pennsylvania
DEPARTMENT OF REVENUE

Restricted Tax Credit Bulletin 2018-01

The Application and Sale of Restricted Tax Credits

The saleable restricted tax credit programs to which this Bulletin applies are as follows:

- Research and Development Tax Credit (R&D);
- FILM Production Tax Credit (Film);
- Neighborhood Assistance Program (NAP);
- Resource Enhancement and Protection Tax Credit (REAP);
- Keystone Innovation Zone Tax Credit (KIZ);
- Keystone Special Development Zone Tax Credit (KSDZ);
- Historic Preservation Tax Incentive(HPI);
- Coal Refuse Energy and Reclamation Tax Credit (COAL)
- Innovate in Pennsylvania Tax Credit (INOV)
- Mixed Use Development Tax Credit (MUD)

Collectively, the above shall be known as the “tax credit programs”.

APPLICATION OF THE RESTRICTED CREDIT TO TAX PERIODS

Many of the tax credit programs require that the credit approved be first applied against the tax liability for the period in which the credit is approved. Taxpayers are encouraged to consult the specific statute for application rules. The unpaid tax liability must be satisfied before any portion of the credit can be carried forward to satisfy the tax liabilities for future years or be sold or passed through. Prior year credits will be applied on a “first-in-first-out” (FIFO) basis until all tax liabilities are satisfied. Restricted credits will be applied before any cash payments. For personal income tax purposes, restricted tax credits will be applied to the unpaid tax liability after the application of the Tax Forgiveness Credit and the Resident Credit for taxes paid to other states.

Example: R&D Tax Credit for a calendar year taxpayer.

Year 1
Credit Approved 12/15/2009 – $2,500
Tax Liability for the Period Ending 12/31/2009 – $1,500
Portion of 12/15/2009 credit used – $1,500
Tax Credit Carry Forward from 12/15/2009 – $1,000

Year 2
Credit Approved 12/15/2010 – $4,000
Tax Liability for the Period Ending 12/31/2010 – $2,700
Portion of 12/15/2010 credit used – $2,700

Tax Credit Carry Forward from 12/15/2010 – $1,300
Sale of 12/15/2009 Tax Credit – $500
Tax Credit Carry Forward from 12/15/2009 – $500

Year 3
Credit Approved 12/15/2011 – $1,000
Tax Liability for the Period Ending 12/31/2011 – $2,600
Portion of 12/15/2011credit used – $1,000
Portion of 12/15/2009 credit used – $500 (FIFO)
Portion of 12/15/2010 credit used – $1,100
Tax Credit Carry Forward from 12/15/2011 – $0
Tax Credit Carry Forward from 12/15/2009 – $0
Tax Credit Carry Forward from 12/15/2010 – $200

APPLICATION OF RESTRICTED CREDITS TO CORPORATE ACCOUNTS:

All restricted credits, either originally approved or purchased, are the first credit(s) applied to a taxpayer's liability. Complying with this rule will insure maximum utilization of the credit within the taxpayer's account. It also provides for any "cash" paid into the period to be available for transfer or refund.

For taxpayers who are required to make quarterly estimated payments, restricted credits may be used to satisfy a quarterly liability. For credits that are sold, the original approval date of a restricted credit is always preserved on both the seller's and buyer's corporation tax ledgers.

REQUIREMENTS TO BE MET BY SELLERS BEFORE APPROVAL

A completed tax report *must be filed* for the period in which the credit was approved before the credit may be passed through, carried forward, sold or assigned. In addition, the sale or assignment of a restricted credit will not be approved if the seller has any unpaid state taxes. Therefore, a seller must have filed *all* state tax reports and returns and paid *all* state tax liabilities as of the date the department is asked to review the seller's records as part of the process to approve the sale of a credit.

Entities that are no longer subject to filing the RCT-101 Corporate Tax Report as a result of the phase out of the Capital Stock & Foreign Franchise Tax are required to file the PA- 20S/PA-65, S Corporation/Partnership Information return prior to selling a credit. Every domestic or foreign PA S corporation (72 P.S. § 7330.1), partnership (72 P.S § 7335(c)), or entity formed as a limited liability company that is classified as a partnership or S corporation for federal income tax purposes, must file the PA- 20S/PA-65 Information Return. Single Member Limited Liability Companies with an individual, partnership or corporation as the single member are required to file the specified returns: An individual as the single member must file a PA-40 Individual Tax Return. If the single member is a corporation or partnership the return of the owner (RCT-101 Corporate Tax Report or PA 20S/65 Information Return) must be filed.

