



# COMMONWEALTH OF PENNSYLVANIA CT-1 PA CORPORATION TAX BOOK 1997 For Calendar Year 1997 and fiscal years beginning in 1997

PLEASE CAREFULLY REVIEW THESE "HIGHLIGHTS" BEFORE COMPLETING  
ANY TAX REPORTS OR SCHEDULES.

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## HIGHLIGHTS

- The CT-1 PA Corporate Tax Booklet now contains all forms and instructions that were previously included in the REV-1200 and the PA-20S-I.
  - The Net Operating Loss (NOL) carryforward limitation is \$1,000,000. However, no more than \$500,000 can be claimed from tax periods 1990 through 1993. Also, be sure to complete schedule RCT-103 in this booklet to support your claim for an NOL. (Read the RCT-103 instructions carefully.)
  - The Capital Stock/Foreign Franchise Tax fixed formula valuation deduction is increased from \$100,000 to \$125,000 effective for tax years beginning January 1, 1997.
  - Effective January 1, 1998, all Business Trusts are subject to the filing and payment of Capital Stock/Foreign Franchise Tax. Appropriate estimated payments must be submitted during 1998.
  - A tax credit program has been created to help promote and secure job creating economic development in the Commonwealth. In addition to the Jobs Creation Tax Credit, the Commonwealth has enacted two more tax credits which are the Waste Tire Recycling Investment and the Pennsylvania Research and Development Tax Credits. For more information on these credits, refer to the instructions in this booklet.
  - Effective for tax years beginning January 1, 1997 or later, a corporation that confines its activities in this Commonwealth during the course of a calendar year to attendance at an organized "Show" or "Flea Market" for the purpose of exhibiting its goods and making sales therefrom shall not be subject to the minimum tax imposed under Article VI based solely upon such attendance if limited to no more than twenty days during the year, with no more than five days being consecutive.
  - As part of the Secretary of Revenue's ongoing effort toward improved Taxpayer Assistance, the PA Department of Revenue now maintains information and tax forms via the Internet at: <http://www.revenue.state.pa.us>, or at our e-mail address: [parev@epix.net](mailto:parev@epix.net).
  - A toll-free service is available to assist taxpayers with general information, tax forms, and schedules. For help call 1-888-PA TAXES (1-888-728-2937).
  - It is imperative that you file **ONLY** Department of Revenue approved forms and schedules. The Department employs sophisticated imaging and scanning technology to expedite the processing of tax returns, coupons and payments. Non-approved forms must be processed manually and could delay the updating of a taxpayer's account. This may result in unnecessary notices and collection action or even the imposition of penalties.
  - When filing your PA Corporate Tax Report, Form RCT-101, make sure that all necessary forms are filed with this report such as the Federal Tax Report, RCT-106, Form 1120S and all supporting schedules, etc. (Read all instructions in this book carefully.) Also, please follow instructions in Section I, page 1 on how to assemble these forms to complete the PA Corporate Tax Report, Form RCT-101 Package. If you file an "incomplete" report it may not be accepted by the Department or may result in a "jeopardy settlement," which will force the taxpayer to pursue further resolution through the appeal process.
  - Please review the RCT-101, STEP E completion instructions beginning in Section I, page 6, especially if one or more tax types are overpaid and the remaining tax types are underpaid. If any tax type is overpaid (RCT-101 STEP D, Column C amount is negative), you **must** complete the RCT-101 STEP F Overpayment section to instruct the Department how to transfer and/or refund the overpaid portion, even if other tax types are underpaid and you are making a payment when filing the RCT-101.
  - Ensure that an officer of the company signs the RCT-101 on Page 1 at STEP G. Unsigned annual reports will not be accepted and will be returned for signature.
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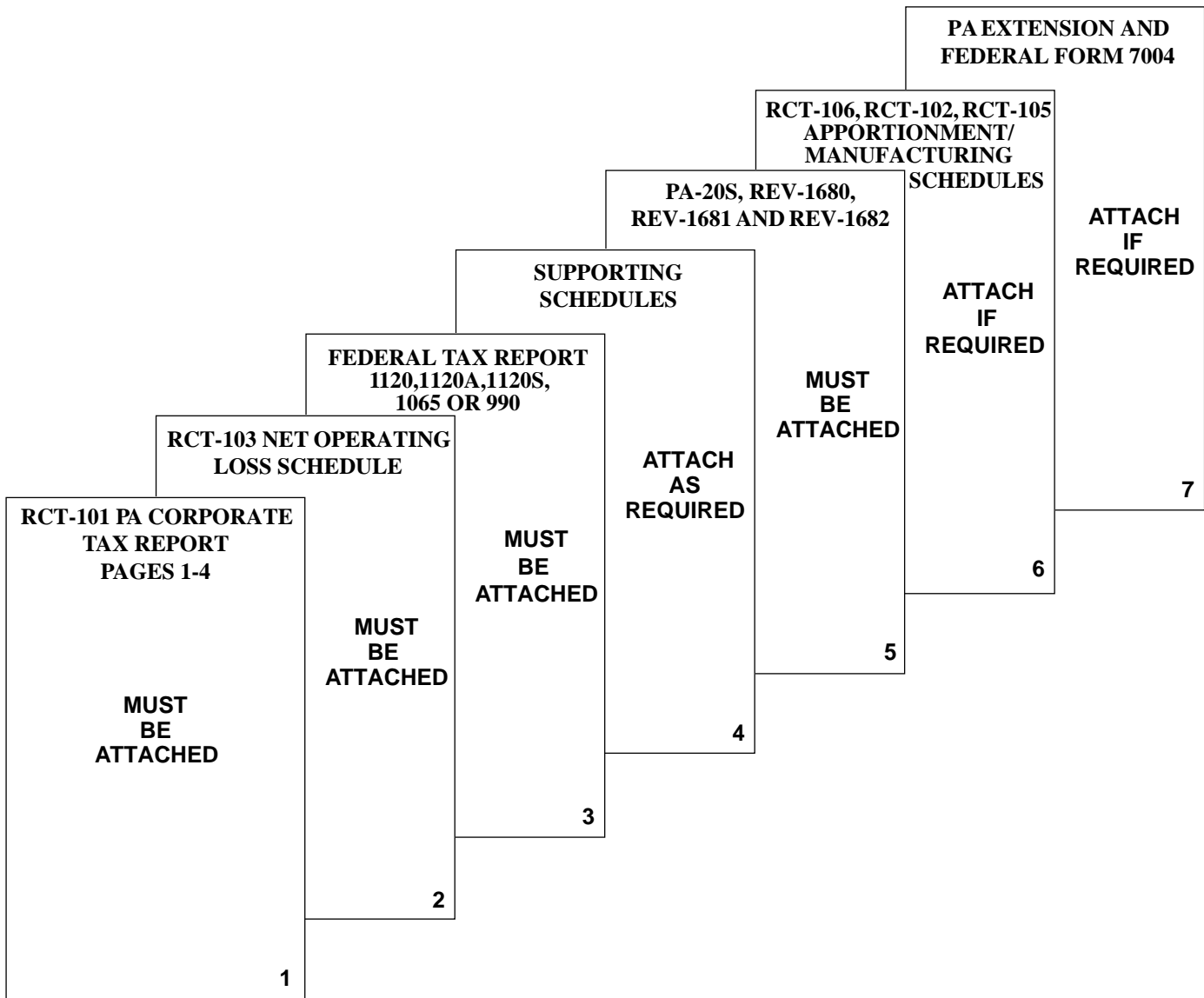
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# ASSEMBLY OF THE COMPLETED PA CORPORATE TAX REPORT RCT-101 PACKAGE



**Assemble the completed 1997 PA Corporate Tax Report in the following order:**

**Sequence Description**

1. RCT-101 PA Corporate Tax Report Pages 1 through 4 completed and assembled in order.
2. RCT-103 Net Operating Loss Schedule
3. Federal Form 1120, 1120A, 1120S, (Income statement, balance sheet and other schedules, including details of taxes expensed and Schedule M adjustments), 1065 or 990.
4. Supporting schedules to the Federal and PA Corporate Tax Reports, **including a Consolidated Balance Sheet.**
5. PA-20S, REV- 1680, REV- 1681 and REV- 1682.
6. RCT-106 Insert Sheet  
RCT-102 Single Factor Manufacturing Exemption  
RCT-105 Three Factor Manufacturing Exemption
7. PA Extension Approval Letter and Federal Form 7004

**Filing Requirements**

- ALL TAXPAYERS MUST INCLUDE A COMPLETE RCT-101.**
- ALL TAXPAYERS MUST INCLUDE A COMPLETE RCT-103 TO CLAIM A NET OPERATING LOSS DEDUCTION/CARRY FORWARD.**
- ALL TAXPAYERS MUST INCLUDE A COPY OF THE FEDERAL REPORT**
- AS REQUIRED (To support specific adjustments and computations on the RCT-101.)
- ALL PENNSYLVANIA S CORPORATIONS MUST FILE A PA-20S WITH SUPPORTING SCHEDULES**
- IF REQUIRED (Those claiming exemptions or using three factor apportionment must include schedules.)
- IF REQUIRED (Those who obtain a Pennsylvania approved extension to file.)

**PENNSYLVANIA CORPORATE TAX REPORT  
INSTRUCTIONS FOR FORM RCT-101**

**GENERAL INSTRUCTIONS**

**S CORPORATIONS**

If a corporation has elected to be taxed as an S corporation for federal tax purposes, but has not made an election to be taxed as a PA S corporation, it must: (1) complete Section C of RCT-101, (2) attach a copy of federal Form 1120S to the PA Corporate Tax Report and (3) attach a schedule reflecting adjustments to Line 21 of federal Form 1120S for the pass-through items on Schedule K (Shareholders' Share of Income, Credits, Deductions, etc.). These adjustments should produce taxable income similar to that for a C corporation and must be reported in Section C, Line (1) of the RCT- 101.

**Inactive Corporations. Inactive corporations must complete and file form RCT-101-I located in this booklet. Only skeleton corporations - those performing no business activity and owning no assets anywhere - may use the RCT-101-I.** Corporations which have business activity outside of Pennsylvania must complete and file the common PA Corporate Tax Report, RCT-101. A copy of the federal Form 1120 must be attached and apportionment fractions reported.

**Inactive corporations (no assets and no stock) are permitted to file composite returns covering more than one taxable period.** Active corporations must file a separate report for each taxable period.

**PRIOR PERIOD FORMS ARE NOT ACCEPTABLE. "DO NOT use a 1997 RCT-101 for any period other than 1997."**

**COPY OF FEDERAL FORM 1120 or 1120S**

**A copy of the U.S. Corporation Income Tax Return - Form 1120, 1120A, 1120S, 1065 or 990 or other applicable federal form must be attached to the PA Corporate Tax Report.**

Pennsylvania does not allow consolidated filing of corporate tax reports. In the case of a corporation participating in the filing of a consolidated return to the federal government, it will be necessary to include the following:

1. **Separate Company** income statement reflecting taxable income which would have been returned to and ascertained by the federal government, if a separate return had been made to the federal government.
2. **Separate Company** balance sheet reflecting financial position of the taxpayer at the beginning and end of the taxable period, if separate return had been made to the federal government. *A corporation with subsidiaries also must include a consolidated balance sheet.*
3. Schedules reflected on the federal Form 1120 or 1120S on a separate company basis, including a schedule of taxes expensed.

**WHERE TO FILE/PAY**

Submit PA Corporate Tax Reports (RCT-101) and payments to PA Department of Revenue, Bureau of Corporation Taxes, Dept. 280427, Harrisburg, PA 17128-0427. **If the total taxes you must pay as a result of filing this report are less than \$20,000, make your check payable to the PA Dept. of Revenue and use the preaddressed return envelope contained in the Instruction Booklet to mail the tax report. If the total taxes you must pay are \$20,000 or more, you must pay using an Electronic Funds Transfer (EFT) Method. (See next section.)**

**EFT PAYMENT REQUIREMENT**

**The PA Departments of Treasury and Revenue have implemented a program which enables taxpayers to pay certain taxes through Section I, Page 2**

**Electronic Funds Transfer(EFT).** Taxpayers remitting a payment of \$20,000 or more must make such payments by one of the EFT payment methods available (ACH Debit or ACH Credit). This applies to payments required to be made on or after July 1, 1992. To participate in the EFT program, the Department **first** must receive your completed Authorization Agreement. For more information on these requirements and for EFT registration material, call the Department's EFT Unit at 1-800-892-9816 (EFT calls only).

**DUE DATE OF REPORT AND PAYMENT**

The PACorporate Tax Report (RCT-101) is due annually on April 15 of the year following the year for which the report is submitted for a calendar year reporting corporation, or 30 days after the federal due date for LLCs and corporations reporting to the federal government on a fiscal year basis. **For corporations reporting on a 52-53 week basis, the last day of the month, rather than the varying 52-53 week date nearest the end of the month, should be considered the last day of the year. Corporations which close their year on any of the last seven days in December or the first seven days of January are deemed calendar year taxpayers with a year ending date of December 31.** Domestic International Sales Companies (DISC) must file on or before the 15th day of the 10th month following the close of the fiscal year.

**FILING REQUIREMENTS**

First reports of domestic corporations must begin with the date of incorporation. All domestic corporations are required to file annual reports even though no business activity was conducted during the taxable period.

First reports of foreign corporations must begin with the date of the issuance of the Certificate of Authority or the date of the commencement of activities in Pennsylvania, whichever date is earlier. **All corporations are required to file annual reports even though no business activity was conducted within the Commonwealth during the tax period. (See below.)**

**OUT OF EXISTENCE/WITHDRAWAL**

Domestic corporations desiring to be marked "Out of Existence" and foreign corporations desiring to be marked "Withdrawn" on the records of the Bureau of Corporation Taxes should note the following:

A PA corporation that has ceased doing business and completely or totally divested itself of **ALL** assets, or a foreign corporation that has ceased to do business in Pennsylvania and liquidated **ALL** PA assets may be relieved of the responsibility of filing corporate tax reports by completing the "Out of Existence/Withdrawal Affidavit" (REV-238) that is included in this booklet. (Note: Active solicitation of sales in Pennsylvania qualifies an account as being subject to tax.) **This affidavit must be notarized and attached immediately behind the RCT-101 and before any other attachments to the report filed with the PA Department of Revenue.**

Final reports should be identified by checking the "LAST REPORT" block in STEP C of Page 1 of the RCT-101.

To qualify for the "Out of Existence" or "Withdrawn" status, the corporation must:

1. File all corporate tax reports and pay all taxes due the Commonwealth up to and including the date of cessation of activities and divestiture of assets. Where capital assets have been sold prior to liquidation, complete in detail a schedule reflecting the gain or loss realized as a result of the sale.

2. Include with the corporate tax reports a "Distribution of Assets" (reverse side of REV-238) which must reflect the date or dates of divestiture of all assets. Where a distribution of assets is made directly by the corporation to its shareholders in return for their stock, attach to the "Distribution of Assets" a copy of federal Form 1099-DIV.

**PA corporations that never have transacted business or held title to assets, or foreign corporations that never have transacted business in Pennsylvania, are required to file annual tax reports until they file a final return and qualify for "Out of Existence" or "Withdrawn" status.** Such inactive corporations should mail the executed affidavit directly to:

**PA Department of Revenue  
Bureau of Compliance  
Business Clearance Section  
Dept. 280947  
Harrisburg, PA 17128-0947**

## REINSTATEMENT

A corporation that has been marked "Out of Existence through the acceptance of an affidavit may reinstate with the PA Department of Revenue by: (1) confirming with the PA Department of State, Corporation Bureau, that the corporation name currently is available for use, and (2) filing a composite tax report (one report for more than one year of inactivity). This information can be confirmed by calling (717) 787- 1057.

## RECORDING DOLLAR AMOUNTS

All tax computations must be shown in **whole dollar amounts**. Any amount less than 50 cents is eliminated and any amount that is 50 cents or more is increased to the next dollar.

All negative amounts should be enclosed in **parentheses**.

## COMPLETING TAX REPORTS

The completed reports must either be typewritten or printed in ink. Pencil copies are not accepted by the Department.

Affix the peel-off identification label to the top of Page 1 of the RCT-101 (STEP B). The label is found on the cover of the Instruction Booklet. Use of the identification label contributes to timely and accurate processing by the Department. In the event that a label is not available, carefully print the corporation name and address, Account ID and Entity ID (EIN) in the designated area of the RCT-101.

