules NRK-1. For use by nonresident partners, shareholders, members and beneficiaries. Include the amount from

Line 6 of the PA Schedules NRK-1 that indicate an amount withheld.

### **Line 18 Total Estimated Payments**

Add Lines 14 through 17.

## **REQUIREMENTS FOR MAKING ESTIMATED PAYMENTS**

If a taxpayer expects to have more than \$8,000 of PA-taxable income not subject to employer withholding in the tax year (interest, dividends, gains, self-employment income), he/she must make estimated tax installments payments. If the nonwithheld income produces a tax due of \$246, the taxpayer needs to file a declaration and pay estimated tax for next year in equal installments (April 15, June 15, Sept. 15 and Jan. 15). Even if the taxpayer is not required to make estimated payments due to Tax Forgiveness, a Pennsylvania income tax return must be filed.

### **Exceptions:**

- If a taxpayer expects to obtain at least two-thirds of the total estimated gross taxable income from farming for the period, the taxpayer has the option of either filing the PA-40 and paying the estimated tax at any time up to March 1 or paying the entire estimated tax by Jan. 15. This option applies if the farm schedule (PA Schedule F) shows the gross income on Line 12 is greater than or equal to two-thirds of the amount on Line 11 of the PA-40. Since the amount on Line 12 of PA Schedule F is not required on the PA-40, these amounts will have to be compared for evaluation.
- If a taxpayer's total estimated tax is \$246 or less, he/she has the option of filing his/her declaration and paying his estimated tax at any time up to Jan. 15 following the close of the tax year
- If an individual expects to be entitled to 100 percent Tax Forgiveness in the current year, no estimated payments should be submitted. If during the year the taxpayer realizes a non-forgiven tax liability will be incurred, he/she should immediately begin making payments to make up any missed payments and to spread

any remaining payments out over the remaining quarters.

A taxpayer whose estimated tax exceeds \$246 for the taxable year may opt to make one payment by April 15 of the tax year.

In the event that circumstances change during the year making payment of estimated tax necessary, the first payment amount should be calculated to make up any previous payment periods missed and to spread out the additional amount over the remaining payment periods.

The estimated tax declaration should be made on Form PA-40ES. This form is sent to taxpayers who made a declaration for the prior taxable year.

A first-time estimated tax filer should use Form PA-40ESR. Copies of Form PA-40ESR can be obtained from any Revenue district office or downloaded from the department's website. Specific instructions for estimating personal income tax and filing the form are explained in Form REV-413,

An estimated underpayment penalty can be imposed if timely prepayments are not at least 90 percent of the tax as shown on the return and can result in assessment of interest/penalty against the taxpayer. Under PA law these penalties are calculated on a quarterly basis. These penalties are based on a daily calculation of interest on the underpayment.

The amount of estimated payments credited, other than a payment made with an extension, may be verified by the taxpayer. He/she may call the department's automated 24-hour toll-free line, 1-(888) PATAXES (728-2937) or verify payments online at [www.revenue.pa.gov](http://www.revenue.pa.gov).

### **Estimated Underpayment Penalty**

The penalty will be imposed if:

- There is \$8,000 of taxable income that was not subject to PA withholding; and
- The credits for tax withheld, Tax Forgiveness, taxes paid to other states and the other credits do not offset the tax due on the \$8,000 of income not subject to withholding, and estimated payments were not made to offset the liability on the income.

No penalty will be imposed if:

- Each installment payment due and made is equal to the installment payment that should have been made based upon the prior full year's income at the current years tax rate; or
- Each estimated tax installment made is equal to 90 percent of the installment payment due for each quarter based upon the actual income received during that period.

**NOTE:** Unlike federal guidelines, PA penalty determination is based upon the quarterly amount of tax due, not necessarily on one-quarter of the final amount. If the department determines the payments were not properly made, REV-1630 must be submitted along with an explanation of why the calculation is in error.

## **LINES 19A, 19B, 20, 21; PA-40 TAX FORGIVENESS CLAIMED ON SCHEDULE SP GENERAL INFORMATION AND INSTRUCTIONS**

The law allows a joint claim for married persons and defines a dependent for Tax Forgiveness purposes as a dependent child for federal purposes. The allowance for each dependent child is \$9,500. For qualifying married claimants, eligibility income begins at \$13,000. For qualifying single claimants, eligibility income starts at \$6,500. A PA Schedule SP must be filed to claim Tax Forgiveness. A dependent child is eligible for Tax Forgiveness if a dependent of a parent (parents) who is (are) eligible for Tax Forgiveness. The dependent child must file a separate PA tax return and PA Schedule SP. Please read all the instructions before you begin.

### **WHAT IS TAX FORGIVENESS?**

Tax Forgiveness is a credit that allows eligible taxpayers to reduce all or part of their PA tax liability.

Tax Forgiveness:

- Gives a state tax refund to some taxpayers; and
- Forgives some taxpayers of their liabilities even if they have not paid their PA personal income tax.

### **WHO IS ELIGIBLE FOR TAX FORGIVENESS?**

A person and spouse (if applicable) are eligible if:

- He/she/they is/are subject to PA personal income tax. A person and/or spouse are liable for PA tax on income (or would be liable if he/she/they earned, received, or realized PA-taxable income);
- He/she/they is/are not a dependent on another person's federal tax return; and
- He/she/they meet the eligibility requirements.

**NOTE:** A dependent child may be eligible if he or she is a dependent on the PA Schedule SP of his or her parents, grandparents, or foster parents and they also qualify for Tax Forgiveness.

If the taxpayer is unmarried or deceased, he/she must meet all three requirements. If married, a joint claim may be filed if at least one spouse meets all three requirements. A joint return may also be filed if each meets the eligibility requirements.

#### **Eligibility Income**

Eligibility income is the total taxable and non-taxable income earned in the year the taxpayer is claiming the SP credit. Since eligibility income is different from taxable income, taxpayers must fill out a PA Schedule SP. Certain sources of income, such as Social Security and workers compensation, are not included in determining eligibility income. The level of Tax Forgiveness decreases by 10 percent for every \$250 increase in income. Please review Part C of "Specific Instructions for PA Schedule SP" for further clarification on what income should be included to determine eligibility income.

#### **Line 19a Filing Status**

The filing status for Schedule SP purposes must be indicated by filling in the appropriate oval. This may not always correspond to the filing status on the return.

A person is considered unmarried during the year if:

- Single;
- Divorced; or

- Widowed and could not or did not elect to file a joint return in the year of death of the taxpayer and/or spouse.

A person is considered separated for the year if:

- Separated and lived apart at all times during the last six months of the year; or
- Separated pursuant to a written separation agreement (see below). A person is considered married during the year if:
  - Married and lived together;
  - Separated and lived apart for less than the last six months of the year;
  - Separated, but not by a written agreement; or
  - A joint return was elected to be filed in the year of death with a deceased taxpayer and/or spouse.

Married claimants are not dependents of one another for either federal tax or PA Tax Forgiveness purposes. This is true even if one spouse has no income. However, even if the spouses elect to file separate income tax returns, they are considered married for Schedule SP purposes and must base the forgiveness percentage on the joint eligibility income.

A person is deceased if he/she died during the tax year and/or the deceased person's surviving spouse or deceased spouse could not or did not elect to file a joint return with the deceased taxpayer. Annualization of a deceased taxpayer and/or spouse's income may be required in order to determine total eligibility income for Tax Forgiveness purposes.

### **Joint or Separate Returns**

Spouses who lived together should file a joint PA personal income tax return to claim Tax Forgiveness, unless required to file separately. In addition to the other requirements for filing separate PA-40s, spouses must also file separate returns if one spouse is claimed as a dependent on another person's federal income tax return and either the self-supporting spouse or both are eligible for Tax Forgiveness. However, even in this situation, a married couple must base their Tax Forgiveness eligibility on their joint income. If Tax Forgiveness is not a factor, the

couple may file a joint PA-40. There is no advantage in filing separate returns for Schedule SP purposes.

### **Annualization of Income**

Annualization of income is the process of determining a deceased taxpayer's income as if the person had lived the entire tax year. It is dependent not only on the taxpayer's date of death but is also determined by the nature of the income reported for a tax year. For example, if the income is of a nature that it is paid throughout the year, the income must be projected out for the entire year. However, if the income is from a one-time transaction, no projection of the income for the entire year is required. This ensures that income received during the life period of the person includes what might have been earned during the period after the person dies since the income eligibility tables and exemption amounts are based on annual amounts.

Annualization of income may or may not be required if the taxpayer and/or spouse die during the tax year. It may be required on certain types of income and not be required on others. Depending on the filing status selected for deceased taxpayers, annualization of income may also be required if a combination of factors exist.

In order to annualize a taxpayer's taxable income, you may use the taxable income realized by the decedent, divided by the number of days or months the taxpayer lived and multiplied by 365 days or 12 months. Subtract from that product the amount of realized income and include the remainder in the amount reported on Line 2 of Part C for PA Schedule SP. One time transactions, such as those from the sale of stock or real property, need not be included when determining the amount of the daily or monthly income for a decedent. For other nontaxable items of income, determine the annual amount that would have been received for each line and include the annualized amount for any income amount received ratable over the course of a year on the appropriate line of Part C for PA Schedule SP.