If the seller has non-filed returns or reports, or unpaid liabilities, the sale will not be approved.

WAITING PERIOD PRIOR TO SALE

In addition to the requirement to file a current year tax report prior to the sale of a credit, the KSDZ, NAP, and REAP tax credit programs also require the credit to be held for one year before a sale of the credit may occur.

KIZ TAX CREDIT SALES

The KIZ statute specifically provides that if a Pennsylvania S Corporation does not have an eligible tax liability against which the tax credit may be applied, a shareholder of the Pennsylvania S Corporation is “entitled” to a tax credit equal to the product of (i) the tax credit determined for the Pennsylvania S Corporation for the taxable year; and (ii) the percentage of the Pennsylvania S Corporation’s distributive income to which the shareholder is entitled. This provision applies only to Pennsylvania S Corporations participating in the KIZ program. Therefore, before a Pennsylvania S Corporation can sell a KIZ tax credit, all of its shareholders must agree to the sale.

Taxpayers must complete the appropriate section of the Department of Community and Economic Development’s KIZ sale application identifying each shareholder’s percentage ownership in the Pennsylvania S Corporation and indicate the shareholder’s consent to forgo his respective share of the pass through credit. If any shareholder does not consent, that shareholder’s portion of the KIZ credit will not be available for sale and can only be passed through to that shareholder.

PASS THROUGH REQUIREMENTS

Pennsylvania S corporations (PA S corporations), limited liability companies (LLCs), partnerships and disregarded entities that are no longer subject to filing the RCT-101 Corporate Tax Report, as a result of the phase out of the Capital Stock & Foreign Franchise Tax, may pass through the R&D, Film, NAP, REAP, HPI, COAL and MUD credits to their shareholders, members, partners or owners.

To request the pass through of a credit (except the KIZ Credit), complete the credit claim form attached to the credit certificate or include a list of the shareholders, members or partners and the amount of credit to be passed through to each on the business’s letterhead, signed by an authorized representative. A request to pass through available credit should be returned to:

> Pennsylvania Department of Revenue
> Bureau of Corporation Taxes
> Dept. 280701
> Harrisburg, PA 17128-0701

PA S Corporations, LLCs, and partnerships wishing to pass through the KIZ credit to their shareholders, members or partners must complete the appropriate section of the Department of

Community and Economic Development's KIZ sale application identifying all the shareholders, members, and partners and the amount of credit to be passed through to each.

For tax years beginning on or after Jan. 1, 2016, PA S corporations, LLCs and partnerships, that are no longer subject to filing the RCT-101, Corporate Tax Report, as a result of the phase out of the Capital Stock & Foreign Franchise Tax, may pass the credits through to its shareholders, members or partners unless subject to the built in gains tax.

For tax years beginning prior to Jan. 1, 2016, before any credit may be passed through to its shareholders, members or partners, it must first be applied to the business's corporate tax liability, if any, for the tax year in which the credit is approved. After a credit is claimed on the business's corporate tax report, any remaining credit may be passed through by election to the shareholders, members or partners. Once an election is made to pass any remaining credit through to the shareholders, members or partners, that election may not be revoked in order to apply the credit to the business's corporate tax report.

Note: Credit may only be passed through once to a parent or member of a disregarded entity. The credit cannot be passed a second time to the parent's shareholders.

PURCHASED CREDITS

Buyers of restricted credits must use the credit in the year in which the purchase or assignment is made. The credit "shall be immediately claimed" and is prohibited from being carried forward, carried back, refunded, sold or assigned. They may not carry over, carry back, obtain a refund of or sell or assign the credit.[1]

The "immediately claim" language as well as the prohibition against "assigning" means that a purchased credit must be used by the purchasing entity or passed-through, by a pass-through entity and used by resident or non-resident shareholders, members or partners. The credit may not be passed through twice.

Tax credits are applied to the buyer's account for the tax period open as of the date the seller's report is filed for the period in which the credit is approved or for the period as of the date the seller becomes compliant.

Tax period open refers to the current tax year open, regardless as to when the taxpayer files a tax return for the tax period.