The completed tax report **must** be signed and dated by a corporate officer. Other corporate employees such as a secretary, clerk or staff accountant should **not** sign the report.

The preparer signature block must be completed by someone who has charged a corporation for the completion of the tax report. In addition to the signature of the preparer, the preparer's name, firm name, address and Entity ID (EIN) or Social Security Number must be typed or printed in the appropriate blocks provided in STEP H of the RCT-101.

## FILING PERIOD

Reports must be filed on the same filing basis as reported to the federal government. Where a change in filing period has occurred, insert the new month, day and year in the designated area on form REV-854 EIN/Filing Period/Address Change Coupon from the REV-857I Estimated Payment Coupon Book. Indicate a permanent change in filing period on the RCT- 101, if the REV-854 has not been filed.

## EXTENSION OF TIME TO FILE

A request for an Extension of Time to File must be submitted on or before the due date of the PA Corporate Tax Report. **A request for a**

**federal extension does not automatically qualify the corporation for a PA extension.** Extension requests must be submitted on REV-853 Annual Extension Request Coupon included in the REV-857I Estimated Payment Coupon Book.

After receipt and review by the PA Department of Revenue, you will receive written notice as to whether your extension request was **approved** or **denied**.

If you are requesting an automatic six month extension of time to file federal Form 1120 or 1120S, you must attach a copy of both the PA Extension Approval Letter and the federal Form 7004 to your Annual PA Corporate Tax Report at the time of filing.

Do not submit a RCT- 101 annual tax report based on estimated figures when submitting the extension request.

Make sure you are using the correct REV-853 coupon to request an extension by ensuring that the **month** and **year** displayed in the Period Ending block on the REV-853 coupon exactly matches the month, day and year end of the tax period for which you want the extension.

No extensions of time are granted for the **payment** of annual taxes or the **payment** of estimated taxes. Also use the REV-853 Annual Extension Request Coupon to record the annual tax payments due and to send the check in payment of these taxes, if the taxes being paid total less than \$20,000.

If the taxes total \$20,000 or more, you must request the extension and make the required payment in an EFT payment method. Do not file the REV-853 coupon.

## PENALTIES IMPOSED FOR FAILURE TO FILE REPORTS WHEN DUE

**10% of first \$1,000 of settled tax**

**5% of next \$4,000 of settled tax**

**1% of settled tax over \$5,000**

If a report is filed late, the taxpayer should wait until billed by the Department to remit the penalty amount. Interest does not accrue on penalties. Do not include penalty with tax amounts reported on form RCT-101.

## INTEREST

Taxpayers should not precalculate and remit interest, but should wait until an interest settlement is issued by the PA Department of Revenue. Do not include interest with the tax amounts reported on form RCT-101.

## REFUNDS OF CORPORATE TAXES

After completing STEP D "Tax Summary on Page 1 of the RCT-101 Annual Report, if an overpayment exists on **any** line (tax type) in Column C "Calculation," you must instruct the Department as to how you want this overpayment to be transferred and/or refunded. You provide these instructions to the Department by selecting **only one** of the options available at STEP F "Overpayment." **YOU MUST SELECT ONE OF THESE STEP F OPTIONS** if any STEP D, Column C amount is a negative number (meaning overpaid), even if the Column C TOTAL amount is a zero or positive amount (meaning a payment is still due).

Requests for refunds and/or transfers of overpayments in a year not covered by the annual report being filed should be made on the REV-855 Custom Refund/Transfer Request Coupon included in the REV-857I Estimated Payment Coupon Book.

## ASSIGNMENT OF CREDIT (OVERPAYMENT)

As an alternative "use" of a credit (overpayment), a corporate taxpayer can assign the credit to other taxpayers for their use. However, assignment of credit can only be executed by use of a very controlled process. Credits CANNOT be assigned via the normal methods' taxpayers use to instruct the Department of Revenue as to how credits should be applied, transferred, and/or refunded. These normal techniques are:

- Completing STEPF "Overpayment" on Page 1 of the RCT-101 Annual Corporate Tax Report; or
- Completing the REV-855 Custom Refund/Transfer Request coupon (included in the REV-857I Estimated Payment Coupon Book).

Rather, assignment of credit can only be accomplished by both the assignor and assignee executing the form REV-774 Assignment of Tax Credit. Furthermore, only credits that meet the following criteria/conditions can be assigned:

- All corporate taxes, additions to the tax, penalties and interest must be paid in full (except those under active appeal or still appealable).
- All other taxes, additions, penalties and interest owed by the taxpayer (assignor) must be paid in full (except those under active appeal or still appealable). Other taxes include sales/use tax, employer withholding tax, liquid fuels tax, etc.
- Credits to be assigned must have originated from cash payments by the taxpayer. **Restricted** credits CANNOT be assigned. Restricted credits are those originating from special tax credit programs such as Neighborhood Assistance, Employment Incentive Payments, Mortgage Emergency Assistance Fund, Jobs Creation, Waste Tire Recycling Investment and Pennsylvania Research and Development Tax Credit.
- The REV-774 Assignment of Credit must be completely executed by both the assignor and assignee.

The assignment of credits is discussed in the Department regulation entitled "Credits" (61 Pa. Code 151.21-151.22).

Call the Bureau of Corporation Taxes' Accounting Division at (717) 787-1355, TDD# (717) 772-2252 (Hearing Impaired only) if you have any questions concerning credit assignment and to request the REV-774 assignment form.

## DEPARTMENT GENERATED STATEMENTS

1. **ACCOUNT REVIEW STATEMENT** - A summary of a corporate taxpayer's account is mailed automatically with each significant event occurring during the year. Such events include receipt of a tax report and its subsequent settlement or resettlement(s). Information contained on the Account Review is categorized under the following captions.

- **SETTLED** - Reported tax which has been reviewed by the Department of Revenue and approved by the Department of the Auditor General.
- **NONSETTLED** - Tax report(s) filed, but pending review/settlement.
- **ESTIMATED/TENTATIVE** - Prepayments on an account in anticipation of a tax for which the tax report(s) have not been filed.

2. **DELINQUENT STATEMENT** - This statement is a billing notice for settled unpaid taxes not under appeal. Such a statement may accompany an Account Review or could be mailed as a reminder of unpaid obligations. The Delinquent Statement is designed as a mail-back document to assure that payment is credited correctly to the account.

3. **INTEREST** - Interest due the Commonwealth is assessed at the time of a late payment or credit transfer. As the payment or the credit transfer posts to your account, a Notice of Interest Settlement will be printed. Interest is imposed from the appropriate due date through and including the date of payment.

4. **ADDITION TO TAX** - Only accounts which have not made adequate prepayments of the safe harbor or estimated amount of the current year's tax are subject to an Addition to the Tax. A replacement Notice of Settlement for such additions is generated with each settlement or resettlement, allowing for both increases and decreases in the original Addition to Tax.

5. **NOTICE OF CREDIT** - This notice informs the taxpayer when a significant event (such as filing of an annual report or settlement of a tax report) creates a TAX overpayment/credit. This notice will explain the source of the credit, confirm your instructions on how the overpayment should be transferred/refunded, or seek transfer/refund instructions from you if you did not previously do so (such as in STEP F on Form RCT-101).

## KEEPING YOUR ACCOUNT CURRENT

Upon receipt of a tax report, the Department will carry out your instructions (STEP F option selected) in order to transfer and/or refund all overpayments in the tax period covered by the annual report filed. Upon settlement, increases/decreases in your self-assessed tax are brought to your attention through the Account Review. Use the REV-855 Custom Refund/Transfer Request Coupon to direct the PA Department of Revenue to transfer available credits to pay outstanding liabilities, or refund any overpayments, thereby keeping your account current.

## AMENDED REPORTS

The RCT-101X, Amended PA Corporate Tax Report (1997) must be filed to amend the Capital Stock/Foreign Franchise, Loans or Corporate Net Income Taxes previously reported for tax period 1997.

An amended report which is received prior to settlement of the original tax report generally will be considered by the Department of Revenue in making the settlement. Also, the Department may resettle the original report based on verification of information contained in an amended report. However, an amended report filed within 90 days after the mailing date of the original settlement will not be acted upon within this 90 day period to preserve the corporation's right to file a Petition for Resettlement. The Department may not resettle a tax report beyond a three year period beginning on the date of the original settlement.

The Amended PA Corporate Tax Report, RCT-101X, only should be filed if an original PACorporate Tax Report, RCT- 101, was filed previously for the same tax period. Federal Form 1120X must be attached, if applicable, and all changes must be fully documented. The instructions used in completing the RCT-101 apply here except:

1. On Page 1 of the RCT-101X, STEP D is expanded to include the self-assessed tax liabilities as set forth in the original report in Column A. The amended tax liabilities are reported in Column B.
2. STEP E reflects the application of the payment required with the amended report.
3. On Pages 2, 3 and 4 of the RCT-101X, only enter **changes** which are made from the original report. These changes should be incorporated in the calculation of the amended tax. Do not complete specific tax sections in which no changes are made from the original report.
4. Changes in taxable income based on federal audits **must** be submitted on form RCT- 128B (for tax years prior to 1981 ) or RCT-128C (for tax years 1981 and thereafter).

## REPRODUCTION OF FORMS

Authority to reproduce the various forms in the annual PA Corporate Tax Report package must be requested and approved in writing by the Department prior to use. To be approved, the reproduction (including computer-produced forms) must be identical to the PA Corporate Tax Report provided by the Department of Revenue. However, the coupons from the REV-857I coupon book package **CANNOT BE REPRODUCED UNDER ANY CIRCUMSTANCES** - the official coupons provided by the PA Department of Revenue **must be used in all cases**.

To request approval to reproduce forms in the annual report package, write to:

**PA Department of Revenue  
Bureau of Corporation Taxes  
Annual Report Forms - Reproduction  
Dept. 280700  
Harrisburg, PA 17128-0700**

## QUESTIONS ON FILING FORMS

Questions regarding the filing of PA Corporation Tax forms, including forms from the REV-857I PA Corporation Tax Estimated Payment Book, should be directed in writing to:

**PA Department of Revenue  
Bureau of Corporation Taxes  
CT Forms  
Dept. 280701  
Harrisburg, PA 17128-0701**

or by telephoning:

<b>Number</b>	<b>Topic</b>
(717) 783-1751 . . . . .	Estimated Payments
(717) 787-2632 . . . . .	Extension to File Annual Report
(717) 787-6256 . . . . .	Transfer/Refund of Overpayments
TDD# (717) 772-2252 . . .	(Hearing Impaired Only)

**Please call between the hours of 8:00 a.m. and 4:00 p.m. Monday through Friday (state holidays excluded).**

## REV-857I PA CORPORATION TAX ESTIMATED PAYMENT COUPON BOOK

The REV-857I coupon book is mailed separately from the tax instruction booklet to each corporation at the beginning of the taxable peri-

od. The package mailed to taxpayers includes coupons and instructions, along with return envelopes for filing each of the coupons.

Corporations must use the preprinted coupons included in the REV-857I. Photocopies or other facsimile, including computer generated forms, or reproductions of the computer generated coupon scan lines, are not acceptable. Use of the forms provided by the PA Department of Revenue will enhance the accuracy and timeliness of processing. Use of the REV-856 or REV-856A is no longer acceptable. To order the REV-857I coupon book, call (717) 783-8839, between the hours of 8:00 a.m. and 4:00 p.m., Monday through Friday (state holidays excluded).

The PA Corporation Tax Estimated Payment Coupon Book (REV-857I) contains coupons which permit a corporation to:

- Make up to four (4) estimated payments;
- Request an extension for filing the annual tax report while making payment of the balance due;
- Direct the Department to refund or transfer overpayments from taxable periods other than that covered by the annual report;
- Notify the Department of changes in address, filing period and EIN; and
- Update the names of corporate officers.

## ADDITIONAL FORMS ORDERING

You may order any Pennsylvania tax form or schedule by calling the special 24-hour answering service numbers for forms ordering: Nationwide 1-800-362-2050; or within the local Harrisburg area (717) 787-8094. The Department provides toll-free assistance through recorded messages at **1-888-PATAXES** (728-2937). Within the local Harrisburg area, call (717) 772-9739.

Address written requests to:

**PA DEPARTMENT OF REVENUE  
TAX FORMS SERVICE UNIT  
711 GIBSON BLVD.  
HARRISBURG, PA 17104-3200**

All material will be mailed directly to you.

You also may visit your local Revenue district office to obtain PA tax forms or schedules.



# SPECIFIC INSTRUCTIONS

## LINE BY LINE INSTRUCTIONS FOR THE PA CORPORATE TAX REPORT RCT-101

### RCT-101 - PAGE 1. STEP A TAX PERIOD

**Line (1).** Enter month and day (MM DD 97) for the tax period beginning and month, day and year (MM DD YY) for tax period ending. The 1997 PA Corporate Tax Report is for use only with the tax periods beginning in 1997. **For corporations reporting on a 52-53 week basis, see instructions on Section I, Page 2, "Due Date."**

### STEP B LABEL/ADDRESS AND FILING PERIOD CHANGES

**Line (2).** Affix the peel-off identification label from the cover of the Instruction Booklet to the designated area on the RCT-101. Use of this label will enhance the PA Department of Revenue's processing of the report. If the label is not available, print or type the corporation name, complete address, Account ID and Entity ID (EIN).

**Line (3).** If the label is not affixed to the tax return, check the block  if the printed or typed address is a change. First year corporations which are not using a label always should check the block. Be sure to file form REV-854.

**Line (4).** Check the block  if the filing period (tax period ending) is a **permanent** change. Be sure to file form REV-854.

**Line (5).** Check the block  if you only require a label next year.

### STEP C CHECK SPECIAL FILING STATUS

**Line (6).** Check the block  if the corporation has approved **PA S** status for this tax period. A copy of federal Form 1120S (U.S. Income Tax Return for an S Corporation) must accompany the PACorporate Tax Report (RCT-101).

**Line (7).** Check the block  if this is a **first report**.

**Line (8).** Check the block  if this is a **last report**.

**If not** previously filed, complete REV-238 Out of Existence/Withdrawal Affidavit and attach this form immediately after the RCT-101 and prior to the copy of the federal return, if applicable.

**Line (9).** Check the block  if the corporation filing the annual report is a parent to one or more subsidiary corporations. Attach federal Form 851 to the federal return. Also submit a Consolidated Balance Sheet.

**Line (10).** Check the block  if the corporation is a registered LLC. Make sure the proper forms and/or schedules are enclosed with this report (i.e., federal Form 1065). Refer to Corporation Tax Bulletin No. 118 for further instructions.

**Line (11).** Check the block  if the corporation is a 52-53 week filer.

**Line (12).** Check the block  if the corporation is a family farm and is not subject to the Capital Stock/Foreign Franchise Tax.

**Line (13).** Check the block  if the corporation is a registered first class corporation and is not subject to the Capital Stock/Foreign Franchise Tax.

**Line (14).** Check the block  if the corporation is a qualified Holding Company **AND** is electing to use the special 10% apportionment for Capital Stock/Foreign Franchise tax. (See specific instructions.)

**Line (15).** Check the block  if the corporation is a Regulated Investment Company. (See specific instructions.)

### STEP D TAX SUMMARY

**Line (16). Column A. Tax Liability.** Carry tax liabilities from Pages 2 and 3, Section A, B and C, to Page 1:

- Line ( 18), Section A for Capital Stock/Foreign Franchise Tax (on Page 2).
- Line (4), Section B for Loans Tax (on Page 2).
- Line (14), Section C for Corporate Net Income Tax (on Page 3).

*Enter whole dollars only; enclose negative amounts with parentheses.*

Add the individual tax type amounts, and enter the sum on the TOTAL line of Column A.

**Column B. Estimated Payments and Credits on Deposit for the Current Period.** For each tax, enter the total of estimated payments and credits applied **to the current period**. If you want to use credits from a **prior** year to pay the current period's tax, complete and separately file the REV-855 Custom Refund/Transfer Request Coupon. Do not include any payments **not yet** transferred in this column.

Add the individual tax type amounts and enter this sum on the TOTAL line of Column B.

**Column C. Calculation.** Subtract the amounts in Column B from those in Column A and enter the results in Column C. Amounts less than zero should be placed in parentheses.