When determining the amount of annualized income, you may also base the total eligibility income on the prior year's return if the individual was eligible for Tax Forgiveness, received approximately the same



income during this taxable year and did not have any transactions that were different from the previous tax year. The department will usually accept a reasonable calculation of the decedent's annual eligibility income.

Some examples of when annualization of income is required and the types of income that are required to be annualized are as follows:

- Jerry and Pat have been married for 50 years and Jerry dies on October 1 of the most recent tax year. Pat elects to file a joint return with her deceased spouse. Jerry worked as a custodian for a local school to supplement their social security income and died while still employed. Jerry and Pat also had joint interest and dividend income during the tax year. Jerry's compensation income must be annualized and the amount Jerry might have earned for the remaining three months of the tax year must be included on Line 2 in Part C of PA Schedule SP. Because Pat elected to file a joint return with her deceased spouse, the interest and dividend income from the joint ownership of the assets are not required to be annualized.
- Jay and Liz are retired and have interest, dividends and capital gains that they report every tax year from cds, bank accounts and stocks and bonds they each hold/own separately. Liz dies on May 1 of the most recent tax year and the executor of the estate does not elect to file a joint return with the surviving spouse. Jay is not required to annualize the income he earned during the tax year, but Liz's executor must annualize her Income. The interest and dividend income she earns must be annualized by the executor to report the income that may have been earned during the remaining eight months of the tax year in order to determine her eligibility income for Schedule SP purposes. The executor is not required to annualize any capital gains reported during the period of January 1 to May 1.
- Bob and Peggy are retired and all the income they have is from jointly owned property. Peggy dies on August 15 and the administrator of her

estate does not elect to file a joint return with her surviving spouse. Bob must report on his tax return one half of all the income earned by the couple through the date of Peggy's death and then reports the full amount of the income from the jointly owned property thereafter. Peggy's administrator must report one half of the joint income through the date of her death and must annualize her income to determine the amount of annualized income to include for the remaining four and a half months of the tax year on PA Schedule SP, Part C, Line 2 to determine if she is eligible for Tax Forgiveness.

- Bud and Mary have filed joint tax returns for the three years they have been married. During January of the most recent tax year, Bud is diagnosed with a terminal illness and he retires from his position as a truck driver in February of that year after four years of service and he elects to take his retirement pay in a lump sum distribution. Bud and Mary also have dividend and interest income from joint ownership of their assets and accounts of \$300. Bud dies on July 31 of the most recent tax year without any life insurance. Mary elects to file a joint return the following spring and include her deceased spouse's income of \$3,500 along with her wages of \$8,000. Bud's compensation should not be annualized because he was retired from service prior to his death. The interest and dividend income are also not required to be annualized as Mary elected to file a joint return with her deceased spouse.
- Tony is a single taxpayer who owns his own business which reports its income on a Schedule C and a rental property where the income is reported on Schedule E. Tony is involved in an automobile accident and dies on June 30 of the most recent tax year. Tony's brother is the executor of his estate and files the final tax return for his brother, his business and his rental property. Tony's brother must annualize his brother's business income and rental income in order to determine if he is eligible for Tax Forgiveness. Tony's brother must include the income he realized through the date of death plus the annualized income for another six



months from both the business and rental properties.

**IMPORTANT:** Surviving spouses should not include any income in respect of a decedent, income that should be included on the estate tax return, or any income of the deceased taxpayer (including the decedent's half of any joint income received prior to the decedent's date of death) in the taxable income or in the calculation of the eligibility income of the surviving spouse when a separate return is filed by the surviving spouse.

**NOTE:** This annualized amount is mandated by law and is used solely for the calculation of Tax Forgiveness. It is not used for the calculation of tax.

### **Who is Considered a Dependent for Tax Forgiveness?**

A dependent is a minor or adult child claimed as a dependent on a federal income tax return. The Department of Revenue has a two-step test for a dependent child:

#### **1. Is the individual a child of the claimant?**

For PA income tax purposes, child includes the natural child, adopted child, or step-child of a parent. Child also includes a grandchild of a grandparent and a foster child of a foster parent. Therefore, a son or daughter, a grandchild, or a foster child can be claimed as a dependent on PA Schedule SP if the child can be claimed as a dependent on the federal income tax return. However, an aunt, uncle, or unrelated person cannot claim a child as a dependent as defined above, even if claiming the child as a dependent on a federal income tax return unless granted custody by a court of law.

#### **2. Can the claimant claim the child as a dependent for federal tax purposes?**

The age, status as a full-time student, and gross income of a daughter, son, granddaughter, grandson, or foster child are factors only in determining whether the claimant can claim the child as a dependent for federal purposes. For example, parents that can claim a qualifying 30-year-old child for federal purposes can claim that child as a dependent for PA Schedule SP purposes.

You cannot claim a dependent child on PA Schedule SP if:

- The dependent is not the taxpayer's child, as defined above;
- The child cannot be claimed on the taxpayer's federal tax return;
- The taxpayer is unmarried for Tax Forgiveness purposes, and their former spouse by agreement or court decree can claim the child as a dependent for federal and PA Schedule SP purposes; or
- The child's other parent, by agreement or court decree, can claim the child as a dependant for federal tax and PA Tax Forgiveness purposes.

You cannot claim any other adult as a dependent, even if doing so on a federal tax return. A dependent child with taxable income in excess of \$33 must file a PA tax return. If that child's parents qualify for Tax Forgiveness, that child is also eligible for this credit. The child must file a tax return and a PA Schedule SP. The child must also include any child support paid to his/her parent in his/her Eligibility Income.

### **Specific Instructions for PA Schedule SP**

Be sure to enter the name of the claimant(s) and Social Security number(s). If filing for a married couple filing separately, both names and numbers must be entered.

#### **Part A. Determining Filing Type for Tax Forgiveness**

Be sure to answer the two eligibility questions to determine if the person claiming this credit is a dependent on another person's federal income tax return and if the person claiming him/her qualifies for Tax Forgiveness.

- If the taxpayer is unmarried as defined earlier, fill in this oval and the corresponding "unmarried" oval on Line 19a of the tax return. Also, fill in the appropriate oval to indicate if this category is selected because the taxpayer is:
  - Single, unmarried as of Dec. 31. This includes divorced and widowed individuals who did not remarry during the year, and who could not or did not elect to file a joint return in the year of death of the taxpayer and/or spouse; or

- Single and claimed as a dependent on a parent(s) PA Schedule SP. The Social Security number and name of the person(s) claiming the individual must be noted.
- If the taxpayer is separated pursuant to a written agreement or married but has lived apart for the last six months of the tax year, fill in this oval and the corresponding "unmarried, or separated" oval on Line 19a of the tax return.
- If the taxpayer is married, fill in this oval and the corresponding "married" oval on Line 19a of the tax return. Also, fill in the appropriate oval to indicate if this category is selected because the taxpayer is:
  - Married and claiming tax forgiveness together on a joint return;
  - Married and filing separate tax returns (Be sure the spouse's name and Social Security number are entered at the top of the schedule.);
  - Married with a spouse who is a dependent on another person's PA Schedule SP or federal income tax return. This other person's name and Social Security number must be noted; or
  - Separated and lived apart from their spouse but for less than the last six months of the year; or
  - Electing to file a joint return with a deceased spouse. Remember to annualize the deceased taxpayer's and/or deceased spouse's income to determine eligibility income for the Tax Forgiveness credit.
- If the taxpayer is deceased, and could not or did not elect to file a joint return with a surviving spouse fill in this oval and the corresponding "deceased" oval on Line 19a of the tax return. Remember to annualize the decedent's income to determine eligibility for the Tax Forgiveness credit.

### **PART B. Dependent Children**

Enter here only the dependent children the taxpayer can claim as dependents for federal tax purposes.

If the taxpayer cannot list a child on the federal tax return, he or she may not claim that child for tax forgiveness purposes. Married persons are never dependents of each other on PA Schedule SP, even when one spouse has no eligibility income. The taxpayer must provide the number of dependents to determine the percentage of Tax Forgiveness. If claiming a foster child or if the last name is different from that of the claimant, a copy of Page 1 of Form 1040 or 1040A showing the child's name should be included. If there are no dependents, go to Part C.

Line 1: Provide all requested information for each child.

Line 2: Number of Dependent Children. Enter here the number of dependent children being claimed for tax forgiveness purposes. This number should also go on Line 19b of the PA-40.

### **PART C. Line Instructions for PA Schedule SP**

Leave the line blank if there is no income to report on a line. For Lines 2 through 10, calculate and enter the total income received in each category. Nontaxable income includes income not taxable under PA law or regulations and may or may not be taxable for federal purposes. Read each description carefully.

If filing for an unmarried person, married filing jointly return with a surviving spouse complete Column A.