Example: If a sale is approved on 5/1/16, the tax period open is the 2016 tax year. The credit will be available for first use beginning in calendar year 2017 against a liability incurred in the 2016 tax period.

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[1] Film Tax Credit Exception: a purchaser or assignee may carry forward a film tax credit purchased or assigned for calendar year 2010 to 2011 and 2012 years. Calendar year 2013 against qualified tax liabilities incurred in 2014. Calendar year 2014 against qualified tax liabilities incurred in 2015

BUYER TAX LIABILITY OFFSET LIMITS

Purchased credits may be applied up to the following percentages of the tax liability:

- Research & Development – 75%
- Keystone Innovation Zone – 75%
- Neighborhood Assistance Program – 100%
- Film Tax Credit Program 50%
- Resource Enhancement and Protection Program– 75%
- Keystone Special Development Zone Program –75%.
- Coal Refuse Energy and Reclamation Tax Credit – 75%
- Innovate in Pennsylvania Tax Credit -100%
- Mixed Use Development Tax Credit -100%

Buyers should consider the percentage limit of each type of credit when determining the amount of credit to purchase. It is the buyer's responsibility to be aware of its potential tax liability prior to any purchase.

As such, buyers are required to acknowledge that all sales and assignments are final and may not be reversed by the Department. The acknowledgement is signed by a representative of the buyer and notarized as a legal document within the sale and assignment application.

Any portion of the purchased credit not used by the buyer in the year of the purchase is lost and may not be used in any other tax year. The buyer may not carry forward, carry back, obtain a refund of, or assign the purchased credits. All sales and assignment transactions are final and may not be reversed.

Buyers are required to acknowledge the utilization rules on a signed and notarized

There is no specific order in which such credits are applied. Since the credit cannot be carried forward or back, sold or assigned, each credit will be applied up to the percentage limit of the tax liability. Any amount of credit that exceeds the credit limit is removed from the buyer's account.

ADDITIONAL BUYER AND SELLER TAX RETURN REPORTING REQUIREMENTS

Buyers and sellers of restricted tax credits must also report a gain (or loss) on the sale of the tax credit in the tax year the credit is utilized by the buyer or sold by the seller. Buyers must report a gain (or loss) on the difference between the credit value purchased and the purchase price of the credit for the tax year the purchased credit is utilized. Sellers must report the amount realized from the sale of the credit (sales price less cost of sale) as gain for the tax year the credit was sold.

FREQUENTLY ASKED QUESTIONS

Approved Credits (Sellers):

(1) What is the "effective date" of a restricted credit?
The effective date of a restricted credit is the original approval date. This date appears on the taxpayer's corporate tax account in the original approval year and any carryforward years.

(2) How is originally approved credit applied to an open tax liability?
For those credit programs with sale provisions, the current year's approved credit must first be applied to that year's tax liability. If additional liability remains and the period contains any carry forward credits from prior years, credits will be applied on a "first in, first out" (FIFO) basis.

(3)In what order will a combination of current year approved credits, purchased credits, carry forward credits from prior periods, non-saleable credits, and saleable credits be applied to the tax liability?

- **Category 1:** First applied are: purchased credits, originally approved credits (that are not saleable and have no carry forward provision) and credits in their last carry forward year. If the liability is paid prior to utilization of all Category 1 credits, the balance of credit is removed. Any other credit available for carry forward is applied to the next tax year.

- **Category 2:** Apply that portion of the *current year approved credits* (that are required to be applied to the taxpayer's current year before they can be sold) in order starting with the credit program having the shortest carry forward period to the credit program with the longest carry forward period.

- **Category 3:** Apply non-saleable credits starting with the credit program having the shortest carry forward remaining lifespan to the credit program having the longest carry forward remaining lifespan.

- **Category 4:** Apply saleable credits starting with the credit having the shortest carry forward remaining lifespan to the credit having the longest carry forward remaining lifespan.

(4) When is a credit available for sale?
Credits approved in the current year must first be applied to the seller's tax liability for the year in which the credit is approved. In addition, before an application for sale of a credit is approved, the department must make a finding that the applicant has filed all required state tax reports for all years and paid all state tax due as determined by the Department.

(5) Is there a waiting period before I can sell any remaining available credit?
The NAP, KSDZ and REAP tax credit programs require the seller to hold the credit for one year prior to sale.