The Column C TOTAL should equal both the Column C sum of the three tax amounts and the amount calculated by subtracting Column B TOTAL from the Column A TOTAL.

**Line (17).** If the Column C TOTAL is greater than "0," a payment or transfer of credit is required. STEPE must be completed.

**Line (18).** If the Column C TOTAL is less than "0" or if any amount in Column C is negative, an overpayment exists. STEP F must be completed.

**Line (19).** If the Column C TOTAL is "0," skip to STEP G.

### STEP E TAX PAYMENT APPLICATION

**Line (20).** If the Column C TOTAL is greater than "0," this step must be completed or transfer of credit instructions must be provided. Indicate the amount being paid with this report for each tax. Also indicate the TOTAL PAYMENT which is the sum of the payments for all three taxes.

If the STEP D, Column C calculations for any of the tax types is less than "0," the credit(s) should be applied toward any other current period tax balance. The net tax due and any zero balance tax must be shown in STEP E. The Column C TOTAL from STEP D must equal the TOTAL PAYMENT of STEPE (plus transfer of credit). See the example on the following page.

*Enter whole dollars only.*

#### Reminders:

- TOTAL PAYMENT from STEP E **must equal** Column C TOTAL from STEP D less transfers of credit.
- The amount of payment entered for each tax must be "0" or greater.
- Do **not** include payments for late filing penalty, interest and additions to tax. These items will be computed and separately billed by the PADepartment of Revenue.

**Example of Tax Payment Application (Steps D and E, Page 1, RCT-101):**

**STEP D  
Tax Summary**

16. Compute tax liability for Capital Stock/Foreign Franchise, Loans and Corporate Net Income Taxes on page 2 and 3 then complete this tax summary.

	A. TAX LIABILITY FROM TAX REPORT	B. ESTIMATED PAYMENTS AND CREDITS ON DEPOSIT FOR THE CURRENT PERIOD	C. CALCULATION COL AMINUS Col. B POSITIVE OR (NEGATIVE)	
CAPITAL STOCK FOREIGN FRANCHISE TAX ■	500	200	300	ENTER WHOLE DOLLARS ONLY
LOANS TAX ■	100	-0-	100	
CORPORATE NET INCOME TAX ■	1400	1500	(100)	
<b>TOTAL ■</b>	<b>2000</b>	<b>1700</b>	<b>300</b>	

17. If Column C TOTAL is greater then zero, complete STEP E.  
 18. If Column C TOTAL is less than zero, an overpayment exists. Skip to STEP F.  
 19. If Column C TOTAL is zero, no payment is due. Skip to STEP G.

**STEP E  
Tax Payment Application**

20. Apply C TOTAL from STEP D by tax. The payment amount for each tax must be zero or greater

DEPARTMENT USE ONLY			PAYMENT	
I	P			
		CAPITAL STOCK FOREIGN FRANCHISE TAX ■	200	ENTER WHOLE DOLLARS ONLY
		LOANS TAX ■	100	
		CORPORATE NET INCOME TAX ■	-0-	
		<b>TOTAL PAYMENT ■</b>	<b>300</b>	

**TOTAL PAYMENT MUST EQUAL THE COLUMN C TOTAL FROM STEP D.**  
 MAKE CHECK FOR THIS AMOUNT PAYABLE TO:  
 "PA DEPT. OF REVENUE"

Please check this block  if the TOTAL PAYMENT amount shown to the right has been (or will be) paid by Electronic Funds Transfer (EFT).

- If the combined tax due payment with your RCT-101 is less than \$20,000, make a check in the amount of the total payment payable to the "PA Department of Revenue." Use whole dollars only. Attach the check to Page 1 of the RCT-101 at the space indicated.
- If the combined tax due payment with your RCT-101 is equal to \$20,000 or more, you must make payment through an Electronic Funds Transfer (EFT) Method. Additionally, the block in STEP E, Tax Payment Application must be checked indicating the payment was made through EFT For more information on EFT call 1-800-892-9816. (EFT calls only.)

**STEP F OVERPAYMENT**

**Line (21).** If **any tax type** is overpaid (if any amount is negative at Column C of STEP D), you **must** select one of the STEP F options.

By selecting one of these options, you are instructing the Department of Revenue how you want the overpayment applied and/or refunded

Taxpayers have three options for handling overpayments of tax in the current period. Check the block which directs the Department to handle the overpayment for the current tax period as desired. **TAXPAYERS MUST SELECT ONE, AND ONLY ONE, OF THE OPTIONS LISTED BELOW:**

A. If this option is selected, any overpayment in the current tax period is transferred automatically to off-

set underpaid taxes in the current tax period and the remaining portion of the credit is applied to the next tax period for **Estimated Tax** purposes.

- B. If this option is selected, the **amount** of the overpayment **to be transferred** to the next tax period for **Estimated Tax** purposes **must be entered**. Any overpayment in the current tax period is transferred automatically to offset any underpaid taxes in the current period. Secondly, the designated amount of the overpayment to be applied to the next period will be transferred automatically. Finally, the remaining portion of the overpayment will be refunded.
- C. If this option is selected, any overpayment in the current tax period is transferred automatically to offset any underpaid taxes in the current tax period and the remaining portion of the overpayment will be **refunded**.

**STEP G SIGNATURE**

**Line (22).** **A corporate officer must sign the report.** Otherwise, the report will not be accepted and will be returned to the taxpayer for signature. The signature must be an original one, no photocopies or faxes please. The telephone number and title of the signer must be provided, along with the date signed.

**STEP H SETTLEMENT NOTICE MAILING ADDRESS**

**Line (23).** Check the block  if the Notice of Settlement resulting from the review of this tax report, as well as any request for additional information needed to settle this report, is

to be mailed to the preparer's address which must be entered on Line 24. If the block is not checked, the Notice of Settlement will be mailed to the corporation's address.

**Line (24).** Paid preparers must sign and date all tax returns. The preparer's name, complete address and telephone number along with the Entity ID (EIN) or Social Security Number and the date prepared must be typed or printed in the appropriate blocks.

**RCT-101 - PAGE 2.**  
**SECTION A: CAPITAL STOCK/FOREIGN**  
**FRANCHISE TAX**

**AVERAGE BOOK INCOME:**

**History of Earnings:** The history of earnings should include all taxable periods within the last five years regardless of when PA activity commenced. Due to short tax periods, there may be more than five tax periods in the last five years; however, **the beginning of your oldest period should not go back more than five full years.**

Enter the taxable period's **beginning** and **ending** dates by inserting the two digits representing the month (MM), day (DD), and year (YY) in the appropriate spaces. Enter the data for the oldest period in the first line of the history of earnings. Continue entering the dates and book income (loss) of each taxable period up through the immediate prior taxable period. (Losses) should be indicated by **parentheses**. Skip lines not required for completing the history of earnings.

**Line (1).** Enter the dates and book income (loss) of the current tax period.

**Line (2).** Add/subtract each book income (loss) entry, and enter the total on Line (2).

**Line (3).** Enter in years (including fractional part if necessary) the length of the taxable years in the corporation's history of earnings, carried three places to the right of the decimal point.

- a. If a corporation has existed for more than five full years, and there has been no change in its filing period during this time, enter 5.000.
- b. If a corporation has existed for less than five years, or if it has changed its filing period, enter the number of full years to the left of the decimal point. To the right of the decimal point, enter the result of dividing the number of days in the short period by the number of days in the full year. All taxable periods falling **completely** within the last five years must be included in the history of earnings.

**NOTE: First-year corporations must use the fractional part of the year actually in existence as the divisor.**

**EXAMPLE:** Assume BJM Corporation has a fiscal year end of June 30 from 1993 through 1996. On January 16, 1997, it is purchased by VMJ Corporation and changes to a calendar year end. On December 31, 1997, its five year history of earnings would include the following:

	<b>BEGINNING</b>	<b>ENDING</b>
Oldest Period	070193	063094
	070194	063095
	070195	063096
	070196	011597
Current Tax Period	011697	123197

The fiscal year ending June 30, 1993 is excluded since it would extend the history of earnings beyond five years. Since the history of earnings is 4-1/2 years in length, a four (4) is placed to the left of the decimal point. The period extending beyond the four full years is 184 days.

Therefore,  $184 \div 365 = .504$  which is placed to the right of the decimal point. The entry on Line (3) would be 4.504.

**Line (4).** Divide the amount on Line (2) by the amount on Line (3).

**Line (5).** Enter the amount on Line (4), but not less than 0.

**Line (6).** Capitalize the average book income by dividing Line (5) by .095.

**EXAMPLE:** If average book income on Line (5) is \$ 100,000, Line (6) would be \$1,052,632. ( $100,000 \div .095 = 1,052,632$ ).

**NET WORTH:**

**Line (7).** Enter the **end** of the period net worth. To determine net worth, add capital stock, paid-in capital and retained earnings, and subtract treasury stock. All values are determined as of the **end** of the year. If negative, use negative numbers.

**A corporation with one or more subsidiaries must use consolidated net worth in computing its capital stock value, and should attach a consolidated balance sheet that includes all foreign and domestic subsidiaries.**

**Line (8).** Enter the **beginning** of the period net worth. [See Line (7) above.] If negative, use negative numbers.

**Line (9).** Enter the amount on Line (7) unless:

- a. Line (7) is more than 2 times greater than Line (8)

**-OR-**

- b. Line (7) is less than one-half of Line (8).

If either (a) or (b) is true, add the **end** of the period net worth sum [Line (7)] to the **beginning** of the period net worth sum [Line (8)] and divide by 2. If either Line (7) or Line (8) is less than 0, raise the value to zero (0) before averaging. Enter the amount on Line (9).

**Line (10).** Enter the amount on Line (9) or 0, whichever is greater.

**Line (11).** Multiply Line (10) by 0.75.

**CAPITAL STOCK VALUE:**

**Line (12).** Add Line (6) to Line ( 11).

**Line (13).** Divide Line (12) by 2.

**Line (14).** The \$125,000 valuation deduction has been inserted on the RCT-101.

**Line (15).** The \$125,000 valuation deduction Line (14) is subtracted from Line (13) to determine capital stock value. On Line ( 15) enter this amount or 0, whichever is greater.

**TAXABLE VALUE AND TAX CALCULATION:**

**Line (16).** Enter the proportion from Schedule A-1, Line (5). See instructions for Schedule A-1, on the next page. If there are no exempt assets and all business is conducted in Pennsylvania, make no entry on Line (16).

**Line (17).** If Line (16) is blank, enter the amount from Line (15). If there is an entry on Line (16), multiply Line (15) by the proportion on Line (16) to determine Line (17). If negative, enter "0."

**EXAMPLE:**

1. Assume BJM, Inc. has a capital stock value of \$200,000, has no exempt assets and is not eligible to apportion. Line ( 16) would be left blank and \$200,000 would be entered on Line ( 17).
2. Assume VMJ, Inc. has a capital stock value of \$200,000 with a 75% manufacturing exemption. Line

(16) would be .250000 and Line (17) would be \$50,000 ( $\$200,000 \times .250000 = \$50,000$ ).

**Line (18).** Multiply Line (17) by .01275 (1.275%), and enter this amount on Line (18). Taxpayers filing reports for short periods may prorate the tax based on the number of days in the tax year.

**MINIMUM TAX:** All entities subject to the Capital Stock or Foreign Franchise Tax are required to pay annually a minimum tax of \$300. The minimum tax can be prorated by taxpayers filing short period reports for the actual number of days in the short period.

Domestic and foreign corporations engaged in manufacturing, processing or research and development activities in Pennsylvania, holding companies and regulated investment companies are subject to the \$300 minimum tax, unless the actual computation results in a higher tax. Family farm corporations and corporations of the first class do not have to pay the minimum tax.

Effective for tax years beginning 1-1-97 or later, a corporation that confines its activities in this Commonwealth during the course of a calendar year to attendance at an organized "Show" or "Flea Market" for the purpose of exhibiting its goods and making sales therefrom shall not be subject to the minimum tax imposed under Article VI based solely upon such attendance if limited to no more than twenty days during the year, with no more than five days being consecutive.

## **SCHEDULE A-1 APPORTIONMENT SCHEDULE FOR CAPITAL STOCK/ FOREIGN FRANCHISE TAX**

### **THREE-FACTOR**

**Line (1-3).** Eligible corporations electing to use three-factor apportionment should complete these lines. Those claiming the manufacturing exemption should transfer the numerators and denominators for the property, payroll and sales factors from form RCT-105 to Schedule A-1. Corporations not claiming the manufacturing exemption should obtain this information from form RCT-106, Page 2.

### **SINGLE-FACTOR**

**Line (4).** Corporations electing to use the single-factor taxable assets proportion should complete this line. Those claiming the manufacturing exemption should transfer the numerator and denominator from form RCT-102 to Schedule A-1. Corporations not claiming the manufacturing exemption should obtain this information from form RCT-106, Page 1. Reminder: Foreign corporations electing to use the single-factor must compute the fraction exactly like domestic corporations. (See the instructions for "Additional Schedules for Apportionment of Franchise Tax.")

**Line (5).** For the apportionment proportion, enter either the three-factor **or** the single-factor proportion, but do not combine the two approaches.

a. Three-Factor: Sum the decimals on Lines (1c), (2c) and (3c), and divide by three (3) if all three proportions apply. A factor is ignored if both the numerator and denominator are zero. Divide the sum by two (2) if only two of the proportions apply, or by one (1) if only one proportion applies. Enter the resulting decimal on Line (5). Carry to six (6) decimal places.

- OR -

b. Single-Factor: Divide Line (4a) by (4b) and enter the result on Line (5). Carry to six (6) decimal places.

For corporations using special apportionment, see Special Apportionment Fractions Instructions section of this Instruction Booklet.

## **SECTION B: LOANS TAX**

**Line (1).** Enter the nominal value of taxable indebtedness as computed in Schedule B-1, Page 4 of the RCT- 101. The nominal value is computed by dividing the interest paid during the year by the interest rate applicable to the debt on which the interest was paid.

**Line (2).** Multiply Line (1) by .004.

**Line (3).** Compute and enter treasurer's commission. This amount is computed as follows: 5% on first \$ 1,000 of tax or fractional part thereof; 1% on amount of tax over \$ 1,000 but not exceeding \$2,000; 1/2 of 1% on amount of tax over \$2,000.

**Line (4).** The tax liability is determined by subtracting Line (3) from Line (2).

## **SCHEDULE B-1: CORPORATE LOANS TAX INFORMATION (Page 4, RCT-101)**

**Column 4**—Enter the interest actually paid to Pennsylvania individual resident or resident partnership during the current tax period.

**Column 5**—Enter the interest rate used to compute the interest reported in Column 4.

**Column 6**—Enter the "nominal value of taxable indebtedness" determined by dividing the interest paid in Column 4 by the interest rate in Column 5.

The total nominal value is entered on RCT-101, Page 2, Section B, Line (1).

## **RCT-101—PAGE 3.**

### **SECTION C: CORPORATE NET INCOME TAX**

#### **SECTION C DOES NOT APPLY TO CORPORATIONS WITH APPROVED PAS STATUS**

A copy of federal Form 1120 or other applicable form (U.S. Corporation Income Tax Return) must accompany the PA Corporate Tax Report (RCT101) and be attached immediately following the PA Corporate Tax Report (RCT-101) and before apportionment schedules, manufacturing schedules and extension request documents, if an extension has been approved.

#### **DEDUCTIONS FROM AND ADDITIONS TO INCOME:**

**Line (1).** Income represents "taxable income as returned to and ascertained by the federal government before the net operating loss deduction and special deductions." (Line 28 of federal Form 1120.)

**Line (2).** a. Corporate Dividends received. Dividends received from United States corporations are deductible to the same extent as allowed to arrive at the federal dividend deduction as indicated on federal Schedule C, Column C. An additional deduction will be allowed for dividends received from foreign corporations and reported on Lines 13 and 14 of the federal Schedule C plus a deduction will be allowed for dividends received under Section 78 (foreign dividend gross-up) of the Internal Revenue code of 1986. Taxpayer must complete Schedule C-2, PADividend Deduction Schedule. Specific instructions for Schedule C-2 are shown on Section I, Page 11 in this booklet.

b. Interest on United States Securities. Interest on U.S. securities is deductible, but must be reduced by:

- Any interest on indebtedness incurred to carry the securities;

- Any expenses incurred in the production of such interest income;
- Any other expenses deducted on the Federal Income Tax Return that would not have been allowed under Section 265 of the Internal Revenue Code of 1986, if the interest were exempt from Federal Income Tax.