If filing for a deceased individual, complete Column A. The annualized income of deceased individuals should be included in each category.

If married taxpayers are filing separately, Columns B and C must be completed, and jointly held income must be divided between them. If both taxpayers have taxable income, both may file for Tax Forgiveness and complete PA-40 Schedule SP. The schedules will be identical with the exception that the figures in Columns B and C will be reversed. If one taxpayer is not required to file due to his/her taxable income being less than \$34, that spouse need not file. The total eligibility income of both spouses must be added together and shown in Line 11. The percentage of Tax Forgiveness is based on the joint income of both spouses.

- Line 1: Taxable income is the PA taxable income amount(s) from Line 9, Total PA Taxable Income, from Form PA-40's tax return. Taxpayers are not permitted to qualify for Tax Forgiveness by reducing PA-taxable income through contributions to tuition account programs, health savings accounts or medical savings accounts.
- Line 2: Nontaxable income including interest, dividends and gains includes income from investments in direct obligations of the federal government (such as U.S. Savings Bonds), Pennsylvania and political subdivisions of Pennsylvania, even if received through a mutual fund or other regulated investment company. Include the tax-exempt interest from Lines 6 and 7 of PA Schedule A and any exempt-interest dividends included in Line 3 of PA Schedule B. If originally issued before Feb. 1, 1994, enter any gains realized from sales of these obligations. Include the nontaxable portion of gain on property acquired before June 1, 1971. Include nontaxable income received as a beneficiary of an estate or trust. Include payments to the taxpayer's employer's cafeteria plan for hospitalization, sickness, disability or death and the value of personal use of employer owned or leased property. Include payments received as a foster parent and supplemental unemployment or strike benefits. Include the amount of any annualized income for a deceased taxpayer. Include the difference between the annualized income for the year and the taxable income at the deceased taxpayer along with any annualized nontaxable income. Also include FEMA money received during the tax year.
- Line 3: Alimony is considered the amount of federally taxable alimony received.
- Line 4: Insurance proceeds and inheritance includes the total proceeds received from life or other insurance policies. This also includes payments from long-term care insurance policies irrespective of whether made to the holder of the policy or to another entity. It includes inherited cash or the value of property received as well as the amount received as reported on federal Form 1099-R with distribution Code 4 reported in Box 7 of the form.
- An inheritance also includes the amount that is received of an IRA or pension plan inherited by a spouse. It does not include the value of any jointly held real property transferring from one spouse to another. In addition, include an survivor annuity benefits reported on federal Form 1099-R with distribution Code 7 reported in Box 7.
- Line 5: Gifts, awards and prizes include the total amount of nontaxable cash or property received as gifts from others. Also include awards given in recognition of civic and social achievements and noncash winnings from the PA Lottery. Also included are court awards less attorney fees and reimbursed medical expenses. Court awards that represent wage replacement should not be entered here, but should be included as compensation on Line 1 of the PA-40.
- Line 6: Nonresident income includes the total of all income received while residing outside Pennsylvania. This includes income that would otherwise be taxable if earned and received in Pennsylvania.
- Line 7: Nontaxable military income represents the difference between the total military income earned and the amount reported to Pennsylvania as taxable on the PA income tax return. Combat zone pay or hazardous duty pay should not be included.
- Line 8: Gain excluded on sale of a residence consists of the total excluded.
- Line 9: Educational Assistance should include the total value of nontaxable scholarships, fellowships and stipends received, but not loans. Include the value of tuition reductions. Do not include awards made directly to your dependent child. Your child

must include this in his/her eligibility income for SP. Federal grants, state grants, Pell grants and grants issued by colleges for education are includable income for tax forgiveness. Subsidized Stafford loans are not part of eligibility income for Tax Forgiveness.

Line 10: Cash receipts for personal purposes from outside your house include nontaxable cash or property received for personal use from spouses, former spouses, children, parents or any other person not living with the taxpayer(s). Include help with taxes or rent or utilities if the cash is given to the taxpayer(s) but not if paid to the landlord, tax collector or utility directly. It also does not include payments received by a parent for child support – these are reported on the PA Schedule SP of the child for whom the support is intended – if that child is eligible. However, any payments received for the providing of in-home care for the foster children must be included. Do not include any money exchanged between household members to pay expenses such as deposits to joint bank accounts or rental like payments from children living at home. Also, include any nontaxable payments made to an employer's cafeteria plan for hospitalization, sickness, disability or death; supplemental unemployment; or strike benefits. This only applies to the contributions into these plans and not to the subsequent benefits derived. Any amounts attributable to the value of the personal use of an employer owned or leased property and any governmental educational grants must be included here. In case of a Chapter 7 or 11 bankruptcy filed under Section 1398 of the Internal Revenue Code, the total amount of income reported on Line 7 of PA-41 Fiduciary Income Tax Return for a resident bankruptcy estate prepared on behalf of the debtor taxpayer should also be reported here.

Line 11: Total eligibility income is the total of Lines 1 through 10 in each column. It is the total amount of PA-taxable and nontaxable income required to be included.

- If Unmarried, Married Filing Jointly or Deceased, use total eligibility income from Column A and enter on Line 20 of the PA-40.
- If Married Filing Separately, use total eligibility income from Columns B and C and enter on Line 20 of the PA-40.

## PART D.

### Calculating Your Tax Forgiveness Credit:

Line 12: PA tax liability is the tax due from Line 12 of PA-40 before any credits.

Line 13: Enter the resident credit from Line 22.

Line 14: Subtract Line 13 from Line 12 for net tax liability.

Line 15: The percentage of Tax Forgiveness depends on the taxpayer's status:

- Unmarried and Deceased filers use Eligibility Income Table 1.
- Married filers use Eligibility Income Table 2. Use the number of dependents from Part B, Line 2 and the Eligibility Income from Part C, Line 11 on the appropriate Eligibility Income Table to find the percentage of Tax Forgiveness. Enter the percentage of forgiveness in the space provided and as a decimal on Line 15.

Line 16: The Tax Forgiveness Credit is calculated by multiplying Line 14 by the amount on Line 15. Enter the figure on Line 22 of the PA-40.

Income that is not included for determining tax forgiveness eligibility:

- Retirement benefits
  - Social Security income
  - Nontaxable pension distributions

**ELIGIBILITY INCOME TABLE 1. Unmarried, Separated and Deceased Claimants**

If your Eligibility Income from PA Schedule SP, Line 11, does not exceed:

YOU →	\$6,500	\$6,750	\$7,000	\$7,250	\$7,500	\$7,750	\$8,000	\$8,250	\$8,500	\$8,750
<b>▼ DEPENDENT CHILDREN</b>										
1	\$16,000	\$16,250	\$16,500	\$16,750	\$17,000	\$17,250	\$17,500	\$17,750	\$18,000	\$18,250
2	\$25,500	\$25,750	\$26,000	\$26,250	\$26,500	\$26,750	\$27,000	\$27,250	\$27,500	\$27,750
3	\$35,000	\$35,250	\$35,500	\$35,750	\$36,000	\$36,250	\$36,500	\$36,750	\$37,000	\$37,250
4	\$44,500	\$44,750	\$45,000	\$45,250	\$45,500	\$45,750	\$46,000	\$46,250	\$46,500	\$46,750
5	\$54,000	\$54,250	\$54,500	\$54,750	\$55,000	\$55,250	\$55,500	\$55,750	\$56,000	\$56,250
6	\$63,500	\$63,750	\$64,000	\$64,250	\$64,500	\$64,750	\$65,000	\$65,250	\$65,500	\$65,750
7	\$73,000	\$73,250	\$73,500	\$73,750	\$74,000	\$74,250	\$74,500	\$74,750	\$75,000	\$75,250
8	\$82,500	\$82,750	\$83,000	\$83,250	\$83,500	\$83,750	\$84,000	\$84,250	\$84,500	\$84,750
9	\$92,000	\$92,250	\$92,500	\$92,750	\$93,000	\$93,250	\$93,500	\$93,750	\$94,000	\$94,250

Then your Percentage of Tax Forgiveness and the Decimal Equivalent is:

100%	90%	80%	70%	60%	50%	40%	30%	20%	10%
1.0	.90	.80	.70	.60	.50	.40	.30	.20	.10

NOTE: If claiming more than nine (9) dependent children, go to the PA PIT Guide on the department's website.