(6) What is required of the seller before an application for sale is approved?
Before approval, the Department of Revenue must make a finding that the applicant has filed all state tax reports and paid all state tax due as determined by the Department.

Purchased Credits (Buyers):

(8)What determines the year in which the credit must be used by the buyer?
If a credit is purchased, the tax credits are applied to the buyer's account for the tax period open as of the date the seller's report is filed for the period in which the credit is approved or for the period as of the date the seller becomes compliant.

(9)Is there a limit to the quantity or types of credits that can be purchased?
No, the amount of credit or type of credit that can be purchased is up to the buyer. It is also the buyer's responsibility to make sure the type of credit purchased can be applied to the buyer's applicable tax liability. Buyers should consider the percentage limit of each type of credit when determining the amount of credit to purchase. It is the buyer's responsibility to be aware of its potential tax liability prior to any purchase. Individuals who purchase credits to apply to personal income tax must calculate their liabilities separately from their spouse and file a separate tax return.

(10) What is the order of application if multiple types of purchased credit are present on a *buyer's* account?
There is no specific order in which such credits are applied. Since the credit cannot be carried forward or back, sold or assigned, each credit will be applied up to the percentage limit of the tax liability. Any amount of credit that exceeds the credit limit is removed from the buyer's account. *Exception:* a purchaser or assignee may carry forward a film tax credit purchased or assigned for calendar year 2010 to 2011 and 2012 years. Calendar year 2013 against qualified tax liabilities incurred in 2014. Calendar year 2014 against qualified tax liabilities incurred in 2015.

(11) Can the survivor of a merger use or sell a restricted credit of the merged entity? The survivor of the merger may use a restricted credit of the merged entity to the same extent as the merged entity could have used the restricted credit. Therefore, the survivor can use or sell the restricted credit it acquired through a merger as if the credit had been originally approved for the survivor.

(12) Can an S Corporation purchase credits and claim those credits on its NRC (nonresident consolidated) return?
Credits purchased by an entity must be applied at the entity level. If an entity qualifies to file a NRC return on behalf of its nonresident shareholders, it may purchase credits to offset the tax liability associated with the NRC return, despite the fact that the NRC return is being filed on behalf of its shareholders. The use of such a purchased credit is limited to the nonresident shareholders' liability listed on the NRC return filing and the limits for application against tax liability for the type of credit purchased as described in the answer to Question 10.

Other Questions:

(13) How are restricted credits applied to the bank shares tax?

The statute defines the bank shares tax as a "spot tax" determined as of January 1 of each year. Credits approved, granted or purchased on or after January 2 of a given year can be first applied by an institution to the spot tax as of January 1 of the following year. Purchased credits are deemed to be purchased on the later of (1) the date the application for sale is submitted to the administering agency, or (2) the date all conditions (*e.g.*, holding period and/or filing of tax reports) necessary to effect the sale are satisfied.

(14) Can REAP credits be invalidated?

Section 1706-E (B) of the Resource Enhancement and Protection Tax Credit Act requires that if the State Conservation Commission determines that best management practices have not been maintained for the period required as determined by the Commission, the owner of the property upon which the project exists is required to return to the department the amount of the tax credit granted.

(15) If a credit is approved in the current year but the business ceased activities in PA in the prior year, is there a current year filing requirement?

No filing is required and the credit may be sold.

(16) Subsequent to an approved sale, if it is determined the original awarded credit is not valid, how will this impact the buyer and seller?

The Buyer will not be held responsible for repayment of the invalid credit purchased. It is the seller's responsibility to repay the Commonwealth. The credit sale transaction will not be reversed.

(17) What is the due date for an election to pass through a carried forward credit that has reached its last eligible carry forward year?

The election to pass through credit must be received by the due date of the last year for which the credit is eligible for carry forward.

(18) Can a restricted credit awarded to a pass through entity be sold to the shareholders of the entity?

Currently there is no prohibition against the sale of a restricted credit to the shareholders of a pass through entity.

(19) Can a restricted tax credit which has been passed through to an entity be passed through again?

No once the restricted credit is passed through to a shareholder, member or partner the credit cannot be passed through again.

(20) How do I verify a purchased credit is on my account?

Call 1-888 PATAXES (728-2937), select option 1 then option 5. Enter your 7-digit account id or 10 digit Revenue Id. The automated system will playback payments and credits on the account.

