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FEDERAL DEDUCTIONS AND EXEMPTIONS NOT ALLOWED FOR PENNSYLVANIA TAX PURPOSES

In general, the deductions and exemptions used to calculate a taxpayer's federal adjusted gross income or federal taxable income are not permitted in calculating the taxpayer's Pennsylvania taxable income. Disallowed deductions include the federal standard deduction and itemized deductions (with the limited exception for unreimbursed employee business expenses deducted from gross compensation). Additionally, Pennsylvania does not allow a deduction for the personal exemption. The following tables provide examples of the types of deductions and exemptions allowed for federal purposes, but not for Pennsylvania purposes.

Deductions Not Allowed for Pennsylvania Personal Income Tax which are Allowed for Federal Purposes in Arriving at Federal Adjusted Gross Income on the Federal Form 1040	
Federal	Pennsylvania Personal Income Tax
IRA deduction	No provision
Student loan interest deduction	No provision
Moving expenses	No provision
One-half of self employment taxes	No provision
Self-employed health insurance deduction	No provision
Self-employed SEP, SIMPLE and qualified plans	No provision
Penalty on early withdrawal of savings	No provision
Alimony	No provision

Deductions in Arriving at Federal Taxable Income but Not Allowed for Pennsylvania Personal Income Tax	
Federal	Pennsylvania Personal Income Tax
Standard Deduction	No provision
Medical and dental expenses	No provision
Taxes paid	No provision
Interest	No provision
Gifts to charity	No provision
Casualty and theft losses	No provision
Job expenses	Unreimbursed business expenses reportable on PA Schedule UE.
Miscellaneous deductions	No provision

DEDUCTIONS ALLOWED FOR PENNSYLVANIA TAX PURPOSES

Pennsylvania allows four deductions against income. Deductions are allowed for: Medical Savings Account contributions; Health Savings Account contributions; IRC Section 529 qualified Tuition Program contributions, and IRC Section 529A Pennsylvania ABLE Savings Account Program contributions.

Pennsylvania follows federal rules for contributions to Medical Savings Accounts and Health Savings Accounts. You may not claim these deductions if you cannot claim them for federal income tax purposes. The amount you report as deductions cannot exceed the federal limits. For more information regarding Archer Medical Savings Accounts, refer to Personal Income Tax Bulletin 2006-05.

For contributions to IRC Section 529 Qualified Tuition Programs, Pennsylvania allows a maximum yearly deduction equal to the annual federal gift tax exclusion (found at IRC § 2503(b)) per beneficiary, per taxpayer.

For contributions to IRC Section 529A Pennsylvania ABLE Savings Account Programs, Pennsylvania allows a maximum yearly deduction equal to the annual federal gift tax exclusion (found at IRC § 2503(b)) per contributor. Refer to the PA ABLE Fact Sheet on the department's website for more information.

For additional information on deductions and limitations (including contribution limits), see the instructions for PA Schedule O.

FEDERAL TAX CREDITS NOT ALLOWED ON PENNSYLVANIA RETURN

Pennsylvania does not allow taxpayers to take a credit on their tax returns for credits deducted on the federal return. The below table lists may of the credits not allowed for Pennsylvania Personal Income Tax, which are allowed for federal income tax purposes.

Credits Not Allowed for Pennsylvania Personal Income Tax which are Allowed for Federal Income Tax Purposes	
Federal	Pennsylvania Personal Income Tax
Foreign tax credit	No provision
Credit for child and dependent care expenses	No provision
Credit for the elderly or disabled	No provision
Education credits	No provision
Child tax credit	No provision
Adoption credit	No provision

RESIDENT CREDIT

Resident Credit for Tax Paid to Another State

A Pennsylvania resident taxpayer who has non-Pennsylvania sourced income subject to both Pennsylvania personal income tax ("PA PIT") and the income or wage tax of another state (according to Pennsylvania sourcing rules) on the same income during the same taxable year, can claim a credit for the tax paid to the other state as a credit against his or her Pennsylvania personal income tax, subject to certain limitations (refer to Amount of Credit below).

For tax years beginning before Jan. 1, 2014, a "state" means any state or commonwealth of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States and any foreign country. For tax years beginning on or after January 1, 2014, a "state" does not include a foreign country.

Amount of Credit

The amount of the allowable credit is the lower of:

- The actual amount of tax paid to the other state for the same taxable year on income subject to Pennsylvania income tax and source-able to the other state using Pennsylvania sourcing rules; or
- The tax paid to the other state on income sourced to the other state using PA income sourcing rules, but no greater than the amount of tax paid to PA on the same income. This is determined by taking the product of the Pennsylvania personal income tax rate for the tax year in which the credit is being claimed multiplied by the amount of income subject to Pennsylvania income tax and source-able to the other state using Pennsylvania sourcing rules.