**ELIGIBILITY INCOME TABLE 2. Married Claimants, even if filing separately**

If your Eligibility Income from PA Schedule SP, Line 11, does not exceed:

YOU & → SPOUSE	\$13,000	\$13,250	\$13,500	\$13,750	\$14,000	\$14,250	\$14,500	\$14,750	\$15,000	\$15,250
<b>▼ DEPENDENT CHILDREN</b>										
1	\$22,500	\$22,750	\$23,000	\$23,250	\$23,500	\$23,750	\$24,000	\$24,250	\$24,500	\$24,750
2	\$32,000	\$32,250	\$32,500	\$32,750	\$33,000	\$33,250	\$33,500	\$33,750	\$34,000	\$34,250
3	\$41,500	\$41,750	\$42,000	\$42,250	\$42,500	\$42,750	\$43,000	\$43,250	\$43,500	\$43,750
4	\$51,000	\$51,250	\$51,500	\$51,750	\$52,000	\$52,250	\$52,500	\$52,750	\$53,000	\$53,250
5	\$60,500	\$60,750	\$61,000	\$61,250	\$61,500	\$61,750	\$62,000	\$62,250	\$62,500	\$62,750
6	\$70,000	\$70,250	\$70,500	\$70,750	\$71,000	\$71,250	\$71,500	\$71,750	\$72,000	\$72,250
7	\$79,500	\$79,750	\$80,000	\$80,250	\$80,500	\$80,750	\$81,000	\$81,250	\$81,500	\$81,750
8	\$89,000	\$89,250	\$89,500	\$89,750	\$90,000	\$90,250	\$90,500	\$90,750	\$91,000	\$91,250
9	\$98,500	\$98,750	\$99,000	\$99,250	\$99,500	\$99,750	\$100,000	\$100,250	\$100,500	\$100,750

Then your Percentage of Tax Forgiveness and the Decimal Equivalent is:

100%	90%	80%	70%	60%	50%	40%	30%	20%	10%
1.0	.90	.80	.70	.60	.50	.40	.30	.20	.10



- Nontaxable IRA distributions and other federally recognized retirement plans
- Disability payments
  - Worker's compensation
  - Occupational Disease Acts benefits
  - Social Security income
- Third party sick pay
- Welfare benefits
- Unemployment compensation
  - SUB pay
- Reimbursements from major medical insurance plans
- Combat zone pay and hazardous duty pay

## EMPLOYEE'S NONWITHOLDING APPLICATION CERTIFICATE

If a person subject to withholding received full Tax Forgiveness last year and expects to qualify for full forgiveness of his/her tax liability this year, he/she can file an Employee's Nonwithholding Application Certificate, REV-419, with the employer. This application expires on Dec. 31 and must be filed each year to gain exemption.

The application must be revoked in writing to the employer within 10 days from the day the employee anticipates he/she will exceed the 100 percent Tax Forgiveness eligibility income.

**IMPORTANT:** One must file a PA-40 and a Schedule SP to file this application.

## LINE 22, PA-40 TAXES PAID BY PA RESIDENTS TO OTHER STATES

If the taxpayer is a PA resident and has income subject to both PA personal income tax and income or wage tax from another state, credit can be claimed for all or a portion of tax paid to the other state on PA Schedule G-L. Part-year residents may claim this credit for the part of the taxable year they were PA

residents. Nonresidents are not eligible for this credit. A copy of the other state's return must be submitted.

If a PA resident received compensation solely from Ohio, Indiana, Maryland, Virginia, West Virginia or New Jersey, no out-of-state credit can be taken on this income unless the compensation is paid to Ohio resident shareholder-employees with a 20 percent or greater interest in a PA S corporation who worked or performed services in Pennsylvania. These states do not impose tax on compensation earned by PA residents if the PA resident has filed a certificate of nonresidence with the reciprocal state similar to Form REV-419. However, if any other type of income is received, or if the other state considers the PA resident a resident of its jurisdiction for taxing purposes, then the out-of-state credit can be claimed. If taxed as a resident in a reciprocal state, a copy of the resident tax return for that state must be submitted.

- If the taxpayer is a shareholder or partner, submit the following: a completed PA Schedule G-L for each state in which a credit is claimed; the statement from the partnership or S corporation providing the breakdown of the states and amounts and classes of income subject to tax in each state; a copy of your PA Schedule(s) RK-1; and a copy of the other states' tax returns. If you are a shareholder or partner and the S corporation or partnership files a composite return on your behalf for the other state or states, your partnership or PA S corporation submits the other state's return with its PA-20S/PA-65 Information Return and a copy of the other states tax returns are not required to be included with the PA-40. In such cases, submit a statement from the S corporation or partnership providing the breakdown of the income and taxes paid to each state on your behalf.

A separate PA Schedule G-L must be completed for each state for which credit is being claimed. The credit is limited to tax paid to the other state or the current tax rate applied to PA taxable income earned in the other state whichever is lower.

If the income on which the credit is being claimed is from a partnership or subchapter S corporation, PA Schedule G-L must be completed and the statement from PA Schedule RK-1 must also be included with the return if the credit claim is from multiple states. A copy of the other state's return is not required as it is submitted by the partnership's or subchapter S corporation's PA-20S/PA-65 Information Return.

**NOTE:** No credit is allowed if the taxpayer's subchapter S corporation has elected NOT to be taxed as a PA S corporation.

**NOTE:** Due to exemptions, deductions and graduated tax rates of other states, the amount shown as withheld on the W-2 or K-1 to another state does not accurately represent that state's liability and, therefore, must be accompanied by a copy of the other state's tax return. If the credit claimed is from an RK-1, be sure to enclose it with the return.

These forms are available online and through the department's Forms Ordering Services.

### **LINE 23, PA-40 SCHEDULE OC**

If claiming any of these credits, a taxpayer and spouse must file separate returns.

The credits listed on PA Schedule OC are restricted credits meaning taxpayers or entities must obtain special documentation authorizing the use of the credits. Documents must also be sent to the Bureau of Corporation Taxes so the credit can be verified and applied to the taxpayer. Additional information on restricted credits is available in Chapter 17 of the PA PIT Guide found on the department's website at [www.revenue.pa.gov](http://www.revenue.pa.gov).

This form is available online and through the department's Forms Ordering Services.

### **LINE 24, PA-40 TOTAL PAYMENTS AND CREDITS**

Add Lines 13, 18, 21, 22 and 23 of the PA-40 and enter the total on Line 24.

### **LINE 25, PA-40 USE TAX**

Use tax is the counterpart of sales tax and applies to taxable purchases made over the Internet, through

toll-free numbers, from mail order catalogs and from out-of-state locations, or any other occasion where sales tax was not charged and collected by the seller. The use tax rate is the same as the sales tax rate: 6 percent state tax, plus an additional 1 percent local tax for items purchased or used in Allegheny County and 2 percent local tax for Philadelphia.

If you purchase items or services subject to sales tax for which the seller does not charge and collect sales tax on the invoice or receipt, you are personally responsible for remitting the use tax directly to the PA Department of Revenue.

Examples of taxable items include the following: antiques, paintings, appliances, books, digital products, stationery, computers, exercise equipment, sports equipment, formal clothing, furniture, furnishings, jewelry, luggage, handbags, musical instruments, office equipment, souvenirs, televisions, radios, stereo equipment, video equipment and camera equipment. Examples of taxable services include lawn care, pest control, self-storage, building cleaning and maintenance services such as house-keeping services. See the Retailer's Information Guide (REV-717) for an extensive, though not comprehensive, list of taxable items and services.

Please see the CAUTION statements in the instructions for Schedule C, Schedule E and Schedule UE for additional information. This method of reporting and paying use tax may not be used for purchases of motor vehicles, watercraft, boats, ATVs, snowmobiles or cigarettes.

If you have receipts or purchase records for items or services subject to use tax, use the worksheet below to calculate your use tax liability. Taxpayers are encouraged to review purchase histories made available online by popular Internet sellers and use that information to calculate the tax due.

Note that this worksheet must be used to calculate use tax due on individual purchases over \$1,000.

If you paid some sales tax on items – for example, sales tax at a lower rate paid to another state or sales tax paid to Pennsylvania but not Philadelphia – you may offset your use tax liability by the sales tax already paid using this worksheet.

<b>Use Tax Worksheet</b>	
	Amount
1. Purchases of taxable items subject to Pennsylvania use tax, including shipping & handling	
2. Purchases of taxable services subject to Pennsylvania use tax	
3. Amount of utilities expense from Schedule C, E and/or UE subject to use tax	
4. Total taxable purchases and utilities expense	
5. Tax rate (0.07 Allegheny County, 0.08 Philadelphia or 0.06 state)	0. __ __
6. Use tax: Multiply Line 4 by Line 5	
7. Additional estimated use tax from Table 1	
8. Sales tax previously paid on any amount included on Lines 1 and 2 (up to 0.07 per item for Allegheny County, 0.08 for Philadelphia or 0.06 state)	
9. Total use tax liability. Add Lines 6 and 7, then subtract Line 8 and enter the amount here and on Line 25 of your PA-40, Pennsylvania personal income tax return	

If you have incomplete or inaccurate receipts to calculate use tax on purchases less than \$1,000, you may use Table 1 to estimate your use tax liability based on taxable income. The income calculation method in Table 1 is not a safe harbor method and does not preclude the department from auditing and assessing use tax liability.