However, interest from repurchase agreements is not considered interest from U.S. Securities. Therefore, it is not deductible.

To compute the “net” U.S. Interest Deduction on Line (2b):

- Enter the Gross (total) Amount of U.S. Interest received in the GROSS INTEREST block; and
- Enter the Total Expenses attributed to this U.S. Interest Income in the EXPENSES block; and
- Enter the “net” U.S. Interest Deduction (GROSS INTEREST less EXPENSES) in block “b” in the column headed “Taxpayer Use.”

Pennsylvania allows a pass-through exemption from Corporate Net Income for interest or dividend income received from a regulated investment company to the extent such distribution or dividend is derived from obligations free from state taxation. Such obligations include those issued by the U.S. Government, the Commonwealth of Pennsylvania, any public authority, commission, board or other agency created by the Commonwealth, any political subdivision of the Commonwealth, or any public authority created by any such subdivision.

To support any claim for a pass-through deduction for corporate net income tax purposes, the taxpayer must submit evidence that the income was received from a regulated investment company. A schedule must be submitted indicating the percentage of income applicable to exempt obligations and the percentage of income applicable to nonexempt obligations, including repurchase agreements, obligations of the Federal National Mortgage Association, (Fanny Mae), the Government National Mortgage Association (Ginnie Mae) and any other obligations that were not actually issued by the U.S. Government.

All income claimed to be exempt must be reduced by any expenses incurred in the production of such income and this information must be included to support all entries on Line 2b.

- c. Other allowable deductions (attach schedule). As an example, certain charitable contributions may be deductible for a subsidiary corporation which has income on a separate company basis. Targeted Jobs credit wages is another deductible item. If issued prior to February 4, 1994, net gains on the sale of U.S. or PA securities are deductible.

The 50% of travel and entertainment expense that is disallowed on the federal form is **not** permitted as a deduction for Pennsylvania purposes.

Insert the sum of Lines 2a, 2b and 2c on Line (2).

**Line (3).** Line (1) less Line (2).

- Line (4).** a. Enter the total amount of taxes imposed on or measured by net income and deducted on the attached copy of the federal tax return. Include a schedule of taxes expensed even though this schedule is not required for federal purposes. (NOTE: The Capital Stock/Foreign Franchise Tax is **not** a tax measured by net income.)
- b. Enter the total of the tax preference items as defined in Act No. 2 of March 4, 1971, as amended, to the extent that such preference items are not included in “Taxable Income” as returned to and ascertained by the federal government. A copy of federal Form 4626 must be attached to the report even though the tax

preference items do not exceed the applicable federal deductions. The Accelerated Cost Recovery deduction under Section 57(a)(12)(B) of the Internal Revenue Code (Recovery Property which is 15 year realty) is a tax preference item. It should be included on this line, but only to the extent it is not included in taxable income as returned to and ascertained by the federal government.

See the table (Section I, Page 11 ) at the end of these line instructions for a suggested format for the supporting schedule.

- c. **EMPLOYMENT INCENTIVE PAYMENT CREDIT ADJUSTMENT.** In computing wages as a cost for tax purposes, Employment Incentive Payment Credits, claimed under the provisions of the Welfare Reform Act of April 8, 1982, shall be deducted, reducing the wages cost item by any Employment Incentive Payment Credit taken by the corporation. Attach PA Schedule W to the RCT101.
- d. **OTHER ADDITIONS (Attach Schedule).**

Insert the sum of Lines 4a, 4b, 4c and 4d on Line (4).

**Line (5).** Line (3) plus Line (4).

If all business is transacted in Pennsylvania, skip Lines (6) through ( 10). Enter the amount from Line (5) on Line (11).

#### **APPORTIONMENT AND ALLOCATION:**

A taxpayer must have income from business activities taxable by Pennsylvania and at least one other state to allocate and apportion income. For purposes of allocation and apportionment of income, a taxpayer is taxable in another state if in that state the corporation is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business or a corporate stock tax, or that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

“Business income” is income arising from transactions and activity in the regular course of the taxpayer’s trade or business and includes income from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer’s regular trade or business operations. “Nonbusiness income” is all income other than business income. Page 2 of the “Insert Sheet” (RCT- 106) must be completed by all taxpayers allocating “nonbusiness income” and apportioning “business income.” A rider reflecting the basis for nonbusiness income must be attached.

Refer to the “Corporate Net Income Tax Basis” portion of the booklet for more detail.

**Line (6).** Enter the total amount of nonbusiness income (or loss) from Column C, Table 4, of Page 2 of the Insert Sheet (RCT- I 06).

**Line (7).** Enter the amount of income to be apportioned by adding the loss or subtracting the income reflected on Line (6) to or from Line (5).

**Line (8).** Enter the apportionment proportion (carried to 6 decimals) from the computation in Schedule C-1, Line (5) of RCT-101. Carefully read the instructions for Schedule C-1 on the next page.

**Line (9).** Enter the income apportioned to Pennsylvania by multiplying Line (7) by Line (8).

**Line (10).** Enter the total amount of nonbusiness income (or loss) allocated to Pennsylvania from Column A, Table 4 of Page 2 Insert Sheet (RCT-106).

**Line (11).** Add the income or deduct the (loss) reflected on Line (10) to or from Line (9). If the entire business is transacted in Pennsylvania, enter the amount from Line (5) on Line (11). If a loss, add to form RCT- 103.

**NET OPERATING LOSS DEDUCTION**

**Line (12).** Net Operating Loss Deduction. (Enter the total of Column 3 from form RCT-103.) Complete form RCT-103 included in this booklet and attach the form to your RCT-101.

**DETERMINATION OF TAX**

**Line (13).** PA Taxable Income or Net Loss. Line (13) must equal Line (11) minus Line (12). If the amount is less than zero, enter "0."

**Line (14).** Compute and enter the PA Corporate Net Income Tax by multiplying the amount reflected on Line (13) by the current rate of **9.99%** (.0999). All taxes due should be shown in whole dollar amounts.

**SCHEDULE C-1: APPORTIONMENT SCHEDULE FOR CORPORATE NET INCOME TAX**

**Line (1a).** Enter the "total average value" from RCT-106, Page 2, Table 1, Column A, of property within Pennsylvania.

**Line (1b).** Enter the "total average value" from RCT-106, Page 2, Table 1, Column B, of property within and outside Pennsylvania.

**Line (1c).** Divide Line (1a) by Line (1b). The decimal should be computed to six places. (Table 1, Line (C), from RCT106, Page 2.)

**Line (2a).** Enter the "Total Payroll" from RCT- 106, Page 2, Table 2, Column A, Payroll within Pennsylvania.

**Line (2b).** Enter the "Total Payroll" from RCT-106, Page 2, Table 2, Column B, payroll within and outside Pennsylvania.

**Line (2c).** Divide Line (2a) by Line (2b). The decimal should be computed to six places. (Table 2, Line (C) from RCT-106, Page 2.)

Amount for Interest, Rents and Royalties should be summed and reflected on the appropriate line of Table 3, Page 2 of the Insert Sheet (RCT- 106).

Gross sales price of assets sold excluding securities (not gains or losses) should be reflected on the appropriate line. All remaining income items should appear on the "Other Income" line. Do not list non-receipts such as discounts or receipts from sales of securities unless a security dealer.

**Line (3a).** Enter the "Total" from RCT- 106, Page 2, Table 3, Column A, sales within Pennsylvania.

**Line (3b).** Enter the "Total" from RCT- 106, Page 2, Table 3, Column B, sales within and outside Pennsylvania.

**Line (3c).** Divide Line (3a) by Line (3b) and multiply the result by two (2). The decimal should be computed to six places. (Table 3, Line (D), from RCT-106, Page 2.) This is the

result of the Double Weighted Sales Factor legislation signed into law on July 1, 1995.

**Only corporations required to use special apportionment (such as railroad, truck, bus, airline, pipeline, natural gas and water transportation companies - refer to instructions) should complete Line (4).** Others should skip to Line (5).

**Line (4a).** Enter PA revenue miles (or other special factor).

**Line (4b).** Enter total revenue miles (or other special factor).

**Line (5).** For the apportionment proportion, enter either the three-factor or the special apportionment, but do not combine the two approaches.

a. Three-Factor Apportionment—Sum the decimals on Lines (1c), (2c) and (3c), and divide by four (4) if all three proportions apply. A factor is ignored if both the numerator and denominator are zero. If only two of the proportions apply and neither one is the Sales Factor, divide the sum by two. If only two of the proportions apply and one of them is the Sales Factor, divide the sum by three. If only one of the proportions apply (not the Sales Factor), divide by one. If only the Sales Factor applies divide by two. Enter the resulting decimal on Line (5). Carry to six (6) decimal places.

**- OR -**

b. Special Apportionment—Divide Line (4a) by (4b) and enter the result on Line (5), carry to six (6) decimal places.

**SCHEDULE C-2: PA DIVIDEND DEDUCTION SCHEDULE**

This Schedule **must be completed** by all taxpayers claiming a Corporate Dividend Deduction on Line 2 of Section C.

**Line (1).** Enter from federal Schedule C, Line 20 total deductions.

**Line (2).** Enter federal Schedule C, Line 15 Foreign Dividend GrossUp (Section 78 total Column A).

**Line (3).** Enter dividends from less than 20% owned foreign corporations listed on Lines 13 and 14 of federal Schedule C times 70%.

**Line (4).** Enter dividends from 20% or more owned foreign corporations listed on Lines 13 and 14 of federal Schedule C times 80%.

**Line (5).** Enter dividends listed on Lines 13 and 14 of federal Schedule C from foreign corporations that meet the 80% voting and value test of IRC § 1504(a)(2) and otherwise would qualify for 100% deduction under IRC 243(a)(3) if they were from a domestic corporation.

**Line (6).** Enter the total PA Dividend Deduction by adding Lines 1,2, 3, 4 and 5. Enter on RCT-101, Page 3, Section C, Line (2a).

**DEPRECIATION OF REAL PROPERTY UNDER SECTION 1250 OF THE INTERNAL REVENUE CODE ON AN ACCELERATED DEPRECIATION BASIS. [See instructions for Section C, Line 4(b), Tax Preference Items.]**

All taxpayers depreciating real property under Section 1250 of the Internal Revenue Code on an accelerated depreciation basis (which includes leasehold improvements qualifying as Section 1250 assets) should complete, and include with the filing of their PACorporate Tax Report, a schedule for the purpose of allowing a buildup to straight line depreciation and reflecting amounts above straight line depreciation. If the schedule is not completed, any amount above straight line will result in an increase in taxable income as determined by the Department and no adjustment decreasing taxable income by depreciation below straight line will be allowed. Asuggested format for this schedule is set forth below:

Description Of IRC 1250 Real Property	Type of Depreciation (eg., DB, DDB, SYD)	Amount of S.L. Depreciation	Depreciation Expense in This Report	Amount Above S.L.	Amount Below S.L.

# STATUTORY BASIS AND EXPLANATION OF THE TAXES

## CAPITAL STOCK TAX (DOMESTIC CORPORATIONS)

### CAPITAL STOCK TAX - BASIS

This tax is imposed upon the value of capital stock of domestic corporations.

A domestic entity is defined for purposes of the Capital Stock Tax as any, "...corporation having capital stock, every joint-stock association, limited partnership and every company whatsoever, now or hereafter organized or incorporated by or under any laws of the Commonwealth, other than corporations of the first-class, nonprofit corporations and cooperative agricultural associations not having capital stock and not conducted for profit, banks, savings institutions, title insurance or trust companies, building and loan associations and insurance companies."

Effective January 1, 1995 the terms "domestic entity" and "foreign entity," as defined for Capital Stock/Foreign Franchise tax have been amended to include "every business trust (excluding REITs and RICs) to which 15 PA C.S. Ch. 95 (relating to business trusts) applies and that for federal income tax purposes is taxable as a corporation." Similarly, effective January 1, 1995, all Limited Liability Companies (LLCs) except those registered as Restricted Professional Companies (RPCs) will be taxed as corporations and their members will be taxed as shareholders in a corporation.

### ADDITIONAL SCHEDULES FOR APPORTIONMENT/ EXEMPTIONS

The taxpayer must complete Section A of Page 2 of the RCT- 101. In addition, where a claim is made for exempt tangible and/or intangible assets, this claim must be supported by completing the first page of RCT-106, Insert Sheet. A corporation claiming the manufacturing, processing or research and development exemption also is required to complete RCT-102, "Capital Stock Tax Manufacturing Exemption Schedule." The applicable part of RCT- 106 must be completed if any constitutional, public policy or other statutory exemption is claimed.

### APPORTIONMENT OF CAPITAL STOCK TAX

A domestic corporation is permitted to compute and pay its Capital Stock Tax by employing the three (3) apportionment fractions; namely, tangible property, payroll and sales which are applicable to Foreign Franchise Tax in lieu of the single-factor apportionment formula. A domestic corporation (as well as a foreign corporation) can use the three-factor apportionment only if it qualifies. To qualify, the corporation must be taxable outside Pennsylvania and be transacting business outside the Commonwealth. Page 2 of RCT- 106 must be completed by companies electing to compute their taxable value of capital stock by utilizing the three-factor apportionment. However, companies claiming the manufacturing, processing or research and development exemption and electing to utilize the three-factor apportionment formula should complete RCT-105, "Three-Factor Capital Stock/Foreign Franchise Tax Exemption Schedule.

### EXEMPTIONS TO CAPITAL STOCK TAX

Because the tax is imposed upon property, constitutional restrictions require that certain property be exempted in arriving at a taxable value. Ataxable proportion is determined by a fraction, the numerator of which is the average value of nonexempt assets and the denominator of which is the average value of total assets. When the total value of a corporation's capital stock is multiplied by the taxable proportion fraction, the taxable value results.

The following exemptions are allowable:

### CONSTITUTIONAL EXEMPTIONS

1. Tangible property located outside Pennsylvania. Retention of lien or title as security interest is not considered tangible property. Movable tangible personal property must acquire an out-of-state tax situs to be considered exempt.

2. Shares of stock of other PA corporations subject to Capital Stock Tax or Bank Shares Tax. National bank shares only if subject to the PA Shares Tax.
3. U.S. Government obligations, including obligations issued by Bank for Cooperatives, Commodity Credit Corp., Export Import Bank, Farmers Home Administration, Federal Deposit Insurance Corp., Federal Farm Credit Bank Consolidated System Wide Notes, Federal Financing Banks, Federal Home Loan Bank Notes and Consolidated Bonds, Federal Housing Administration Mutual Mortgage Insurance Fund Debentures, Federal Intermediate Credit Bank Bonds, Federal Land Bank Bonds and Federal Land Bank Association Bonds, Federal Reserve Stock, Federal Savings & Loan Insurance Corporation, General Insurance Fund, Guam Bonds, Production Credit Association, Puerto Rico Bonds, Sales of Securities under Agreements to Repurchase, Small Business Administration Notes, Student Loan Marketing Association, Tennessee Valley Authority Power Program Bonds, United States Postal Service, United States Treasury Notes, Bonds, Bills, Obligations and Certificates, Virgin Islands Bonds, Zero Coupon bonds and notes.

### STATUTORY EXEMPTIONS

1. Manufacturing, Processing or Research and Development Exemptions. That portion of the capital stock value of corporations organized for manufacturing, processing or research and development purposes which is invested in and actually and exclusively employed in carrying on manufacturing, processing or research and development within Pennsylvania (except those corporations which enjoy and exercise the right of eminent domain) is exempt. That portion of capital stock value invested in any property or business not [strictly incident or appurtenant] directly related to the manufacturing, processing or research and development business remains taxable.

Corporations entitled to the manufacturing, processing or research and development exemption should refer to the instructions reflected on Page 1 of RCT-102, "Capital Stock Tax Manufacturing Exemption Schedule."

2. "Pollution Control Devices." Equipment, machinery, facilities and other tangible property employed or utilized within the Commonwealth of Pennsylvania for water and air pollution control or abatement devices which are being employed or utilized for the benefit of the general public. The pollution control devices exemption is limited to **tangible property only**; intangible property is not exempt.