Note: Pennsylvania does not permit a resident credit for income taxes or wage taxes paid to another state on Pennsylvania source income or income from intangible sources that cannot be sourced to any state using Pennsylvania sourcing rules.

PA-40 Schedule-G-L

If a taxpayer claims a credit for taxes paid to other states, the taxpayer must complete PA-40 Schedule G-L. The taxpayer must also submit with the PA-40, Personal Income Tax Return a copy of the income tax return and W-2(s) filed with the other state. The credit will be disallowed if the taxpayer does not provide the tax return from the state listed on PA-40 Schedule G-L, Line 1.

If the taxpayer is claiming a credit for taxes paid in more than one state, the taxpayer must complete a PA-40 Schedule G-L for each state. The credits from each schedule should be totaled and the total entered on the PA-40, Personal Income Tax Return, Line 22.

In the event that more than one state imposes tax on the same income subject to Pennsylvania personal income tax, the credit may not be claimed twice. The credit is limited to the lesser of the tax paid to the state with the highest tax rate or 3.07% of the income subject to tax in Pennsylvania and the state with the highest tax rate.

Grantor Trusts

Pennsylvania does not follow Federal grantor trust rules. For federal income tax purposes, the income of the grantor trust is treated as income of the settlor. For Pennsylvania personal income tax purposes, income of a grantor trust is taxable income to the trust. Because of this discrepancy, when a Pennsylvania resident trust receives income sourced to another state that follows a federal income tax base, Pennsylvania will tax the income as income of the grantor trust and the other state will tax the income as income of the trust settlor. Because the trust and the settlor are different taxpayers for Pennsylvania income tax purposes, the trust and/or the settlor cannot claim a resident credit for taxes paid to the other state on the trust income.

Compensation Earned in Indiana, Maryland, New Jersey, Ohio, Virginia, or West Virginia by Residents

A resident credit will not be granted for taxes paid to Indiana, Maryland, New Jersey, Ohio, Virginia or West Virginia on compensation earned in those states. These states do not impose tax on compensation of Pennsylvania residents.

Note: Ohio Reciprocal Compensation Agreement - Commencing Jan. 1, 2004, remuneration paid to a Pennsylvania resident 20 percent shareholder-employee of an Ohio S corporation for services performed in Ohio is not covered by the Pennsylvania/Ohio Reciprocal Compensation Agreement and is (can be) subject to tax in Ohio.

Tax Paid to Political Subdivisions of Other States

No resident credit will be granted for taxes paid to political subdivisions of other states or countries.

Foreign Taxes Paid

For tax years beginning before Jan. 1, 2014, taxpayers must submit a copy of the federal Form 1116, Foreign Tax Credit plus a copy of the statement showing the amount of foreign income and any taxes withheld at the source. If the taxpayer does not claim the credit on the federal tax return, the department requires additional documentation to support the taxes paid to foreign countries. Acceptable documentation includes, but is not limited to, copies of brokerage statements showing the amounts of income and tax paid, copies of 1099-DIV or 1099-INT showing the income and tax paid, copies of federal K-1s showing the income and tax paid or statements from partnerships showing the breakdown of the income and tax paid to foreign countries.

Note: Act 2013-52 effective Jan. 1, 2014, eliminated the resident credit for personal income tax paid to foreign countries.

TAX CREDITS CLAIMED ON SCHEDULE OC

General Information

The tax credits reported on Schedule OC are often awarded to PA S corporations or partnerships and passed through to entity owners and are often referred to as restricted tax credits. However, sometimes they are awarded to individual or fiduciary taxpayers. The PA S corporations and partnerships report restricted tax credits on PA-20S/PA-65 Schedule OC. The individuals and entity owners report restricted tax credits on PA-40 Schedule OC. Different provisions apply to various situations, so please review the specific information for each tax credit.

Following is general information regarding restricted tax credits:

- Restricted tax credits claimed on Line 23 of the PA-40, Personal Income Tax Return or Line 14 of the PA-41, Fiduciary Income Tax Return, are listed on PA-40 Schedule OC.
- Except for the Educational Improvement and Opportunity Scholarship Tax Credits, married taxpayers who claim PA-40 Schedule OC tax credits must file separate returns, even if both taxpayers claim the tax credits on their returns. For those other tax credits where joint filing is not permitted, joint filing may be permitted only when the tax credit is claimed by the primary taxpayer, and the secondary taxpayer has no taxable income to report on the return.

- All of the restricted tax credits can be claimed against tax liabilities on any class of income.
- Restricted tax credits are nonrefundable. If applicable, other nonrefundable credits must be applied to the account before restricted credits: resident credit first, followed by tax forgiveness.