<b>Table 1 – Estimated Use Tax Due</b>			
<b>PA-40 Line 9, Total PA-Taxable Income</b>	<b>City of Philadelphia</b>	<b>Allegheny County</b>	<b>Remainder of PA</b>
\$15,000 and less	\$8	\$7	\$6
\$15,001 - \$30,000	\$17	\$14	\$12
\$30,001 - \$50,000	\$22	\$19	\$17
\$50,001 - \$75,000	\$30	\$26	\$23
\$75,001 - \$100,000	\$43	\$37	\$32
\$100,001 - \$150,000	\$59	\$52	\$44
\$150,001 - \$200,000	\$76	\$66	\$57
> \$200,000	.03% (0.0003) of PA-40 Line 9, Total PA-Taxable Income, for PA or \$75 whichever amount is smaller, .035% (.00035) for Allegheny County or \$88 whichever amount is smaller, .04 % (0.0004) for Philadelphia County or \$100 whichever amount is smaller		

**IMPORTANT:** If you do not have a use tax liability or used form PA-1 to report and pay use tax, you must enter zero on Line 25.

The department reserves the right to assess additional use tax due if and when it discovers evidence that the use tax liability amount reported on the PA-40 is less than the actual liability.

Individuals and businesses with Pennsylvania sales tax licenses should report use tax on their sales tax returns.

For detailed information on use tax reporting responsibilities and options, visit [www.revenue.pa.gov/usetax](http://www.revenue.pa.gov/usetax).

**LINE 26, PA-40 TAX DUE**

If the amount shown on Line 12 and Line 25 is greater than that shown on Line 24, enter the tax due, and instruct the taxpayer to pay it in full with the return. If the balance due is \$1 or less, the taxpayer need not make payment. However, the taxpayer still must file a return.

**LINE 27, PA-40 PENALTIES AND INTEREST**

Enter the total of all penalties and interest based on the late filing of the return and/or filing the return after the due date. If this includes a self-assessment for failure to properly file estimated payments, fill in the oval and include Form REV-1630, Underpayment of Estimated Tax by Individuals or REV-1630A, Underpayment of Estimated Tax by Individual Farmers.

When entering a figure on this line be sure to enter one of the codes below indicating the type of penalty:

- L** – Late Payment Penalty and Interest, Failure to File Penalty and Interest or Late Filing Penalty and Interest.
- E** – Estimated Underpayment Penalty only.
- B** – Both Late Payment Penalty and Interest and Estimated Underpayment Penalty.
- X** – Indicates there is no Estimated Underpayment Penalty due to Exception 2 or the Special Exception rules as indicated on the completed and included REV-1630 or REV-1630A.

If no penalty or interest is owed, do not enter an amount on this line. If there is no amount entered, no code should be placed in the block. However, Code X should be entered when Form REV-1630 is included with the return indicating no estimated underpayment penalty due to Exception 2 or the special exception rules.

The department will notify the taxpayer if it is determined penalty and/or interest is due.

Form REV-1630 or REV-1630A may be obtained online or through the Forms Ordering Service.

Penalty and interest can be calculated using an automated tool on the department's website.

**LINE 28, PA-40 TOTAL PAYMENT**

Add Lines 26 and 27 of PA-40. This amount must be paid in full on or before April 15, unless it is less than \$1.

**LINE 29, PA-40 OVERPAYMENT**

Subtract Line 12 from Line 24 (and subtract Lines 25 and 27 if amounts were entered on those lines as well) and enter the amount here. The department will not issue a refund for less than \$1.

If the taxpayer has a previous collectible PA personal income tax liability, his or her overpayment will first be applied to this collectible liability before any overpayment is processed.

**GROUP RETURN OVERPAYMENT PA-40 NRC**

Any overpayment by the partnership, PA S corporation or association will be refunded by check made payable to the partnership, PA S corporation or association. Overpayments can be applied to the estimated income tax for the following year's group return.

**APPLICATION OF OVERPAYMENT**

If a taxpayer has an overpayment of \$1 or more on Line 29 of the PA-40 or Line 11 of PA-40NRC, the taxpayer may request all or part of the overpayment be refunded, credited or donated. Overpayments of less than \$1 will not be refunded.

**IMPORTANT:** The Pennsylvania Department of Human Services is authorized to intercept PA personal income tax refunds of taxpayers who owe overdue child support.

Upon notification by the PA Department of Human Services (DHS) of any delinquencies, the PA Department of Revenue will forward a taxpayer's refund to DHS to resolve a portion of, if not all of, an individual's back child support payments. All questions must be directed to the county's domestic relations section that manages the case.

A married person responsible for child support should file a separate PA income tax return as "Married,

Filing Separately". If a joint return is filed, the Department of Revenue will delay any refund until it receives authorization from the taxpayer to pay the refund to DHS or until separate returns are filed. If the taxpayers do not reply to the department's inquiries, the department will process the return as "Married, Filing Jointly" and forward the refund to DHS without regard to whom the refund was owed.

The Department of Revenue, in conjunction with the Administrative Office of Pennsylvania Courts (AOPC), will also intercept overpayments and apply them to any court-ordered obligation arising from a criminal prosecution or proceeding and pay the amount to the clerk of courts for the county in which the order was entered. A married person with a court-ordered obligation should also file "Married Filing Separately" or the refund will be delayed until separate returns are filed or authorization is received to pay the refund to the AOPC. If a taxpayer does not reply to department inquiries, any refund will be forwarded to the AOPC without regard to whom the refund was owed. All correspondence and inquiries regarding such offsets must be with the county clerk of courts.

The department will also provide notice of refund offset and intercept PA income tax refunds for delinquent federal income tax liabilities. Since the department's only responsibility in this levy process is sending the refund to the IRS, all correspondence and inquiries regarding the offset must be with the IRS.

### **LINE 30, PA-40 REFUND**

The amount of overpayment the taxpayer wants returned in a check. Cash refunds of less than \$7.50 will not be issued unless this line is completed.

### **LINE 31, PA-40**

The amount of overpayment to be credited to the taxpayer's estimated tax next year.

### **LINES 32-36, DONATIONS**

There are eight ways taxpayers can choose from to donate all or a portion of their tax refund. However, they can only donate their tax refund to up to five of those organizations in one tax year due to space limitations on the PA-40. A code box has been included on each of the Lines 32 through 36 so that

taxpayers can select the organization or organizations to which they wish to donate their refund. The organizations and the code for each are as follows:

- A** - PA Breast Cancer Coalition's Refunds for Breast and Cervical Cancer Research Fund
- B** - Wild Resource Conservation Fund
- C** - Military Family Relief Assistance Program
- D** - Governor Robert P. Casey Memorial Organ and Tissue Donation Awareness Trust Fund
- E** - Juvenile (Type 1) Diabetes Cure Research Fund
- F** - PA Children's Trust Fund
- G** - American Red Cross
- H** - Pennsylvania 529 College Savings Program Account

Enter the code for the organization the taxpayer wants to donate to and the amount of Line 29 to be donated.

**IMPORTANT:** PA Schedule P must be completed if a taxpayer uses Code H for a Pennsylvania 529 College Savings Program Account donation.

The total amount of cash refund, carryover credit and donations must be equal to the total amount shown on the overpayment line.

### **TAXPAYER'S SIGNATURE AND VERIFICATION**

A taxpayer must sign and date his/her return. A taxpayer has not filed a valid return unless the return is signed. A taxpayer and spouse who choose to file a joint return must each sign and date the return.

The taxpayer's signature on the return verifies the return has been examined and is true, correct and complete to the best of the taxpayer's knowledge.

Failure to properly sign a tax return may result in a delay in the issuance of a refund.

### **E-FILE OPT OUT**

A paid preparer must fill in this oval if the taxpayer requested to file a paper copy of the return instead of



electronically transmitting the return. If the taxpayer is preparing his/her return, do not fill this oval.

**IMPORTANT:** Do not staple the return and attachments together.

## PREPARER'S NAME, TELEPHONE NUMBER and PTIN/FEIN

This is to be used only if the preparer of the return is being paid to prepare the return. If this is being prepared in a district office or by a VITA/TCE volunteer this should not be completed.

## PAYMENT OPTIONS

Payments can be made via check or money order with or without PA Form PA-V, using a credit/debit card or through electronic funds transfer. In order for the department to more accurately process payments, the department recommends you use the fill-in form version of the 2013 PA-40 PA-V found on the department's website at [www.revenue.pa.gov](http://www.revenue.pa.gov).

### Paying With Fill-In Form PA-V

Complete the fill-in version of Form PA-V as follows:

- Social Security number(s) - print your SSN and your spouse's SSN on your Form PA-V in the same order as they appear on your tax return.
- Name(s) - type in your name(s) on the Form PA-V in the same order as they appear on your tax return. If the name on your Form PA-V is not correct, you may use your Form PA-V. The department will obtain your correct name from your PA tax return.
- Address - type in your address as it appears on your tax return.
- Payment - type in the amount of your payment and print the Form PA-V. Make the check or money order payable to: PA DEPT OF REVENUE. Do not send cash.
- Mailing your payment - Please write (1) the last four digits of your SSN, (2) "2015 PA-V", and (3) daytime telephone number on your check or money order. The department will need the last four digits of your SSN if your check becomes separated from your Form PA-V. Carefully detach

your Form PA-V from the instructions. Do not staple your check or money order to the Form PA-V. Please place your Form PA-V and payment in an envelope with your PA-40 tax return using the "Payment Enclosed" address provided in the mailing instructions on Page 77.