Corporations claiming this exemption should exclude the average net book value from the numerator of the taxable proportion if the single apportionment formula is used. The value of the "Pollution Control Devices" excluded should be reflected in the appropriate space on Page 1, Line B of the Insert Sheet (RCT-106). Corporations electing to use the three-factor apportionment formula should exclude the original cost value from the numerator of the property factor (does not apply to Corporate Net Income Tax Apportionment).

All claims for exemptions must be accompanied by a schedule reflecting a description of the pollution control device, location and value. In addition, a copy of the certification issued by the PA Department of Environmental Protection must be submitted initially in support of the exemption claimed for each and every new device.

3. Obligations issued by the Commonwealth of Pennsylvania, any public authority, commission, board or other agency created by the Commonwealth, any political subdivision of the Commonwealth or any public authority created by any such subdivision.

4. Stock of foreign corporations in which the taxpayer owns more than 50 percent of the outstanding shares of voting stock.
5. Shares of stock of cooperative agricultural associations.
6. A corporation which qualifies as a Family Farm Corporation is exempt from Capital Stock or Foreign Franchise Tax provided that the corporation actually is engaged in the business of agriculture in Pennsylvania. For the purposes of this exemption, the business of agriculture means commercially cultivating the ground to produce products in fields or in large quantities, including the preparation of soil; the planting of seeds; the raising and harvesting of crops; the business of operating a commercial greenhouse; the business of horticulture and floriculture; beekeeping; the rearing, feeding, breeding and management of livestock. The business of agriculture also shall include aquaculture, which is defined as the raising of fish and other aquatic animals for direct commercial use as food or other products.

The following activities are not considered to be the business of agriculture:

- a. Recreational activities such as, but not limited to, hunting, fishing, camping, skiing, show competition or racing;
- b. The raising, breeding or training of game animals or game birds, cats, dogs or pets, or animals intended for use in sporting or recreational activities;
- c. Fur fanning;
- d. Stockyard and slaughterhouse operations;
- e. Manufacturing or processing operations of any kind.

For a corporation to qualify for the family farm exemption, the following conditions must be met:

- a. At least 75% of the family farm corporation's assets must be devoted to the business of agriculture and employed within Pennsylvania. The original cost of such assets is utilized in determining whether a corporation meets the asset test unless the taxpayer can show by clear and convincing evidence that the market value is different. To qualify as assets used in the business of agriculture, the assets must be owned and used directly by the corporation claiming the exemption, be devoted principally to the business of agriculture and be property of the sort commonly utilized in such business.
- b. At least 75% of all shares of stock issued by the corporation must be owned by individuals who are members of the same family to satisfy the stock ownership test. Members of the same family mean an individual, his brothers and sisters, the brothers and sisters of the individual's parents and grandparents, the ancestors and lineal descendants of any of them, and a spouse of any of them. Individuals related by the half blood or by legal adoption are treated as if they were related by the whole blood. Stock of the family farm corporation owned, directly or indirectly, by or for a partnership, trust or estate shall be considered as owned proportionately by its partners or beneficiaries. If stock of the family farm corporation is owned by another corporation, such stock shall be considered owned by a family member in that proportion which the stock of such other corporation owned by family members bears to all of the stock in such other corporation, providing that family members own 50% or more of the stock of such other corporation. Where more than one class of stock is issued, the 75% stock ownership test must be met for each class of stock issued.

Corporations claiming the family farm exemption must file annually with the corporate tax report a schedule reflecting the following:

- a. A brief description of the agriculture business;
- b. A listing of all assets reflecting their original cost and designating which are and which are not used principally in the corporation's agricultural business; and

- c. A listing of all owners of stock including the number of shares of stock owned, the class of stock and the relationship of each stockholder within the family.

## FOREIGN FRANCHISE TAX (FOREIGN CORPORATIONS)

### FOREIGN FRANCHISE TAX - BASIS

This tax is imposed upon the exercise of the corporate franchise in Pennsylvania by a foreign entity. A foreign entity for Foreign Franchise Tax purposes is defined as any, "...corporation (effective January 1, 1995 this includes business trusts that for federal purposes are taxed as corporations, limited liability companies except REITs and RICs that are organized as trusts), joint-stock, association, limited partnership and company whatsoever, now or hereafter incorporated or organized by or under the law of any other state or territory of the United States, or by the United States, or by or under the law of any foreign government, and doing business in and liable to taxation within the Commonwealth or carrying on activities in the Commonwealth **including solicitation** or either owning or having capital or property employed or used in the Commonwealth by or in the name of any limited partnership or joint-stock association, copartnership or copartnerships, person or persons, or in any other manner doing business with and liable to taxation within the Commonwealth other than nonprofit corporations, banks, savings institutions, title insurance or trust companies, building and loan associations and insurance companies." Although the exercise of the corporate franchise is the incidence of the tax, the capital stock value is the measure by which the tax is determined.

Act 77 of 1986 has added solicitation to the list of activities which subjects a foreign corporation to Foreign Franchise Tax.

## ADDITIONAL SCHEDULES FOR APPORTIONMENT/ EXEMPTIONS

Foreign corporations are subject to the Foreign Franchise Tax. **The mechanics of calculating this tax are the same as the computation of the Capital Stock Tax paid by domestic corporations.**

### APPORTIONMENT OF FOREIGN FRANCHISE TAX

Corporations claiming apportionment for Foreign Franchise Tax purposes and electing to utilize the three (3) factor formula must complete Page 2 of form RCT-106, Insert Sheet. To qualify to use the three-factor apportionment, a corporation must be taxable outside Pennsylvania and be transacting business outside the Commonwealth.

Those corporations claiming the manufacturing exemption and using three-factor apportionment should use the RCT-105. In either case, the numerators and denominators of the property, payroll and sales factors should be carried forward to Schedule A-1, Page 2 of RCT-101. Do not Double Weight the Sales Factor!

Special apportionment fractions must be utilized only by railroad, truck, bus and airline companies, pipeline or natural gas companies and water transportation companies as indicated in the instructions in lieu of three-factor apportionment.

Foreign corporations may elect to use the single-factor apportionment formula in apportioning their capital stock value in lieu of the three-factor formula. If this election is made, Page 1 of RCT-106, Insert Sheet, must be completed to support this computation. A foreign corporation electing to use the single-factor formula should compute its fraction exactly as if it were a domestic corporation. Its numerator will be the difference between the value of its average total assets and the value of its average exempt assets and its denominator will be the average value of all its assets. The value of intangible assets, unless specifically exempt, must be included in the numerator.

### THREE-FACTOR APPORTIONMENT

Page 2 of the Insert Sheet (RCT- 106) is used to compute the three-factor apportionment. All amounts, not in agreement with information on federal Form 1120 or 1120S, must be reconciled. If used, the RCT-106 must be attached immediately after the PA Corporate Tax Report (RCT- 101).



## Property Factor

The numerator of the fraction is the average value of the taxpayer's real and tangible personal property owned and used or rented and used in Pennsylvania during the taxable period. The denominator of the fraction is the average value of all the taxpayer's real and tangible personal property owned and used or rented and used during the taxable period.

Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from sub-rentals. The average value of property is determined by averaging the values at the beginning and ending of the taxable period, but the Pennsylvania Department of Revenue may require the averaging of monthly or daily values during the taxable period if reasonably required to properly reflect the average value of the taxpayer's property.

A corporation's interest in a partnership or similar association shall be included in the apportionment fraction as a direct interest of the partner in the assets of the partnership. Apportionment of the partnership's real and personal property, both owned and used or rented and used during the taxable period, to the extent of the taxpayer's interest in the partnership, shall be included in the numerator and denominator of the taxpayer's property factor. The owned and used property should be reflected on the "Other Tangible Property" line of Table 1, Page 2 of the "Insert Sheet" (RCT- 106).

The rented and used property should be reflected on the line titled "Partnership Tangible Property Rented."

A copy of the partnership's federal Form 1065 along with a detailed description of all partnership activity must be attached to the "Insert Sheet" (RCT- 106).

## Payroll Factor

The numerator of the fraction is the total amount paid in Pennsylvania during the tax period by the taxpayer for compensation and the denominator of the fraction is the total compensation paid everywhere during the tax period. If the taxpayer has adopted the accrual method of accounting, all compensation properly accrued shall be deemed to have been paid.

Compensation is paid in this state if:

- a. The individual's service is performed entirely within Pennsylvania;
- b. The individual's service is performed both within and outside Pennsylvania, but the service performed outside the state is incidental to the individual's service within the state; or
- c.
  1. Some of the service is performed in the state and the base of operations is in the state;
  2. If there is no base of operations, the place from which the service is directed or controlled is in the state; or
  3. The base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

"Compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal service.

The partnership's payroll shall be included in the denominator of the taxpayer's payroll factor to the extent of the taxpayer's interest in the partnership. The amount of such payroll attributable to Pennsylvania shall be included in the numerator of the payroll factor. These figures should be reflected on the "Other" line of Table 2, Page 2 of the "Insert Sheet" (RCT-106).

## Sales Factor

The numerator of the fraction is the total Gross Receipts of the taxpayer in this state during the tax period, and the denominator is the total Gross Receipts of the taxpayer everywhere during the taxable period.

Sales of tangible personal property are in this state if the property is delivered or shipped to a purchaser within this state.

The partnership's Gross Receipts shall be included in the denominator of the taxpayer's sales factor to the extent of the taxpayer's interest in the partnership. The amount of such Gross Receipts attributable to Pennsylvania shall be included in the numerator of the sales factor. These figures should be reflected on the "Other Income" line of Table 3, Page 2 of the "Insert Sheet" (RCT-106).

Sales, other than sales of tangible personal property, are in this state if:

- a. The income-producing activity is performed in this state; or
- b. The income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

Dividend and U.S. interest income as well as receipts from sales of securities (unless a securities dealer) must be excluded from both the numerator and denominator of the sales factor.

## Nonbusiness Income

The case of **Welded Tube Company of America v. Cmwlth.** 515 A2d 988 (1986) has become the basis for the determination of whether income is business or nonbusiness income.

TRC §401(3)2.(a)(1)(A) as applied by Commonwealth Court in **Welded Tube** determines business income by using two tests. Under the "transactional test" business income is income "...arising from transactions and activity in the regular course of a taxpayer's trade or business..." Under the "functional test," income is business income if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. Under this test a gain arising from the sale of an asset is business income if the asset produced business income while held by the taxpayer.

Rents and royalties from real or tangible personal property, gains, interest, patent or copyright royalties, to the extent that they constitute nonbusiness income, are allocated as reflected below:

1. Net rents and royalties from real property located in this state are allocable to this state.
2. Net rents and royalties from tangible personal property are allocable to this state if and to the extent that the property is utilized in this state, or in their entirety if the taxpayer's commercial domicile is in this state and the taxpayer is not organized under the laws of or taxable in the state in which the property is utilized. "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.
3. The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction. The numerator of the fraction is the number of days of physical location of the property in the state during the rental or royalty periods in the taxable period. The denominator of the fraction is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable period. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, tangible personal property is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.
4. Interest is allocable to this state if the taxpayer's commercial domicile is in this state.
5. Patents and copyright royalties are allocable to this state if and to the extent that the patent or copyright is utilized by the payer in this state, or if and to the extent that the patent or copyright is utilized by the payer in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this state.
  - . A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, or other processing

in the state or to the extent that a patented product is produced in the state. If the basis of receipts from patent royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the patent is utilized in the state in which the taxpayer's commercial domicile is located.

A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

**NOTE: Nonbusiness income of railroad, truck, bus or airline companies, pipeline or natural gas companies, and water transportation companies operating on high seas or inland waters also is allocated as noted above.**

**SPECIAL APPORTIONMENT FRACTIONS**

■ **Railroad, Truck, Bus or Airline Companies:**

All business income of railroad, truck, bus or airline companies shall be apportioned to the Commonwealth of Pennsylvania by multiplying the income by a fraction. The numerator of the fraction is the taxpayer's total revenue miles within the Commonwealth during the taxable period. The denominator of the fraction is the total revenue miles of the taxpayer everywhere during the taxable period. A "revenue mile" means the average receipts derived from the transportation by the taxpayer of persons or property one mile. Where revenue miles are derived from the transportation of both persons and property, the revenue mile fractions attributable to each such class of transportation are computed separately; and the average of the two fractions, weighted in accordance with the ratio of total receipts from each such class of transportation everywhere to total receipts from both such classes of transportation everywhere, is used in apportioning business income to the Commonwealth.

■ **Pipeline or Natural Gas Companies**

All business income of pipeline companies is apportioned to the Commonwealth by multiplying the income by a fraction. The **numerator** of the fraction is the revenue ton miles, revenue barrel miles, or revenue cubic feet miles of the taxpayer in the Commonwealth during the tax period. The **denominator** is the revenue ton miles, revenue barrel miles, or revenue cubic feet miles of the taxpayer everywhere during the tax period. A revenue ton mile, revenue barrel mile or revenue cubic feet mile means, respectively, the receipts derived from the transportation by the taxpayer of one ton of solid property, one barrel of liquid property or one cubic foot of gaseous property transported one mile.

All business income of natural gas companies subject to regulation by the Federal Power Commission or by the Pennsylvania Public Utility Commission is apportioned to the Commonwealth of Pennsylvania by multiplying the income by a fraction. The numerator of the fraction is the cubic foot capacity of the taxpayer's pipelines in the Commonwealth. The denominator of the fraction is the cubic foot capacity of the taxpayer's pipelines everywhere, at the end of the taxable period. Determine the cubic foot capacity of a pipeline by multiplying the square of its radius (in feet) by its length (in feet).

■ **Water Transportation Companies Operating on High Seas:**

All business income of water transportation companies operating on high seas is apportioned to the Commonwealth of Pennsylvania by multiplying the business income by a fraction. The numerator of the fraction is the number of port days spent inside the Commonwealth. The denominator of the fraction is the total number of port days spent outside and inside the Commonwealth.

"Port days" does not include periods when the ships are not in use because of strikes or withheld from service for repair or because of seasonal reduction of services. Days in port are computed by dividing the aggregate number of hours in all ports by 24.

■ **Water Transportation Companies Operating on Inland Waters:**

All business income of water transportation companies operating on inland waters is apportioned to the Commonwealth of Pennsylvania by multiplying the business income by a fraction. The numerator of the fraction is the taxpayer's total revenue miles within the Commonwealth during the taxable period. The denominator of the fraction is the total revenue miles of the taxpayer everywhere during the taxable period. In the determination of revenue miles, one-half of the mileage of all navigable waterways bordering between the Commonwealth and another state shall be considered Commonwealth miles. A revenue mile means the revenue receipts derived from the transportation by the taxpayer of persons or property one mile.

**EXEMPTIONS TO FOREIGN FRANCHISE TAX**

**Pollution Control Devices are exempt from the Foreign Franchise Tax.** Equipment, machinery, facilities and other tangible property employed or utilized within the Commonwealth of Pennsylvania for water and air pollution control or abatement devices which are being employed or utilized for the benefit of the general public are exempt. Effective January 1, 1991, Act 22 of 1991 limited the Pollution Control Devices exemption to **tangible property only**; intangible property is **not** exempt. Corporations claiming this exemption should exclude the original cost value from the numerator of the property factor and attach an appropriate schedule to the Insert Sheet (RCT-106). This schedule should reflect a description of the pollution control device, location and value. A copy of the certification issued by the PA Department of Environmental Protection must be submitted initially in support of the exemption claimed for each and every new device.

**DETERMINATION OF THE CAPITAL STOCK VALUE: FIXED FORMULA (DOMESTIC AND FOREIGN CORPORATIONS)**

The valuation of capital stock of all domestic corporations and all foreign corporations doing business in Pennsylvania is computed using a fixed formula.