Credits claimed on PA-40 Schedule OC for an individual taxpayer on his or her PA-40, Personal Income Tax Return cannot exceed the tax liability less the resident credit and/or tax forgiveness credit. For example, a taxpayer with a \$4,000 tax liability who receives a \$3,000 resident tax credit cannot claim credits on PA-40 Schedule OC that exceed \$1,000. If the credits exceed \$1,000, a reduction in the amount of the PA-40 Schedule OC credits will be required.

- The request to pass through tax credit to an entity owner is irrevocable, therefore the entity should not pass through more than the owner can use in any single tax year.
- Except for the Educational Improvement and Opportunity Scholarship tax Credits, Tax credits passed through from pass-through entities to other pass-through entities may not be passed through to the owners of the pass-through entities. Refer to Informational Notice Miscellaneous Tax 2015-01, Education Tax Credits, for more information.
- Tax credits passed through or awarded directly to estates or trusts may not be passed through to the beneficiaries of the estates or trusts.
- Generally, Pennsylvania does not limit the deduction of expenses related to the qualifications for a tax credit. However, Pennsylvania does not allow the deduction of certain expenses used to qualify for the Neighborhood Assistance Program (NAP) and the Educational Improvement Tax Credit (EITC).

For additional information, see the specific section for these tax credits.

For all tax credit questions, please call or email the Department of Revenue at 717-772-3896 ra-btftrevkoz@pa.gov, respectively.

Saleable or Assignable Tax Credits

The saleable restricted tax credits include the Research and Development, Film Production, Neighborhood Assistance Program, Resource Enhancement and Protection, ~~and~~ Keystone Innovation Zone, Keystone Special Development Zone, and Historic Preservation Incentive tax credits. The portion of the tax credit that exceeds the tax liability of the awardee of the tax credit may be carried forward (as specified in the enabling legislation) unless the awardee elects to sell or assign the tax credit or pass it through to its owners.

Special rules apply for taxpayers that sell/assign restricted tax credits as well as the taxpayers who purchase them or to whom tax credits are assigned. The rules apply to all taxpayers, whether or not they are incorporated. For specific information regarding these rules, review Restricted Tax Credit Bulletin 2018-01 on the department's website, www.revenue.pa.gov

Tax credits are often sold through credit brokers; however, a credit broker is not a requirement of sale. For additional information about using purchased or assigned tax credits, see the specific section for each tax credit.

Personal Income Tax Reporting Requirements for Sale of Restricted Tax Credits

- **Seller of a Restricted Tax Credit**
For Pennsylvania personal income tax purposes, the sales of restricted tax credits are taxable as gains on the sale, exchange or disposition of property to the sellers or original awardees of the restricted tax credits. The taxpayer selling the restricted tax credit reports the sale of the tax credit as a sale of intangible property for Pennsylvania personal income tax purposes on PA-40 Schedule D, PA-41 Schedule D or PA-20S/PA-65 Schedule D. The taxpayer's cost basis in the restricted tax credit sold is usually \$0 as the credit is awarded based upon income or expenses already included in the current or a prior year's tax return(s) whereas no adjustment or reduction in income or expenses is required to be made to obtain such credit. A reduction in the sales price may be reported if commissions are paid to an agent or broker for the sale of such restricted tax

credits in the amount of the commissions paid that reduce the amount of net proceeds received by the taxpayer. The taxpayer reports the date of the award of the restricted tax credit as the acquisition date and the date sold as the date the sale was consummated. The gross proceeds the taxpayer receives from the sale of the restricted tax credit less any commissions paid are included as the sales price of the tax credit sold.

- **Purchaser of a Restricted Tax Credit**

A taxpayer who purchases a restricted tax credit at a cost to him or her of less than the full value of the tax credit must also report a gain on the sale, exchange or disposition of property for Pennsylvania personal income tax purposes. The taxpayer purchasing the restricted tax credit reports the transaction as a sale of intangible property for Pennsylvania personal income tax purposes on PA-40 Schedule D, PA-41 Schedule D or PA-20S/PA-65 Schedule D. Unlike the sale of a restricted tax credit, the purchaser records as his or her cost basis, the full purchase price of the credit (complete sales price of all such tax credits purchased plus any commissions paid by the purchaser). The taxpayer records the purchase date as the date acquired and records the tax year end date (usually December 31) for the tax year to which the tax credit is applied as the date the restricted tax credit was sold. The sales price of the tax credit is the full value of the tax credit permitted or allowed to be applied to the tax return of the taxpayer. By recording only the amount of tax credit allowed or permitted as the sales price and the full purchase price of the tax credit as the basis, restricted tax credits purchased and not able to be used due to any tax limitations imposed under the law permitting the use of a purchased tax credit require no pro-ration of credit cost and no separate reporting of the loss on unused tax credits.