If you filed electronically mail only your Form PA-V and payment to the "Payment Enclosed" address using the mailing instructions on Page 77.

### Paying Without a Form PA-V

If you do not use the Fill-In version of Form PA-V:

- Make your check or money order payable to: PA DEPT OF REVENUE.
- Write (1) your complete SSN, (2) "2015 PA-V", and (3) daytime telephone number on your check or money order. If you are filing a joint return, enter the complete SSN of the taxpayer shown first on your return. The department will need your complete SSN to more quickly and accurately apply your payment. Do not staple your check or money order to your return. Please place your payment in an envelope with your PA-40 tax return using the "Payment Enclosed" address provided in the mailing instructions on Page 77.

### Credit/Debit Card

A taxpayer can also pay his/her PA taxes due with a major credit card or a debit card. Credit card transactions are charged a 2.49 percent convenience fee (\$1 minimum charge), and debit card transaction fees start at \$3.95. An American Express, Discover, MasterCard or Visa credit card can be used to pay PA taxes due online or by phone. MasterCard or Visa debit cards can also be used to make payments online. Select one of the following options to pay using a credit/debit card:

- 1. Internet.** Go to Official Payments Corporation at [www.officialpayments.com](http://www.officialpayments.com).
- 2. Telephone.** Call 1-800-2PAYTAX (1-800-272-9829).

### Electronic Funds Transfer

Taxpayers may also pay PA tax due using electronic funds transfer by accessing the Revenue e-Services

Center at [www.revenue.pa.gov](http://www.revenue.pa.gov). A taxpayer will be prompted for bank account information, and the payment will be deducted from the account on the date specified by the taxpayer. There is no charge for using this option.

## AMENDED RETURNS

If taxpayer realized a mistake on the PA tax return, they must correct the return by filing a separate PA-40 return, marking the amended return oval on the return and completing and submitting Schedule PA-40X with the amended return. The Schedule PA-40X only applies to amended returns for the year 2008 and forward. See Page 39 of the 2015 PA-40 booklet for additional instructions on how to complete Schedule PA-40X.

## REFUNDS

If a taxpayer over-reported income or is entitled to credits or deductions not claimed and seeks a refund, the taxpayer must complete and file an amended return within three years from the original or extended due date. Under PA law, a taxpayer must file a refund petition no later than three years following the date of payment. For a refund on tax shown on a timely filed PA tax return, the department will not accept an amended return unless the taxpayer files the return within the three-year statutory timeframe. An amended return should not be filed requesting a refund within nine months of the close of the statute of limitations for a tax period (three years from the original or extended due date of the return). A Petition for Refund (Form REV-65) should be filed for amendments requesting refunds during that time period to protect appeal rights in the event the request for refund is denied. A Petition for Refund may not be acted upon by the Board of Appeals if an amended return refund is denied and the Petition for Refund is filed after the three-year period has ended.

## UNDERREPORTED INCOME

If after a return is filed a taxpayer discovers the income was underreported, credits were erroneously claimed or deductions were not allowed, the taxpayer must correct the error within 30 days by completing

and filing an amended return and paying the additional tax, applicable penalty and interest. There is no statute of limitations for filing a return when an error is discovered that results in additional tax due.

## GENERAL GUIDANCE

To file an amended Pennsylvania personal income tax return, use the appropriate return for the tax year you are correcting, clearly printing "Amended Return" at the top. Be sure to fill in completely the oval marked "amended" at the top of the front side of Form PA-40. If the original return was submitted on paper or by using TeleFile, e-file or padirectfile, the amended return must be filed on Form PA-40 or through the Federal/State e-file program using the following procedures:

- Enter the amounts from the original return not being amended.
- Enter the amended amounts. Explain the reason an amended return is being filed, and include the amended forms or schedules supporting the amended amounts.
- Calculate the amended total PA taxable income.
- Calculate the PA tax liability.
- Calculate the total credits and payments. The department will take the original refund or payment into account when reviewing the amended return. The amended return must be signed.

An amended return may not be filed after an assessment has been issued if the amendment relates to the same taxable year and the same item of income or gain, deduction or loss involved in the assessment. In this instance, the taxpayer must either file a petition for reassessment with the Board of Appeals within 90 days of the mailing date of the assessment or pay the assessment and file a petition for refund with the Board of Appeals within six months of the mailing date of the notice of assessment. A taxpayer may access the petition form, REV-65, by visiting [www.boardofappeals.state.pa.us](http://www.boardofappeals.state.pa.us) or calling the department's Automated Forms Ordering Service.

## UNDERPAYMENT PENALTY

If a return is filed on time and the tax liability is not paid in full, a 5 percent underpayment penalty will be imposed on the unpaid balance after the due date of the return.

## LATE FILED RETURNS PENALTY

If a return is filed after the original due date (or the extended due date if an extension was granted), a penalty of 5 percent of any tax due will be imposed for each month or fraction thereof that the return is late. The maximum penalty is 25 percent of the unpaid balance, the minimum penalty is \$5.

## FRAUD PENALTIES

If any part of any underpayment of the tax is due to fraud, 50 percent of the underpayment will be added to the tax.

## ADDITIONS, PENALTIES AND FEES

If a taxpayer fails to include in taxable income an amount more than 25 percent of the taxable income that was reported, by reason of negligence or intentional disregard of rules and regulations but without intention to defraud, there shall be added an amount equal to 25 percent of the amount of underpayment.

Any person required to furnish an information return who furnishes a false or fraudulent return shall be subject to a penalty of \$250 for each failure.

If any individual, estate or trust files a return meeting any of the criteria below, the filer shall pay a \$500 penalty.

- The return does not contain sufficient information to determine the correct liability.
- The return contains information indicating the liability is significantly incorrect.
- The return is filed frivolously or to delay or impede the administration of the tax law.

## BAD CHECK PENALTY

If a check is returned to the Department of Revenue that cannot be cashed, a 10 percent bad check

penalty (minimum \$25/maximum \$1,000) and with 5 percent underpayment penalty will be imposed.

## INTEREST

If the taxpayer does not pay the tax due on or before the due date, simple interest will be calculated daily from the date the tax is due to the date of payment. The annual interest rate established by the U.S. Treasury Secretary each calendar year is the rate of interest in effect when the tax is due and payable. The interest rate on Jan. 1 remains in effect until the tax is paid in full or until Dec. 31 of that year, whichever comes first.

On a bad check the interest is calculated daily on the face amount of the check from the application date of the returned check until the liability is satisfied.

## MAILING THE RETURN

It is important that each return or payment be mailed under separate cover.

If there is a tax due – more than \$1 on Line 28 – mail to:

PA DEPT OF REVENUE  
PAYMENT ENCLOSED  
1 REVENUE PLACE  
HARRISBURG PA 17129-0001

If there is an overpayment – \$1 or more on Line 29 – mail to:

PA DEPT OF REVENUE  
REFUND/CREDIT REQUESTED  
3 REVENUE PLACE  
HARRISBURG PA 17129-0003

If there is no tax due or overpayment - no amount on Line 28 or 29 - mail to:

PA DEPT OF REVENUE  
NO PAYMENT/NO REFUND  
2 REVENUE PLACE  
HARRISBURG PA 17129-0002

Do not use these addresses to send any other correspondence to the department.

## CONSOLIDATED GROUP RETURN FOR QUALIFIED ELECTING NONRESIDENT PARTNERS/SHAREHOLDERS

A qualifying partnership, association or Pennsylvania S corporation may file a combined PA-40NRC return on behalf of its qualified electing nonresident individual partners/shareholders if the following requirements are satisfied:

- The partner/shareholder must be an individual whose tax year is the calendar year.
- The individual and the individual's spouse must be a domiciliary of a state or country other than Pennsylvania at the close of the partnership's/PA S corporation's taxable year.
- The individual or individual's spouse must not maintain a permanent place of abode in Pennsylvania at the end of the calendar year.
- The nonresident must have no PA taxable income derived from or connected with PA sources other than the partner's/shareholder's distributive share of partnership/PA S corporation income for the calendar year.
- The nonresident must have elected to join in the filing of a consolidated return and estimated tax declaration by the partnership or PA S corporation on his/her behalf for the calendar year.
- The partnership or PA S corporation maintains at its principal office for inspection the following:

A list of each qualified electing non-resident's name (last names must be in alphabetical order), address, Social Security number, share in the partnership/PA S corporation, distributive share of total taxable income, tax due before application of payments and credits, share of estimated tax withheld or payments and share of overpayment, if any.

One of the following: (1) a certification that each of the qualified electing non-residents listed has elected to join in the filing of a consolidated return for the taxable year; or (2) a certified copy of the partnership agreement if it evidences that each of the

qualified electing nonresidents listed has agreed to join in the filing of a consolidated return for the taxable year.