The definition of "Capital Stock Value" for Capital Stock Tax and Foreign Franchise Tax purposes reads: "The amount computed pursuant to the following formula: the product of one-half times the sum of the average book income capitalized at the rate of 9.5% plus 75% of net worth from which product shall be subtracted \$125,000, the algebraic equivalent of which is:

$$(.5 \times [\text{average net income} \div .095] + (.75) (\text{net worth})) - \$125,000$$

<b>EXAMPLE:</b>	<b>Corporation with \$190,000 average book income and \$3,000,000 net worth.</b>		
<b>Average Book Income</b>			
\$ 190,000 ÷ .095 =	\$2,000,000		
	+		
<b>Net Worth</b>			
\$3,000,000 x .75 =	\$2,250,000		
		\$4,250,000	
			<b>Capital Stock Value</b>
\$4,250,000 ÷ 2 =	\$2,125,000	- \$125,000 =	\$2,000,000

"Average Book Income" for Capital Stock Tax and Foreign Franchise Tax purposes is the sum of the net book income or loss for each of the current and immediately preceding four years divided by five. If the entity has not been in existence for a period of five years, the average income shall be the average book income for the number of years that the entity actually has been in existence beginning with the date of incorporation. In computing average book income, losses shall be entered as computed, but in no case shall average book income be less than zero. The book income or loss of the entity for any taxable period shall be the amount set forth as income per books on the income tax return filed by the entity with the federal government for such taxable period or, if no such return is made, as would have been set forth had such a return been made, subject, in either case, to any correction thereof for fraud, evasion or error. In the case of an entity which has an investment in another corporation, the net book income or loss

shall be computed on an **unconsolidated** basis exclusive of the net book income or loss of such other corporation, but shall include dividends received.

Corporations which are liquidating under IRC Section 337 must include the gains on sale of assets in book income in the history of earnings. Forgiveness of debt shall also be included in book income.

“Net Worth” for Capital Stock Tax and Foreign Franchise Tax purposes is the sum of the entity’s issued and outstanding capital stock, surplus and undivided profits set forth on the books for the close of the taxable period as reported on the income tax return filed by the entity with the federal government, or if no such return is made, as would have been set forth had such return been made, subject, in

either case, to any correction thereof for fraud, evasion or error. In the case of any entity which has investments in the common stock of other corporations, the net worth shall be the **consolidated** net worth of such entity computed in accordance with generally accepted accounting principles. Net worth shall in no case be less than zero.

If net worth as determined under the above definition for the last day of the current taxable period is greater than twice or less than one-half of the net worth which would have been calculated as of the first day of the current taxable period, then net worth for the period shall be the average of these two amounts. If the end of period net worth or the beginning of period net worth is less than zero (0), the period value must be raised to zero (0).

These computations should be reflected when the taxpayer completes Lines (7) through (10) of Section A, Page 2 of RCT-101.

<b>EXAMPLES:</b>									
<b>FIRSTYEAR CORPORATION</b>									
	<b>1 - 1 -97</b>		<b>12-31 -97</b>						
Capital Stock	0		\$ 50,000						
Retained Earnings	0		150,000						
	<u>0</u>	+	<u>\$200,000</u>	=	\$200,000	÷	2	=	\$100,000 Average Net Worth
<b>GOING CONCERN #1</b>									
Capital Stock	\$ 50,000		\$ 50,000						
Retained Earnings	150,000		450,000						
	<u>\$200,000</u>	+	<u>\$500,000</u>	=	\$700,000	÷	2	=	\$350,000 Average Net Worth
<b>GOING CONCERN #2</b>									
Capital Stock	\$50,000		\$ 50,000						
Retained Earnings	(150,000)		450,000						
	<u>(\$100,000)</u>	+	<u>\$500,000</u>	=	\$500,000	÷	2	=	\$250,000 Average Net Worth
	0	+	\$500,000	=	\$500,000	÷	2	=	\$250,000 Average Net Worth
<b>FINALREPORT</b>									
Capital Stock	\$ 50,000		0						
Retained Earnings	150,000		0						
	<u>\$200,000</u>	+	<u>0</u>	=	\$200,000	÷	2	=	\$100,000 Average Net Worth

**REGULATED INVESTMENT COMPANIES**

Every domestic corporation and every foreign corporation registered to do business in Pennsylvania and (1) which maintains an office in Pennsylvania, (2) has filed a timely election to be taxed as a regulated investment company with the federal government and (3) duly qualifies to be taxed as a regulated investment company under the provisions of the Internal Revenue Code of 1954, as amended, shall be taxed as a regulated investment company, and the Capital Stock or Foreign Franchise Tax shall be the sum of:

1. \$75 multiplied by the quotient rounded to the nearest whole number, produced by dividing the net asset value by one million.  
 “Net asset value” is determined by adding the net asset values as of the last day of each month during the taxable period and dividing the total sum by the number of months involved. Each monthly net asset value shall be the actual market value of all assets owned without any exemptions or exclusions, less all liabilities, debts and other obligations. (See example on next page.)
2. Apportioned undistributed personal income tax income of the regulated investment company multiplied by the personal income tax rate for the same period. (See example on next page.)

“Personal income tax income” includes compensation, net profits from the operation of a business (investment), profession or farm, interest income, dividends, net gains or income from the sale or disposition of property, rents, royalties, patents and copyrights, income from estates or trusts and gambling and lottery winnings.

“Undistributed personal income tax income” means all personal income tax income, other than personal income tax income undistributed on account of the Capital Stock or Foreign Franchise Tax, less all personal income tax income distributed to shareholders. At the election of the company, income distributed after the close of a taxable period, but deemed distributed during the taxable period for Federal Income Tax purposes, shall be deemed distributed during that period. If a company in a taxable period has both current income and income accumulated from a prior period, distributions made during the year shall be deemed to have been made first from current income.

Undistributed personal income tax income is apportioned to Pennsylvania by a fraction. The numerator of the fraction is all income distributed during the taxable period to shareholders who are PAresident individuals, estates or trusts. The denominator of the fraction is all income distributed during the taxable period. Resident trusts shall not include charitable, pension or profit-sharing or retirement trusts.

Personal Income Tax income and other income of a company each shall be deemed either to be distributed to shareholders or undistributed in the proportion each category bears to all income received by the company during the taxable period.

Regulated investment companies should reflect their self-assessed tax on Line 18, Section A on Page 2 of RCT- 101 and insert the abbreviation “Reg. Inv. Co.” on the dotted line area on Lines (11) through (14). The tax is prorated for short periods.

**A schedule reflecting the data utilized in arriving at the Capital Stock or Foreign Franchise Tax must be attached to the RCT-101 PACorporate Tax Report.**

**EXAMPLE:**

$$(1) \quad \frac{\text{Total of Monthly Net Asset Values}}{\$633,000,000} \div \frac{\text{No. of Months}}{12} \quad \frac{\text{Net Asset Value}}{= \$52,750,000} \div \$1,000,000 = \$53^* \times \$75 = \$3,975 \quad (A)$$

\*Rounded to the nearest whole number.

(2)	Undistributed Personal Income Tax Income	x	Income Distributed to Pennsylvania Individuals Estates or Trusts ÷ by Total Income Distributed During Period	=	Apportioned Undistributed Personal Income Tax Income	x	Personal Income Tax Rate (1997 2.8%)	=	\$280 (B)
	\$500,000		\$1,000,000 50,000,000		\$10,000		.028		
(3)	(A) \$3,975	+	(B) \$280	=	Total Tax \$4,255				

**HOLDING COMPANIES**

Any holding company may elect to compute the Capital Stock or Foreign Franchise Tax by applying the tax rate upon each dollar to 10% of the capital stock value. If exercised, this election shall be in lieu of any other apportionment or allocation to which such company would otherwise be entitled.

A holding company is any corporation which meets both of the following tests: (1) the company **must** have gross income at least 90% of which must be derived from dividends, interest, gains from the sale, exchange or other disposition of stock or securities and the rendition of management and administrative services to subsidiary corporations, and (2) the company **must** have assets and at least 60% of the actual value of the ending total assets must consist of stock, securities or indebtedness of subsidiary corporations. This two part test must be met annually.

Holding companies should enter the elected taxable proportion of “.100000 on Line (5) of Schedule A-1 on Page 2 of RCT-101 and insert the abbreviation “Hldg. Co.” on the dotted line area on Lines (11) through (14) of Section A.

**CORPORATE LOANS TAX**

This tax is not actually imposed upon corporations, but upon certain classes of holders of corporate indebtedness. The corporations by statute are designated as the Commonwealth’s agents for withholding the tax from the interest payable on the indebtedness.

**LOANS TAX—BASIS**

This tax is imposed upon intangible personal property restricted to corporate obligations owned by individual residents of Pennsylvania and/or resident partnerships in Pennsylvania. All domestic private corporations issuing, assuming and paying interest on taxable indebtedness and all foreign private corporations doing business in the state which issue, assume and pay interest on taxable indebtedness and have resident treasurers or other comparable officers within the state are required to file the reports and withhold and pay the tax determined to be due.

Nonprofit corporations, mutual savings institutions, mutual casualty and fire insurance companies, cooperative agricultural associations, life insurance companies and building and loan associations are not required to withhold the tax under the provisions of the law.

Taxable indebtedness includes script, bonds, certificates, or other evidences of indebtedness assumed by a corporation on which interest is paid; e.g., notes, mortgages, debentures, bonds, trust certificates, etc. Bank notes or notes discounted by any bank or banking institution, savings institution or trust company, interest bearing accounts in any bank, banking institution, savings institution, employee’s thrift or savings institution or trust company, ground rents and bailment leases are examples of exempt forms of indebtedness.

Tax is payable only in the event a corporation pays interest on indebtedness during the year. No tax is imposed when holders of corporate indebtedness are domestic or foreign corporations, residents of other states, banks, savings institutions, title and trust companies, savings institutions without capital stock, building and loan associations, charity institutions, pension or profit sharing trusts exempt under the Internal Revenue Code, fire companies and fire relief associations, life insurance companies and mutual casualty and fire insurance companies, secret and beneficial societies, labor union and labor union relief associations, beneficial organizations paying sick or death benefits and certain cooperative associations.

**CORPORATE NET INCOME TAX (DOES NOT APPLY TO CORPORATIONS WITH APPROVED PAS STATUS)****CORPORATE NET INCOME TAX—BASIS**

The Corporate Net Income Tax is imposed on domestic and foreign corporations for the privilege of doing business, carrying on activities, having capital employed or used or owning property in Pennsylvania. Certain entities are specifically excluded from the tax including building and loan associations, banks, bank and trust companies, national banks, savings institutions, trust companies, insurance and surety companies and PAS Corporations.

**ADDITIONAL SCHEDULE FOR APPORTIONMENT THREE-FACTOR APPORTIONMENT**

Refer to the explanation of Apportionment in the section for Capital Stock Tax and Foreign Franchise Tax. All provisions and schedules for Three-Factor Apportionment and Special Apportionment are the same except that, effective with tax periods beginning on or after January 1, 1995, a Double Weighted Sales Factor **MUST** be used to apportion a taxpayer’s Pennsylvania taxable income or losses. On form RCT- 106, Page 2, Table 3, Line D is the computation of the Double Weighted Sales Factor which is then carried over to form RCT-101, Schedule C-1.

**NET OPERATING LOSSES**

Effective for tax periods beginning on or after January 1, 1995, taxpayers are again permitted to offset Pennsylvania taxable income with carry overs of net operating losses (NOLs). The allowable NOL carryforward can not exceed \$1,000,000 in any tax period. Also, no more than \$500,000 of the NOL carryforward can be comprised of previously unused and suspended NOL’s from tax periods 1990 through 1993. (Act 22-91 previously suspended the NOL carryforward provision.) In addition, the unused NOL’s are subject to special carryforward provisions as to what years they may be applied. Refer to form RCT- 103, Net Operating Loss Schedule, for further instructions.

**PENNSYLVANIA CORPORATE TAX REPORT  
INSTRUCTIONS FOR FORM PA-20S**

**GENERAL INSTRUCTIONS**

**INTRODUCTION**

This book explains taxation of PA S Corporations and their shareholders under the Tax Reform Code of 1971.

Effective for tax years beginning in 1984, qualified small corporations could elect to be taxed as a PAS Corporation.

**DUE DATE FOR FILING THE PA-20S INFORMATION RETURN**

The PA-20S must be filed on or before the 15th day of the fourth month following the close of the corporation's tax year; e.g. April 15 for a calendar year PAS Corporation.

The PA S Corporation's Capital Stock/Foreign Franchise Tax Return (RCT-101) also is due on or before the 15th day of the fourth month following the close of the corporation's tax year; e.g., April 15 for a calendar year filer.

The U.S. Postal Service postmark date on the envelope is proof of timely filing.

**EXTENSION OF TIME TO FILE THE PA-20S INFORMATION RETURN**

There are two ways to obtain an extension to file.

1. If the corporation is granted an extension of time for filing its Federal 1120S by the IRS, the corporation will be granted an extension of time to file its PA-20S. You must attach a copy of the letter or form granting the federal extension to your PA-20S when it is filed.

However, the PA-20S extension does not automatically grant an extension for the filing of the Pennsylvania Corporate Tax Report (RCT-101). Instructions covering requests for an extension to file the PACorporate Tax Report are reflected in Section I of this Instruction Booklet. The granting of an extension to file the PA Corporate Tax Report automatically will grant the same extension for the filing of the PA-20S.

2. If the PA S Corporation has not been granted an extension of time for filing the federal return, it still may request an extension for filing the PA S return. The extension request must be in writing and received in sufficient time for the Department to consider and act upon it prior to the due date of the PA-20S return. Mail the extension request to the PA Department of Revenue, Bureau of Corporation Taxes, Specialty Tax, Dept. 280704, Harrisburg, PA 17128-0704.

No extension will be granted for longer than six months.

**NOTE: A corporate extension will not automatically produce a comparable extension to file for shareholders of the PA S Corporation. EACH shareholder, individually, must have an approved extension to file the (PA-40) PA Personal Income Tax Return or (PA-41) Fiduciary Income Tax Return.**

**AMENDED INFORMATION RETURNS**

If, at any time after the corporation files its PA-20S, it discovers that it **underreported** its income or erroneously claimed credits or deductions to which it was not entitled, or events transpire which increase its reportable income, including an IRS Report of Change, it must correct the error by completing and filing a PA-20S (clearly marked) "**Amended Return**" and provide its shareholders with amended Schedule RK-1's or NRK-1's (REV-1682) within 30 days from the determination of such increase. The corporation's shareholders must

file an Amended PA Individual Income Tax Return upon receipt from the corporation of the amended RK-1's or NRK-1's.

For shareholders to receive a refund of taxes they paid if the corporation has **overreported** its income or is entitled to credits or deductions which it failed to claim, the corporation must complete and file an amended PA-20S and provide its shareholders with amended Schedule RK-1's or NRK-1's, (REV-1682) in sufficient time for the shareholders to file an Amended PA Individual Income Tax Return within the PA Personal Income Tax three-year refund statute of limitations.

See the PA-40 Instruction Booklet "Amended Return" for Resident or Nonresident Shareholders.

**CHANGES MADE BY DEPARTMENT**

If the Department makes any changes to the corporation's PA-20S return, the corporation must provide its shareholders with amended RK-1's or NRK-1's upon notification of the change made by the Department. The corporation's shareholders must file an Amended PA Individual Income Tax Return.

**RECORDS MUST BE MAINTAINED**

All amounts reported on the PA-20S and its accompanying schedules are subject to verification and audit by the Department. Books and records must be maintained to verify such information. The statute of limitations is three years.

**PENNSYLVANIA S  
CORPORATION STATUS**

**EFFECT OF PENNSYLVANIA S CORPORATION STATUS**

As a PA S Corporation:

1. The corporation will not be subject to the corporate net income tax and Section C, Page 3 of RCT-101 does not have to be completed.
2. The corporation will remain subject to all other PA corporate taxes including the Capital Stock or the Foreign Franchise Tax.
3. The income, loss and credits of the PA S Corporation will be passed through to the shareholders in the applicable class of income and taxed under the PA Personal Income Tax Act. Pennsylvania law states that income and (losses) are determined in accordance with "generally accepted accounting principles and practices." Personal Income Tax rules, unless otherwise stated, must be used to determine the income of the corporation which is passed through to each shareholder on a pro rata share whether the income is distributed or not distributed.

**QUALIFIED SUBCHAPTER S SUBSIDIARIES**

For Personal Income Tax purposes, a qualified Subchapter S subsidiary owned by a Pennsylvania S Corporation shall not be treated as a separate corporation, and all assets, liabilities and items of income, deduction and credit of such qualified Subchapter S subsidiary shall be treated as assets, liabilities and items of income, deduction and credit of the parent Pennsylvania S Corporation.