A taxpayer who sells a tax credit and/or offsets their tax liability with a purchased or assigned tax credit does not need to send documentation of sale or assignment with their Pennsylvania tax return. However, the department reserves the right to request this documentation if needed.

Individual taxpayers are reminded that joint tax returns cannot be filed if restricted tax credits are claimed. A separately filed PA-40, Personal Income Tax Return for the taxpayer and spouse are required to report the use of restricted tax credits. Restricted tax credits purchased and used by taxpayers should also have code "PA" entered in the credit description code box for the appropriate line on the PA-40 Schedule OC.

Passing Through Tax Credit to Entity Owners

Some tax credits must first be applied to the entity's corporate tax liability, if any, for the year in which the tax credit is granted, prior to being passed through to its owners. If the entity has a tax liability for the tax year in which the contribution was made, the tax credit must first be applied to that tax liability. Review the specific information for each tax credit to determine if the tax credit must first be applied to corporate tax liability.

If an entity does not use all approved tax credits, it may elect in writing to pass through all or a portion of the tax credit to owners in proportion to the share of the entity's distributive income to which the owner is entitled. In most cases the tax credit may be applied up to the full amount of owners' tax liabilities (minus any other nonrefundable credits that are applied first). See the information regarding specific tax credits to review existing restrictions or limitations.

An owner of a pass through entity to whom a tax credit is transferred shall immediately claim the tax credit in the taxable year in which the transfer is made. The owner may not carry forward, carry back, obtain a refund of, sell, assign or pass through the tax credit again.

Except for with the Educational Improvement and Opportunity Scholarship Tax Credits, married couples with joint ownership in pass through entities must be separately listed on the entity's pass through of credit request in order for credit to be applied to each individual's tax number.

Example: Husband and wife, Jim and Jane, jointly own a 50 percent interest in a partnership, and their son John owns the other 50 percent. All income is distributed according to the ownership percentages. The request to pass through credit must separately list Jim's and Jane's tax numbers, each receiving 25 percent of the credit, and John receiving the remaining 50 percent under his tax number. This method must be followed even though Jim and Jane receive a separate RK-1 or NRK-1 from the partnership.

To pass through tax credits to owners, an entity must submit a request on entity letterhead to the Department of Revenue at the address below, listing total amount of credit to be distributed to the entity owner(s), the name and

address of each owner, amount of tax credit to be passed through to each owner, tax year, tax type and owner's tax identification number. See the [Example](#).

A request to pass through the available tax credits must be returned to:

PA DEPARTMENT OF REVENUE
BUREAU OF CORPORATION TAXES
PO BOX 280701
HARRISBURG PA 17128-0701

There are two exceptions. To pass through an Educational Improvement or Opportunity Scholarship Tax Credit, complete and submit form REV-1123 Educational Improvement/Opportunity Scholarship Tax Credit Election Form. To pass through a Keystone Innovation Zone tax credit, visit the Department of Community and Economic Development's (DCED) website at dced.pa.gov or call DCED Customer Service at 1-800-379-7448.

For each tax credit's carry-forward and pass through rules, applications, guidelines, and developments, refer to the description and website referenced for each tax credit.

Specific Information about Each Tax Credit

For specific information regarding tax credits available to taxpayers, refer to the Tax Credits section of the Department's website and the appropriate PA Schedule OC.

RESIDENT CREDIT FOR A PA S CORPORATION TAXED AS A C CORPORATION

In some states, certain S corporations are not treated and taxed as S corporations but are treated and taxed as C corporations. In such cases, an entity may account for the taxes paid to the other state and claim a resident tax credit for that state. The other state's C corporation tax return must show the payment of tax by the PA S corporation, and a copy of the C corporation return including necessary supporting documentation should be included with the PA-20S/PA65 Information Return.

The S corporation for Pennsylvania reports on Line 5 of the PA-20S/PA-65 Schedule OC the lesser of the amount of tax paid on the apportioned income as compared to the tax rate of Pennsylvania. The entity then distributes the amount reported on Line 5 according to ownership percentage and includes the amount on Line 9 of PA-20S/PA-65 Schedule(s) RK-1. The S corporation should also include a statement along with the PA-20S/PA-65 Schedule RK-1 to each shareholder providing them with a breakdown of the name of the state, the shareholder's share of income subject to tax in the other state, the tax paid in the other state and the amount of the credit.

Note: Shareholders who receive this type of credit on their PA-20S/PA-65 Schedule RK-1 report the credit on PA-40 Schedule G-L as a resident credit for taxes paid to another state.