Business taxpayers and tax practitioners have the ability to electronically request and receive a more detailed version of the Statement of Account (e-SOA) in PDF format through the new Document Center section in e-TIDES. The e-SOA can be requested at any time and is made available in PDF format in the Document Center to print or download on the next business day.

Logon to e-TIDES and request an e-SOA through the e-TIDES Document Center.

(21) Can a sale or pass through be reversed?

No, all completed sales and pass throughs are final and cannot be reversed.

Editor's Note: Restricted Tax Bulletin 2018-01 replaces Corporation Tax Bulletin 2014-04 replaces Corporation Tax Bulletin 2011-03 replaces Corporation Tax Bulletin 2008-02 issued July 21, 2008, revised December 12, 2008 and January 15, 2010, and reissued October 20, 2010.

uick Reference Table:

Credit Type	Administering Agency	Application Deadline	Applicable Taxes	Carry Forward	Purchaser's Liability Offset Limit	Waiting Period Before Sale
R&D	**Dept. of Revenue**	**September 15**	• Capital Stock / Foreign Franchise • Personal Income Tax • Corporate Net Income	**Approval Yr. +15 Yrs.**	**75%**	Seller must file return for the tax period which T/C was approved or granted.
KIZ	**Dept. of Community & Economic Development**	**September 15**	• Capital Stock / Foreign Franchise • Personal Income Tax • Corporate Net Income	**Approval Yr. + 4 Yrs.**	**75%**	Seller must file return for the tax period, which T/C was approved or granted.
NAP	**Dept. of Community & Economic Development**	**July 1**	• Capital Stock / Foreign Franchise • Insurance Premium • Bank Shares • Corporate Net Income • Mutual Thrift • Personal Income Tax • Title Insurance	**Approval Yr. +5 Yrs.**	**100%**	**1 Yr.** **And** Seller must file return for the tax period, which T/C was approved or granted.
Film	**Dept. of Community & Economic Development**	**N/A**	• Capital Stock / Foreign Franchise • Personal Income Tax • Corporate Net Income • Bank Shares • Insurance Premium • Title Insurance • Mutual Thrift	**Approval Yr. + 3 Yrs.**	**50%**	Seller must file return for the tax period, which T/C was approved or granted.
REAP	**State Conservation Commission**	**1st Monday in August**	• Capital Stock / Foreign Franchise • Personal Income Tax • Corporate Net Income • Bank Shares • Insurance Premium	**Grant Yr. + 15 yrs.**	**75%**	**1 Yr.** **And** Seller must file return for the tax period, which T/C was approved or granted.

			• Title Insurance • Mutual Thrift			
KSDZ	**Dept. of Community & Economic Development**	**February 15**	Capital Stock / Foreign Franchise • Personal Income Tax • Corporate Net Income • Bank Shares • Title Insurance • Mutual Thrift	**Approval yr. + 10 yrs.**	**75%**	**1 Yr. And** Seller must file return for the tax period, which T/C was approved or granted.
HPI	**Dept. of Community & Economic Development**	**N/A**	• Capital Stock / Foreign Franchise • Insurance Premium • Bank Shares • Corporate Net Income • Gross Receipts • Personal Income Tax • Title Insurance • Mutual Thrift	**Approval yr. + 7 yrs.**	**100%**	Seller must file return for the tax period, which T/C was approved or granted.
COAL	**Dept. of Community & Economic Development**	**February 1**	• Personal Income Tax • Corporate Net Income • Capital Stock / Foreign Franchise • Bank Shares • Title Insurance • Insurance Premium • Gross Receipts Tax • Mutual Thrift	**Approval Yr. + 15 Yrs.**	**75%**	Seller must file return for the tax period which T/C was approved or granted.
INOV	**Dept. of Community & Economic Development**	**N/A**	Insurance Premiums Tax	**12/31/2025**	**100%**	Seller must be approved by the Department of Revenue and Department of Insurance to sell the credit.

MUD	**Pennsylvania Housing Finance Agency**	**May 22**	• Personal Income Tax • Corporate Net Income • Capital Stock / Foreign Franchise • Bank Shares • Title Insurance • Insurance Premium • Gross Receipts • Mutual Thrift	**Approval yr. + 7 yrs.**	**100%**	Seller must file return for the tax period which T/C was approved or granted and must be approved by the PHFA to sell the credit.