**OBTAINING PENNSYLVANIA S CORPORATION STATUS**

A corporation may become a PA S Corporation if

1. It is a "small corporation" as defined below;

2. All shareholders of the corporation consent to the corporation's election of PAS Corporation status; and
3. The corporation files an election with Pennsylvania to indicate its choice of PA S Corporation status.

A qualified Subchapter S subsidiary is not eligible to elect Pennsylvania S Corporation tax treatment independent of its parent Federal S Corporation. A qualified Subchapter S subsidiary will not receive Pennsylvania S Corporation tax treatment if its parent Federal S Corporation does not have a valid Pennsylvania S Corporation election in effect.

## SMALL CORPORATION

To elect PAS status, a corporation must meet the definition of a small corporation as contained in the PA Personal Income Tax Act. The requirements of a small corporation are:

1. The corporation must have a valid and approved federal election in effect under Section 1361 (Subchapter S) of the Internal Revenue Code as amended to January 1, 1997.
2. The corporation must not have passive investment income in excess of 25% of its gross receipts. (See "Passive Investment Income," Section II, Page 7.)

## PENNSYLVANIA ELECTION AND CONSENT

A corporation which qualifies as an eligible small corporation must elect affirmatively to be treated as a PA S Corporation. **Although Federal S Corporation status is a requirement to elect PAS status, it will not automatically confer PA S status on the corporation.**

## FORM AND METHOD OF ELECTION-REV- 1 640

Any corporation which qualifies as a small corporation may elect Pennsylvania S status by completing and submitting:

1. The PA S Corporation Election and Shareholders' Consent form, REV-1640. All information on the election form including the name of the corporation, the name, address, social security number and signature of all shareholders, percentage of stock held by each shareholder, as well as the statement of election signed by an authorized officer of the corporation must be completed and submitted to the PA Department of Revenue, Bureau of Corporation Taxes, Specialty Tax, Dept. 280704, Harrisburg, PA 17128-0704.
2. A copy of the federal Notice of Approval of S Corporation status at the same time that the Pennsylvania election form is submitted. Corporations which have requested federal S Corporation status, but have not yet received the federal Notice of Approval, may start the election process for Pennsylvania by submitting a completed REV-1640 and noting that the federal Notice of Approval will be forwarded when received by the corporation.
3. The corporation shall attach a schedule to the Pennsylvania S Corporation election identifying the name, address, Pennsylvania Corporation Tax Account ID (box) number, if applicable, and Federal Employer Identification Number of each qualified Subchapter S subsidiary owned by the corporation.

If the corporation is unable to obtain a copy of the federal Notice of Approval, the corporation may submit, in lieu thereof, a copy of the latest federal Form 1120S return filed by the corporation with the federal government.

## SHAREHOLDERS' CONSENT

A corporation's election of PAS Corporation status is valid only if all shareholders sign a consent to the election. A shareholder's consent is binding and may be revoked only as explained in "Revoking Pennsylvania S Corporation Status."

## WHO MUST CONSENT?

Each person who is a shareholder at the time the election is made must consent to the election.

**Co-owners.** Each co-owner, tenant by the entirety, tenant in common and joint-tenant must sign the consent. Also, if stock is owned as community property or the income from the stock is community property, the consent must be signed by both the husband and wife.

**Minors.** If minors own stock that is in the name of a guardian or custodian, each minor is considered a shareholder. The consent of a minor may be made by the minor or by his or her legal guardian. A custodian may give consent only if he or she is also the legal or natural guardian of the minor, unless the stock is being held in accordance with the provisions of the Uniform Gifts to Minors Act. In such cases, the custodian of the account may consent to the election.

**Estates.** The consent of a qualified estate holding stock in an S Corporation must be made by the executor or administrator of the estate.

**Trusts.** The consent of a qualified trust holding stock in an S Corporation must be made by each person who is counted as a shareholder of the S Corporation for federal tax purposes.

## FORM OF CONSENT

Shareholders may consent to a corporation's election to be treated as a PA S Corporation by providing the information that is required on the PAS Corporation Election and Shareholders' Consent form, REV-1640, and signing in the appropriate space.

Shareholders also may consent by signing a separate statement of consent, which may be attached to the Pennsylvania form. The separate consent must contain:

1. The name, address, Account ID and Entity ID (EIN) of the corporation.
2. The name, address, social security number or identification number of the shareholder(s).
3. The percentage of stock ownership owned by the shareholder and the date or dates acquired. Do not list the percentage of shares of stock for those shareholders who sold or transferred all stock in the corporation during the part of the tax period that occurred before the Pennsylvania election form is filed with the PA Department of Revenue.
4. The day and month of each shareholder's tax period end.

The consent of all shareholders may be included in one statement. The corporation's election to be treated as a PAS Corporation is not valid if any consent is not timely filed.

## EFFECTIVE DATE OF ELECTION

An election filed on or before the 15th day of the third month of a current tax period is effective for the current tax period. An election filed after the 15th day of the third month of the current tax period is effective for the following tax year of the corporation. Thus, if a calendar year corporation files its election on or before March 15, 1998, its election will be effective for the 1998 calendar year. If however, the corporation files its election after March 15, 1998, its election will be effective for the 1999 calendar year.

Corporations reporting on a fiscal year, other than a calendar year, must file their election on or before the 15th day of the third month of the corporation's fiscal year. For example, a corporation with a fiscal year beginning December 1 must file its notice of election by February 15, 1998, to be effective for fiscal year 1997-98.

If a corporation makes an election for a short taxable period, the election must be filed on or before the 15th day of the third month to be effective for such short taxable period. For example, if a corporation has a short fiscal year which runs from July 1, 1997 to December 31, 1997, the corporation's election will be effective for the short calendar year if it is filed on or before September 15, 1997. If filed after September 15, 1997, the election will be effective for the corporation's subsequent tax year/period.

Newly formed corporations must file within 75 days of incorporation date or first date of activity in Pennsylvania.

### **WHEN ELECTIONS ARE CONSIDERED EFFECTIVE**

A corporation's Pennsylvania S election is not deemed made until:

- The Department receives a completed and signed REV-1640, Pennsylvania S Corporation Election and Shareholders' Consent form;
- All shareholders required to consent submit their consent; and
- The federal S status has been approved and the required federal forms are filed with the Pennsylvania Department of Revenue except:

Where a corporation has requested S Corporation status from the federal government, but has not yet received its federal Notice of Approval, the corporation's election will be deemed made as of the date the corporation's election and shareholders' consent are filed with the Department provided federal approval is granted. The federal Notice of Approval must be filed with the Department promptly upon its receipt.

The Certified Mail Receipt is proof of timely filing.

### **ACKNOWLEDGEMENT OF RECEIPT OF ELECTION**

Within approximately ninety (90) days from the receipt of this election, the Department of Revenue will issue a conditional approval letter granting PA S status. The letter will be mailed to the taxpayer or their representative, whoever made the election. If a letter is not received within this time, the taxpayer should call the Bureau of Corporation Taxes at 717-783-6035 to verify if the election was received. It is the exclusive responsibility of the taxpayer or its representative to provide timely proof of mailing, preferably a certified mail receipt.

### **DURATION OF PENNSYLVANIA S CORPORATION ELECTION**

Once an election to be treated as a PA S Corporation is made, it is effective for the first tax year as explained in the instructions and all future tax years until such election is either terminated or revoked. "Termination or Revocation of Pennsylvania S Corporation Status is explained in this Instruction Booklet.

### **CORPORATION'S TAX YEAR**

Any corporation which elects PA S Corporation status must use the same year that is used in reporting to the federal government.

### **FIGURING PENNSYLVANIA S CORPORATION PERSONAL INCOME TAX, INCOME AND EXPENSES**

For PA Personal Income Tax purposes, the reportable income of a PA S corporation generally is computed in the same manner as the Pennsylvania taxable income of an individual, with the following differences:

1. Any class of income, loss or credit item, the separate treatment of which could affect the PA Personal or Fiduciary Income Tax liability of any shareholder, is stated separately on the PA S Corporation Information Return (PA20S) and must be passed through in the applicable class of income only to the appropriate shareholder(s).
2. The items that may be claimed by an individual for PA Personal Income Tax purposes that may not be claimed by a PAS Corporation are:
  - a. The deduction for unreimbursed employee business expenses.
  - b. Special tax forgiveness credit.

### **INCOME**

Taxable income in respect of a PA S Corporation is taxable to its shareholders, WHETHER OR NOT IT IS DISTRIBUTED. The character of any item includable in a shareholder's share is determined as if the item were realized directly by the shareholder from the source from which it was realized by the PAS Corporation or incurred in the same manner as incurred by the PA S Corporation. Actual distributions of money or property are not taxable so long as the shareholder's basis in their stock is not exceeded.

All PA S Corporation income, gain, loss, expense, cost or liabilities for the taxable period must be placed in one of the following income classes:

1. Net income or loss from the operation of a business, profession or farm;
2. Interest derived from obligations which are not statutorily free from Pennsylvania taxation;
3. Dividends;
4. Net gain or loss from the sale, exchange or dispositions of property;
5. Net rents, royalties, patent or copyright income or loss; and
6. Gambling and lottery winnings.

In computing the income of the PA S Corporation, you cannot offset gains in one of the above classes with a loss in any other class; nor may losses be carried back or forward to another taxable period. Losses shown on the REV-1682 RK-1 or NRK-1, however, may be set-off by a shareholder against gains in that same class received from other sources by the shareholder.

### **OTHER RULES**

The PA S Corporation may deduct allowable costs and expenses attributable to business, profession or farm income, income from the sale, exchange or disposition of property or rents and royalties.

Forfeited interest penalties incurred by the corporation, which result from a premature withdrawal of a time deposit, may be deducted only against the interest income from that account or certificate. You cannot offset such interest penalty against other interest income, if the total penalty exceeds the interest on an account or certificate. The excess may be taken as a loss on PA Schedule D.

### **ALLOCATION OF INCOME**

Shareholders who are nonresident individuals, estates or trusts are taxed only on taxable income allocable to Pennsylvania. Items of income, loss, cost, expense and liability not allocable to Pennsylvania are ignored in computing the Pennsylvania taxable income of such shareholders.

Special allocation rules apply to each of the following:

- Net gains or income/loss derived through trusts, estates, partnerships and other PAS Corporations;
- Net profit or loss from the operation of a business, profession or farm;
- Net gains or losses from the sale, exchange or disposition of tangible property;
- Net gains or losses from the sale, exchange or disposition of intangible personal property;
- Net gains or income/loss from ownership of property.

Additional detailed information on Allocation of Income is contained in the PADepartment of Revenue publication PA-65I, Information for Partnerships.

### **BASIS AND GAIN RULES**

1. The method of accounting, inventory valuation and tax year chosen by the corporation for its federal Form 1120S also must be used in completing the PA-20S.

2. Internal Revenue Code rules for determining basis, adjustments to basis and gains by the corporation generally are to be followed with these exceptions:
  - For business assets placed into service after 1982, their basis will not have to be reduced by a percentage of the Federal Income Tax credit for which the asset qualifies.
  - Losses realized by a PA S Corporation on bona fide sales or exchanges of property with related taxpayers may be offset against any gains received from other sales or exchanges. See Federal Publication 589 for definition of “related taxpayers.”
3. If the asset being disposed of by the corporation was acquired prior to June 1, 1971, the June 1, 1971 valuation should be used in determining gain or loss. See the PA-40 Instruction Booklet on “Computation of June 1, 1971 Value.”
4. Beginning with sales made on or after January 1, 1984, the corporation may elect to report a gain from an installment sale of real or tangible personal property on the installment sales method. See the PA-40 Instruction Booklet on “Installment Sales.”
5. There is no preferential treatment for gains recognized as “capital gains” under the Internal Revenue Code and no disadvantageous treatment for losses recognized as “longterm” under the Internal Revenue Code.

### **DEFINING NET PROFITS/LOSS FROM BUSINESS, PROFESSION OR FARM**

Net profits or loss from the operation of a business, profession or farm are computed solely by reference to those items of revenue, cost expense or liability that are derived or incurred either:

1. In the ordinary course of, and from or in “the operation of a business”; or
2. In connection with securities employed as working capital in “the operation of a business,” accounts and notes receivable from sales of products or services sold in the ordinary course of “the operation of a business” or assets which serve an operational function in the ordinary course of “the operation of a business.”

In order to constitute the “operation of a business,” each of the following requirements must be met:

1. The PA S Corporation must market a product or service to customers on a commercial basis;
2. Such marketing activity must be conducted (or must ordinarily be conducted) with the manifest objective of achieving profitable operations; AND
3. Such marketing activity must be conducted with regularity and continuity and must not be limited or exclusive.

Choosing to form a corporation and receiving and reporting income or gain as corporate income does not alone make the income in the ordinary course of, and from the operation of a business.

Net profits or loss from the operation of a business, profession or farm must be computed **WITHOUT REFERENCE** to any item of revenue, cost, expense or liability derived or incurred in connection with, or attributable to:

- Asale, discontinuation or abandonment of a business or segment thereof.
- An event or transaction of a type that not only would not reasonably be expected to recur in the foreseeable future, but also possesses a high degree of abnormality vis-a-vis other events or transactions in the course of the PA S Corporation’s business operations.
- The ownership or disposition of assets that are held for longterm investment purposes or otherwise serve an investment function.

- Trading in securities on an established securities market for personal purposes and not for the accounts of customers.
- A nonoperating interest in coal, oil, gas or minerals in place (unless they will serve an operational function in the operation of the holder’s business).
- Any tax imposed on, or measured by, gross or net earned or unearned income.

### **Allowable Deductions**

Only ordinary, reasonable, current expenses paid or incurred during the taxable period that are necessary to the production and marketing of products or services are allowable deductions. If an expense is part business and part personal, the personal part must be separated from the business part and only the business part is deductible. Deductions allowable under MACRS, including the IRC Section 179 additional first year depreciation allowance for small businesses, are acceptable depreciation deductions for Pennsylvania purposes.

### **DEFINING NET RENTS AND ROYALTIES**

Gross rents and royalties include all items of gross income or receipts derived from rents, royalties, patents, copyrights, secret processes, formulas, goodwill, trademarks, trade brands, franchises and similar property, derived in the form of rents or royalties or incidental to the production of rents and royalties **OTHER THAN**:

1. Income or receipts derived from the sale, exchange or other disposition of rents, royalties, patents, copyrights, secret processes, formulas, goodwill, trademarks, trade brands, franchises and similar property.
2. Income or receipts derived from operating oil, gas or mineral interests includable in the computation of net profits or loss from business, profession or farm or otherwise derived in the ordinary course of, and from the operation of a business.

### **Allowable Deductions**

Only expenses paid or incurred during the taxable period which are ordinarily incurred and necessary for the production or collection of rents and royalties or the management, conservation or maintenance of rents, royalties, patents, copyrights or similar property are deductible. Such expenses include advertising, cleaning and maintenance, agents’ commissions, insurance, legal fees, management fees, interest, repairs, supplies, utilities and depreciation expense or depletion. Deductions allowable under MACRS, including the IRC Section 179 additional first year depreciation allowance for small businesses, are acceptable depreciation deductions for Pennsylvania purposes.

Deductions are not allowable for capital investment or capital improvements.

### **RENTS VS. NET PROFITS**

The leasing of tangible property constitutes the marketing of a product or service only if one or more of the following applies:

- The average period of customer use of the property is 30 days or less, or the property is customarily made available for use only during defined business hours.
- In connection with the leased property, the PAS Corporation also provides significant services to the lessee or, relative to rents, substantial current operating expenses directly related to the delivery of products or services to the lessee are incurred.
- The leasing activity is incidental to a real estate sales business.

Generally, services are considered provided to a lessee if they are primarily for the lessee’s convenience and they customarily are not provided in connection with the rental of rooms or other space for occupancy only. For example, the provision of maid service constitutes a significant service. However, furnishing self-operating elevators, heat, electricity, light, cleaning public entrances, exits, stairways and lobbies and collecting trash are not considered as services.