### Effect of Consolidated Group Return

Unless acceptance of a consolidated return is revoked by the department, the consolidated return will be considered as a group of separate returns that meet the individual filing requirements of the Personal Income Tax Act. The department's acceptance of a consolidated return is tentative and subject to revocation upon audit or otherwise. The department expressly retains the right at any time to require the filing of an individual nonresident income tax return by any of the individual partners or shareholders or to withdraw and modify the authority to file consolidated returns upon notice. If an individual discovers that he/she should not have joined in the filing of a consolidated return, due to reasons such as having other PA source income to report, that individual should file PA-40 and PA-40NRC should be amended, unless the department indicates otherwise.

### FILING REQUIREMENTS

- Form PA-40NRC is to be filed under the identification number, name and address of the partnership or PA S corporation.
- Enter the number of nonresidents electing to file and the total of their ownership percentage on PA-40NRC.
- A PA Schedule NRK-1 for each electing nonresident partner or shareholder must be submitted with Form PA-40NRC.
- PA tax withheld cannot exceed the amount allocated to those partners/shareholders who elected to file on the consolidated return.

The return must be signed by the partner/corporate officer designated as the person responsible for the filing of the consolidated nonresident return and whom the department may contact concerning Form PA-40NRC. The return is not valid unless signed. Provide the telephone number where the partner/corporate officer may be called between the hours of 8:30 a.m. and 4:00 p.m.

## MAILING INSTRUCTIONS

Mail completed Form PA-40NRC and PA Schedules NRK-1 to:

PA DEPARTMENT OF REVENUE  
CONSOLIDATED RETURN  
PO BOX 280418  
HARRISBURG PA 17128-0418

**Overpayments:** Overpayments will be applied to the partnership's/PA S corporation's estimated income tax account for the following year or refunded to the partnership/PA S corporation.

## RECORDS MUST BE MAINTAINED

The department has the statutory authority to verify and audit all of the amounts reported on tax returns and accompanying schedules. Books and records must be maintained for at least four years after filing, as evidence of the information reported on PA income tax returns. Basis documentation for any item reported or potentially reportable on current or future tax returns must be kept indefinitely or at least four years after the asset is sold, exchanged or disposed of by a taxpayer. For example, books and records used to calculate basis for retirement plans, stocks,

bonds, mutual funds, business assets, business interests, tuition account programs, principal residence, etc. must be kept indefinitely.

## FORMS ORDERING

To obtain forms and publications, visit a Revenue district office or use one of the following services:

**Internet: [www.revenue.pa.gov](http://www.revenue.pa.gov)**

Pennsylvania income tax forms, schedules, brochures, electronic filing options, and other information are available on the department's website. If you do not have Internet access, visit your local public library.

**E-mail Requests for Forms: [ra-forms@pa.gov](mailto:ra-forms@pa.gov)**

**Automated 24-hour Forms Ordering Message Service: 1-800-362-2050**

This line serves taxpayers without touch-tone telephone service.

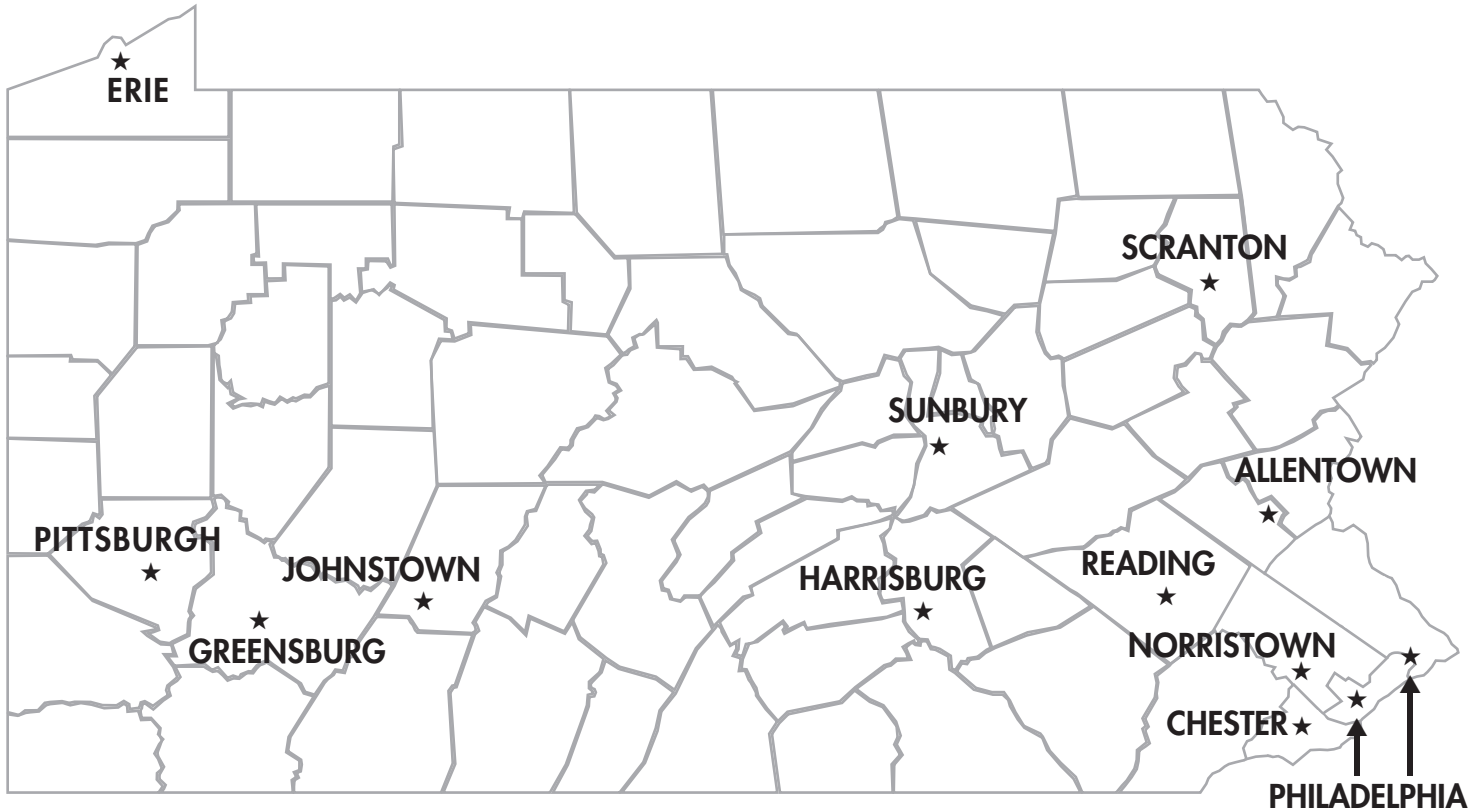
**Written Requests:**

PA DEPARTMENT OF REVENUE  
TAX FORMS SERVICE UNIT  
1854 BROOKWOOD STREET  
HARRISBURG PA 17104-2244



## PA DEPARTMENT OF REVENUE DISTRICT OFFICES

**NOTE:** Please call ahead to verify a district office's address and its services or visit the department's website at [www.revenue.pa.gov](http://www.revenue.pa.gov) for information. Taxpayer assistance hours are 8:30 a.m. to 5 p.m.



**ALLENTOWN**  
STE 4  
555 UNION BLVD  
ALLENTOWN PA 18109-3389  
**610-861-2000**

**CHESTER**  
6TH FL STE 602  
419 AVENUE OF THE STATES  
CHESTER PA 19013-4451  
**610-619-8018**

**ERIE**  
448 W 11TH ST  
ERIE PA 16501-1501  
**814-871-4491**

**GREENSBURG**  
SECOND FL  
15 W THIRD ST  
GREENSBURG PA 15601-3003  
**724-832-5283**

**HARRISBURG**  
LOBBY  
STRAWBERRY SQ  
HARRISBURG PA 17128-0101  
**717-783-1405**

**JOHNSTOWN**  
425 MAIN ST  
JOHNSTOWN PA 15901-1808  
**814-533-2495**

**NORRISTOWN**  
SECOND FL  
STONY CREEK OFFICE CENTER  
151 W MARSHALL ST  
NORRISTOWN PA 19401-4739  
**610-270-1780**

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# INDEX

TOPIC	PAGES
ABLE Savings Program	38-39
Abode	5-8
Address, Home	16
Alimony	67
Allowable Employee Business Expenses	35-37
Amended Returns	17, 76
Annualization of Income	63-65
Annuities	32, 48
Apportioning Income	9-10
Armed Forces, Taxation of Members of	10-14
Bad Checks	77
Business Expenses - Schedule UE	35-37
Business Start-Up Expenditures	47
Cafeteria Plans	29-30
Cancellation of Debt	27-28, 46, 52
Capital Gains Distributions	42, 52
Child Support	17-18, 20
Child Care, Employer Provided	20
Class Action Life Insurance Settlements	48
Clergy	25
Combat Zone Pay	14
Compensation	19-37
Compensation, Exclusions from	20-21
Compensation-Nonresidents, Reciprocal Agreements	8, 9-10
Condemnations	48
Confidentiality	1
Constructive Receipt	29
Copyrights	8, 14, 55-56
Court Awards	48, 67
Covenant Not to Compete	20
Crop Damage	47
Demutualization	48-49
Depreciation	45-46, 51-52
Debt Forgiveness	27-28, 46, 52
Deceased Return	18-19
Deferred Compensation	29
Deferred Payment Contract	52
Dependent	65, 66
Depletion	46, 56
Directors Fees	20
Dividends	41-43
Dividends, Money Market Distributions as	40
Dividends, Mutual Fund Distributions as	40

## INDEX

TOPIC	PAGES
Dividends - Schedule B . . . . .	41-43
Dividends, Capital Gain Distributions . . . . .	42, 52
Dividends, Exempt Interest . . . . .	42
Domicile . . . . .	5-8, 12-13, 16
Drought Relief . . . . .	47
Dual Residency . . . . .	8
Easements and Right of Ways . . . . .	49
Electronic Filing (e-file) . . . . .	2-4
Eligibility Income . . . . .	62
Eligibility Income Table . . . . .	69
Eligibility for Tax Forgiveness . . . . .	62
Employee's Nonwithholding Application Certificate . . . . .	13, 60, 70
Estate Distributions to Beneficiary . . . . .	56-57
Estate or Trust Income - Schedule J . . . . .	56-57
Estimated Tax Payments, Credit for . . . . .	60
Estimated Tax Requirements . . . . .	61-62
Executor Fees . . . . .	20, 25-26
Expenses, Reimbursement by Employer . . . . .	35-37
Extension, Request for . . . . .	4-5
Farmland Preservation . . . . .	51
FEMA . . . . .	48, 67
Federal Active Service . . . . .	10-14
Filing Requirements, Minimum . . . . .	5
Filing Status . . . . .	17-19, 62-63
Filing Status, Deceased . . . . .	18-19, 63
Filing Status, Final . . . . .	18
Filing Status, Married Filing Joint . . . . .	17-18, 63
Filing Status, Married Filing Separate . . . . .	18, 63
Filing Status, Single . . . . .	17, 62
Foreign Service . . . . .	7, 10-12, 13
Forfeited Interest Penalty . . . . .	40
Forms Ordering . . . . .	79
Fringe Benefits, Employees . . . . .	20-21
Gain on Sale of Residence . . . . .	50-51
Gambling Expenses . . . . .	58
Gambling Gains and Losses . . . . .	58
Gifts . . . . .	67
Group Returns . . . . .	47, 78
Guidelines for Tax Assistance . . . . .	2
Holocaust Settlements . . . . .	51
Household Employees . . . . .	26

# INDEX

TOPIC	PAGES
Imputed Interest . . . . .	39
Income Taxes Withheld, Credit for . . . . .	60
Income . . . . .	19-59
Individual Retirement Accounts (IRAs) . . . . .	23, 31-32
Inherited Property . . . . .	54
Installment Sales (Deferred Payment Contract) . . . . .	54-55
Intangible Drilling Costs . . . . .	46
Interest - Schedule A . . . . .	37-41
Interest and Penalties . . . . .	77
Interest Penalty, Forfeited . . . . .	40
Interest, "Dividends" from Credit Unions, etc. . . . .	37
Interest, Tax Exempt . . . . .	39-40
Interest Income . . . . .	37-41
Interviewing Techniques . . . . .	1
Involuntary Conversions . . . . .	45, 49
Joint Returns . . . . .	17, 18-19
Jury Fees, Jury Duty . . . . .	20, 22-23, 35
Keogh Plans . . . . .	30
Keystone Opportunity Zone . . . . .	4
K-1 Income . . . . .	58-59
Lease with Option to Buy . . . . .	56
Long Term Care Policy . . . . .	67
Lottery . . . . .	9, 14, 57-58
Like Kind Exchanges . . . . .	49
Meals and Entertainment Expenses . . . . .	35
Medical Interns and Residents . . . . .	27
Medical Savings Account (MSA) . . . . .	59
Merchant Marines . . . . .	12
Mineral Rights Lease and Royalty Income . . . . .	56
Money Market and Mutual Fund Distributions . . . . .	40
Military Pay . . . . .	10-14, 24
Moving Expense . . . . .	35, 36
Name, Taxpayer . . . . .	15-16
Net Profits from a Business or Profession . . . . .	43-47
Net Profits from a Farm . . . . .	43-47
Non-Employee Compensation . . . . .	22-27, 28
Nonwithholding Application Certificate, Employee . . . . .	13, 60, 70
Nonresident . . . . .	7
Nonresidents, Taxation of . . . . .	8-10, 11
Nonresidents, Reciprocal Agreements . . . . .	9-10
Offsetting Gains and Losses . . . . .	14

## INDEX

TOPIC	PAGES
Oil and Gas Pipeline or Well Access Easements and Right of Ways	49
Oil and Gas Royalty Expenses	56
Original Issue Discount Bonds (OID)	39
Overpayment	73-74
PA Payment Voucher	75
Patents	8, 55-56
Payment of Tax Due	73, 75-76
Payment, Late (Interest)	77
Penalties and Fees	77
Pennsylvania Lottery Winnings	57-58
Pension and Profit Sharing Plans	30-34
Personal Injury, Damages	48
Premature Withdrawal IRA	31-34
Prizes and Awards	57, 67
Pro-Forma Returns for Taxable Bankruptcy Estates	19
Property Damage Payments	56
Proration	50-51, 53-55
Public Assistance	20
Reciprocal Agreement	9-10
Refunds	3, 35, 73-74, 76
Rental Income	8, 55-56
Replacement of Principal Residence	50-51
Repossession of Property	52
Residency	5-8
Residency Status	17
Residents, Part-Year, Taxation of	10
Resident, Part-Year	7
Residents, Taxation of	8
Retirement Benefits	30-34
Return of Capital	53
Revenue District Offices	80
ROTH Individual Retirement Plans	23, 31-32
Royalties	55-56
Sale of Timber	51
Sale or Exchange of Personal Residence	50-51
Sale or Exchange of Property	47-55
Savings Bonds: Series E,F,G,H, EE and HH	39-40
Schedule A - Interest Income	37-41
Schedule B - Dividends	41-43
Schedule C - Net Profits Business or Profession	43-47
Schedule D - Sale or Exchange of Property	47-55
Schedule D-1	54-55
Schedule D-71	53-54



# INDEX

TOPIC	PAGES
Schedule E . . . . .	55-56
Schedule F - Farm Income or Loss . . . . .	43-47
Schedule G-L - Taxes Paid to other States . . . . .	70-71
Schedule J - Estate or Trust Income . . . . .	56-57
Schedule PA-40X - Amended . . . . .	76
Schedule SP - Tax Forgiveness . . . . .	62-70
Schedule T . . . . .	57-58
Schedule UE . . . . .	35-37
Scholarships, Fellowships, and Stipends . . . . .	26-27, 67-68
School District Information . . . . .	16
Severance Pay . . . . .	19
Sick and Disability Pay . . . . .	29-30
Simplified Employee Plans (SEPs) . . . . .	30
Social Security Benefits . . . . .	20, 68
Social Security Number . . . . .	15
Statutory Employees . . . . .	26
Stepped Up Basis . . . . .	50
Stock Options . . . . .	25
Strike Benefits (Sub Pay) . . . . .	21, 29, 68, 70
Summary Transactions . . . . .	48
Tax Due . . . . .	73
Tax Assistance, Guidelines . . . . .	2
Tax Exempt Obligations . . . . .	52-53
Tax Forgiveness, "Dependents" . . . . .	65
Tax Forgiveness, "Eligibility Income" . . . . .	62
Tax Forgiveness, Special Provisions for . . . . .	62-70
Tax Sheltered Annuities . . . . .	32, 38
Taxable Income - Classes . . . . .	14
Taxes Paid by Residents to Other States - Schedule G-L . . . . .	70-71
Taxpayer's Signature and Verification . . . . .	74
Third Party Sick Pay . . . . .	29, 70
Timber, Sale of . . . . .	51
Transfer of Property . . . . .	47-55
Travel and Mileage Expenses . . . . .	35
Treasury Bills and Notes, U.S. . . . .	39-40, 52-53
Trust Income . . . . .	56-57
U.S. Government Obligations . . . . .	39-40, 52-53
U.S. Public Health Service . . . . .	12
Underreported Income . . . . .	76
Unemployment Compensation . . . . .	20
Uniform Gifts to Minors Act . . . . .	39
Use Tax . . . . .	71-72
W-2 Reconciliation Worksheet . . . . .	22

---

## INDEX

---

<b>TOPIC</b>	<b>PAGES</b>
Wash Sales . . . . .	49
Website (Internet Home Page) . . . . .	79
Who Must File a Return . . . . .	5
Worker's Compensation Benefits . . . . .	29-30, 70

# NOTES