## DEFINING INTEREST

Interest includes any charge for money borrowed OTHER THAN:

1. Interest derived from purchase money mortgages on real estate or land contracts that is includable in the computation of net gains or income derived from the sale, exchange or other disposition of property;
2. Interest incidental to the production of rental or royalty income that is includable in the computation of net rents and royalties;
3. Interest derived from assets employed as working capital in a business, and from accounts and notes receivable from sales of products or services sold in the ordinary course of business that is includable in the computation of net profit or loss from the operation of a business, profession or farm; and
4. Interest which is statutorily free from Pennsylvania taxation

## TERMINATION OR REVOCATION OF PENNSYLVANIA S CORPORATION STATUS

A corporation's election of PA S Corporation status remains effective until it is terminated by the Commonwealth of Pennsylvania or until revoked by the shareholders. At any time, shareholders who own more than 50% of the outstanding stock in the corporation may revoke PA S status. The corporation's status as a PA S Corporation may be terminated in either of the following ways:

- By ceasing to qualify to be an S Corporation under Subchapter S of the Internal Revenue Code of 1986, as amended to January 1, 1997.
- By violating the passive investment income restrictions. (See Section II, Page 7.)

**Five-Year Rule.** If the election has been revoked or the PA S status terminated for failing the passive investment income test, the corporation or any successor corporation is not eligible to make an election for any tax year/period prior to its fifth taxable year/period which begins after the first taxable year/period for which the revocation or termination is effective.

In other words, there must be five (5) taxable periods (not necessarily 12 month periods) as a C corporation between the end of the last S corporation period, before the effective date of the revocation or termination, and the beginning of another period covered by an S Corporation election.

**EXAMPLE:** A calendar year corporation revokes its "S" status as of September 1, 1992. Generally, it cannot reelect "S" status until the period beginning January 1, 1997. If the end of the last "S" corporation taxable period is December 31, 1992, generally, the "S" status cannot be elected again until the period beginning January 1, 1998.

## REVOKING PENNSYLVANIA S CORPORATION STATUS BY SHAREHOLDERS

PAS Corporation status can be revoked only if shareholders who collectively own more than 50% of the outstanding shares in the PA S Corporation's stock consent to the revocation. The consenting shareholders must own their stock in the corporation at the beginning of the day the revocation is filed.

**How to Revoke.** The revocation must be made by the corporation and it must be in the form of a statement or on the form prescribed by the Department. A statement of shareholders' consent to the revocation must be attached to the S Corporation's revocation statement. These statements must be sent to the PADepartment of Revenue, Bureau of Corporation Taxes, Specialty Tax, Dept. 280704, Harrisburg, PA 17128-0704.

1. The statement of revocation must provide:

- That the corporation is revoking its election to be treated as a PA S Corporation;

- The number of shares of stock (including nonvoting stock) that are outstanding at the time the revocation is made; and
- The date on which the revocation is to be effective.

This statement must be signed by an authorized corporate officer.

2. The statement of consent must indicate that each shareholder who signs it consents to the revocation of PA S Corporation status. It also must provide the number of shares of outstanding stock (including nonvoting stock) each consenting shareholder holds at the time the revocation is made.

**Effective Date of Revocation.** The revocation is effective:

1. On the first day of the tax period, if the revocation is made on or before the 15th day of the third month of the tax period.
2. On the first day of the following tax period, if the revocation is made after the 15th day of the third month of the current tax period.
3. On the date specified, if the revocation specifies a date on or after the date the revocation is made.

See "Pennsylvania S Revocation or Termination Year" for information on filing returns for the revocation year.

## TERMINATION BY STATE OF PENNSYLVANIA

**Ceasing to Qualify.** A corporation's status as a PAS Corporation will be terminated if the corporation ceases to qualify to be an S Corporation for Federal purposes pursuant to the requirements of the Internal Revenue Code of 1986, as amended to January 1, 1997.

Events that may cause the corporation to cease to qualify as an S Corporation include:

1. Having more than 75 shareholders (A husband and wife and their estates are counted as one shareholder in determining number of shareholders without regard to manner in which stock is owned.);
2. Transferring stock in the S Corporation to:
  - A corporation,
  - A partnership,
  - An ineligible trust, or
  - A nonresident alien;
3. Creating a class of stock other than the voting and nonvoting common stock allowed;
4. Violating the Passive Investment Income Restriction. (See next section.)

**Effective Date of Termination.** The corporation will be a PA S Corporation on the day before the terminating event and will not be a PAS Corporation on the day of and the days following the event. The PA S Corporation status can be terminated at any time on or after the first day of the first tax year for which the corporation is a PA S Corporation.

See "Pennsylvania S Revocation or Termination Year" for more information on filing tax returns for the termination year.

## VIOLATING THE PASSIVE INVESTMENT INCOME RESTRICTION

- The PAS Corporation will lose its status if its passive investment income for the year is more than 25% of gross receipts. (See Section II, Page 7.)
- A termination of PA S Corporation status because of a violation of the passive investment income restriction will be retroactive to the beginning of the tax year in which the violation occurs.

**NOTE: If this violation occurs in the first year for which the election is made, the election is not effective for that year, and the corporation is responsible for reporting and paying Corporate Net**

**Income Tax. The election is not terminated but becomes effective for the next tax year. This is done automatically without any action required of the corporation or its shareholders.**

If the violation occurs in the first and second year for which the election is made, there is a termination of PA S status retroactive to the beginning of the first tax year. The corporation must then make a new election for the following year.

If a violation occurs in any year after a year in which S status has been granted, there is a termination of the PAS status for the year in which the violation occurs. Additionally, the corporation is subject to a five-year rule.

### **PENNSYLVANIA S REVOCATION OR TERMINATION YEAR**

A PA S revocation or termination year is the tax year of a PA S Corporation in which the corporation is treated as a PA S corporation for part of the tax year and a corporation subject to Corporate Net Income Tax for the balance of the tax year.

The Pennsylvania S revocation or termination year is divided into two periods for filing tax returns. These periods are known as:

1. The PA-20S short taxable year; and
2. The RCT-101 short taxable year.

The corporation must file two returns to cover the revocation or termination year; one that covers the PA-20S short taxable year and one that covers the RCT-101 short taxable year.

**PA-20S Short Taxable Year Return.** The PA-20S short taxable year is the part of the revocation or termination year that begins on the first day of the corporation's tax year and ends the day before the revocation or termination is effective.

**Corporate Net Income Tax - RCT-101 Short Taxable Year Return.** The Corporate Net Income Tax RCT- 101 short taxable year is the part of the Pennsylvania S revocation or termination year that begins on the day the revocation or termination is effective and ends on the last day of the corporation's tax year. A form RCT- 101 is due for the Corporate Net Income Tax short year.

**Due Dates.** The form PA-20S for the short taxable year is due 30 days after the date on which the corporation's federal tax return is due. The

form RCT- 101 that is due for the Corporate Net Income Tax short taxable year is due 30 days after the date on which the corporation's federal tax return is due. For a corporation using a calendar year, both the PA-20S and the RCT- 101 are due on April 15.

**Division of Income.** After the Pennsylvania S revocation or termination year is divided into two periods, the separately stated items of income, loss and credit and the amount of the nonseparately computed income or loss must be divided between the periods. There are two methods that can be used to make this division:

1. **Pro Rata Allocation.** This method of allocation must be used unless the shareholders and the PA S Corporation specifically choose the other allocation method.

The pro rata allocation is made as follows:

- a. First determine the amount of each separately stated item of income, deduction, loss or credit and the amount of the nonseparately computed income or loss.
- b. Then divide each amount by the number of days in the Pennsylvania S revocation or termination year. (Total tax year)
- c. Multiply the amounts from STEP (b) by the number of days in the PA-20S short taxable year. Use these amounts to file form PA-20S for the Pennsylvania S revocation or termination year.
- d. Multiply the amounts from STEP (b) by the number of days in the RCT-101 short taxable year. Use these amounts to file the Corporate Net Income Tax Report form RCT-101 for the PAS revocation or termination year.

2. **Allocation Based on Normal Accounting Rules.** This is the alternate method of allocation. The corporation must choose this method, and all persons who are shareholders during the PA S revocation or termination year must consent to the choice. The corporation then will report all items of income, loss or credit based on the corporation's books and records (including worksheets). Therefore, the items will be split between the PA-20S short taxable year and the Corporate Net Income Tax RCT-101 short taxable year according to the time they were realized or incurred based on the books and records of the corporation.

# INSTRUCTIONS FOR COMPLETING THE PA-20S AND ACCOMPANYING SCHEDULES

A PAS Corporation should complete its consolidated federal Form 1120S and accompanying schedules before completing its PA-20S. A copy of the federal Form 1120S must be attached to the RCT-101 Corporate Tax Report to verify the Passive Investment Income test.

## FORM PA-20S

### CORPORATION'S TAX YEAR

Any corporation which elects PAS Corporation status must use the same tax year that is used in reporting to the federal government.

### CORPORATE IDENTIFICATION INFORMATION

Complete Blocks A through D of the PA-20S.

### PART I. (PA-20S) PASSIVE INVESTMENT INCOME TEST

This test should be completed before the corporation completes the remaining portions of its PAS Corporation return.

### PASSIVE INVESTMENT INCOME REQUIREMENT

To meet the Pennsylvania "small corporation" requirements, a corporation must not have passive investment income in excess of 25% of its gross receipts, as determined at the close of each tax year. The corporation annually must complete the "Passive Investment Income Test" on Part I of the PA-20S. For Passive Investment Income test purposes, a qualified Subchapter S subsidiary owned by a small corporation shall not be treated as a separate corporation. All gross receipts and passive investment income of such qualified Subchapter S subsidiary shall be treated as earned by the parent corporation and all intercorporate payments or distributions between the parent corporation and any qualified Subchapter S subsidiary owned by such corporation shall be eliminated.

The Pennsylvania and federal laws contain significantly different passive investment income requirements. The annual Pennsylvania limitation is more restrictive than the federal limitation. The Pennsylvania test is based on the passive investment income at the end of each taxable year, while the federal test is based on a three-year period. A corporation considering PAS Corporation status should examine carefully Pennsylvania passive investment income limitations. Election of PAS status may be disadvantageous for a corporation whose passive investment income could exceed twenty-five percent (25%) of the corporation's gross receipts.

**After reading the instructions, if there is still an area where it is unclear as to whether an item is business or passive income, write to the PA Department of Revenue for a ruling.**

**Line (1). Gross Receipts.** Gross receipts are the total amount a PAS Corporation receives or accrues, including passive income, under the method of accounting it uses to figure its taxable income. Gross receipts are not reduced by returns and allowances, costs or deductions. Gross receipts include the total amount received or accrued from the sale or exchange of any kind of property, from services rendered or from investments. However, only the gains from the sale or exchange of stocks or securities, including gains from tax-exempt obligations, are included in gross receipts. Losses on the sale or exchange of stock or securities are not a part of gross receipts, nor can they be offset against gains on the sale or exchange of stocks or securities when figuring gross

receipts. Gross receipts from the sale or exchange of stock or securities include gains received from the sale or exchange by a PAS Corporation even though it is a regular dealer in stocks and securities.

For passive investment income purposes, a PAS Corporation should include its proportionate share of a partnership's receipts in the corporation's receipts computation in the same class that the partnership earned them. For example, if the partnership had rental income, the PAS Corporation would include its proportionate share of the rental income in the computation of the passive investment income test.

Gross receipts do not include amounts received from a loan, repayment of a loan, contributions to capital or the issuance of stock in the PAS Corporation. Amounts received in exchange for stock in a corporate liquidation are not included in gross receipts if the PAS Corporation owned more than 50% of each class of the liquidating corporation stock on the date of the first distribution or transfer to it. This 50% requirement applies to a class of stock whether or not the class has voting rights.

**Line (2). Passive Investment Income.** Passive investment income is gross receipts derived from royalties, rents, dividends, interest, annuities and sales or exchanges of stock or securities.

**Line (2a). Royalties** include mineral, oil and gas royalties, and the amount the PAS Corporation receives for the use of patents, copyrights, secret processes, formulas, goodwill, trade marks, trade brands, franchises and all other similar property.

**Line (2b). Rents** are the amounts the PAS Corporation receives for the use of, or the right to use, the corporation's real or personal property. Rents do not include payments for the use or occupancy of rooms or other space if significant services also are provided to the occupant.

See Department of Revenue Statement of Policy 61 Pa. Code §9.13(c)(3) (relating to Pennsylvania S Corporation elections).

**Line (2c). Dividends** are distributions of cash or property made by a corporation, association or business trust from accumulated earnings and profits or earnings and profits of the year in which such dividend is paid.

Dividends do not include distributions of the stock of a corporation made by the corporation originally issuing such stock to its own stockholders, if such distributions are not treated as personal income for Federal Individual Income Tax purposes.

**Line (2d). Annuities** are the entire amounts received as an annuity under an annuity, endowment or life insurance contract.

**Line (2e). Interest** is any amount received for the use of money, including tax-exempt interest.

**Line (2f). Gains on Sales or Exchanges of Stock or Securities** are included in passive investment income only to the extent that they are included in gross receipts, as explained under the definition of "Gross Receipts" above.

**Line (4). Effect of Exceeding Passive Investment Income Limitation.** If a corporation exceeds the passive investment income limitation (25%):

1. The corporation's election to be treated as a PA S Corporation is terminated retroactive to the beginning of the tax year in which the passive investment income limitation is exceeded. (See instructions for "Five-Year Rule.")
2. The corporation is subject to the Corporate Net Income Tax for the entire tax year in which the limit is exceeded.
3. The corporation is subject to the estimated tax provisions for Corporate Net Income Tax for the tax year during which the passive investment income limitation is exceeded. (See REV-857I coupon book instructions in Section I of this Instruction Booklet.)

The Corporate Net Income Tax annual report (RCT-101) is due the 15th day of the fourth month following the close of the corporation's fiscal year. For example, annual corporate tax reports are due on April 15 for a corporation whose year ended on December 31.

## **PART II. (PA-20S) DETERMINING TOTAL NET PROFITS FROM BUSINESS, PROFESSION OR FARM ACTIVITIES**

A completed REV-1680, Schedule C-F Reconciliation, must be filed with the PA-20S return, even if the corporation reports a net loss. (See REV-1680 instructions.)

**Line (1a). Total Net Profits.** Enter the amount shown on Line 7 of Schedule C-F Reconciliation.

**Line (1b). Previously Disallowed CNI Deductions.** Enter the total amount of "Previously Disallowed CNI Deductions" on this line.

Any deduction, except a net loss deduction, which was disallowed a corporation when it was subject to the corporate net income tax shall be allowed as an additional deduction while the corporation is in PA S Corporation status to the same extent and in the same manner that the additional deduction would have been allowed had the corporation remained subject to the Corporate Net Income Tax. Additional deductions will be allowed for:

1. **Disallowed Accelerated Depreciation on Tax Preference Items.** Accelerated depreciation of tax preference items which was disallowed when the corporation was subject to the Corporate Net Income Tax will be allowed as an additional deduction to the extent and amount allowed had the corporation remained subject to the Corporate Net Income Tax. For further information, see the Department's regulations in Title 61 PA Code § 153.14.

Any previously disallowed CNI deduction shall be separately determined and must be taken against "net profits from business, profession or farm." Resident shareholders shall be allowed the full amount of any previously disallowed CNI deduction. Nonresident shareholders will be allowed only a previously disallowed CNI deduction to the extent that the deduction would have been considered a deduction against "income from sources within Pennsylvania" in the year disallowed.

Attach a separate rider for each deduction indicating the basis for each claimed deduction and the year in which the deduction was disallowed. The earliest "Previously Disallowed CNI Deduction" must be used first.

**Line (1c). Total Adjusted Net Profits From Business, Profession or Farm Activities.** Subject Line 1b from Line 1a. Enter this amount on Line 1c.

## **PART III. (PA-20S) DETERMINING NET BUSINESS INCOME/LOSS ALLOCABLE TO PENNSYLVANIA**

If the PA S Corporation is engaged in the operation of a business and has a shareholder that is a nonresident individual, trust or estate, it may be necessary to allocate or apportion the income, loss, costs, expenses and liabilities derived from or in such operations (see "Allocation of Income" in Section II, Page 3). If apportionment is required, complete Schedule H before proceeding. If neither allocation nor apportionment is required, proceed to Part III.

**Important: For Lines 2a, 2b, and 2c, negative numbers should be treated as such.**

**Line (2a).** If apportionment is required, enter the amount from Schedule H, Line 7, on Line 2a. Otherwise, enter the amount of net profit or loss from operations allocable to Pennsylvania.

**Line (2b).** If this PAS Corporation is a member of a partnership, PA S Corporation or joint venture, determine from the Pennsylvania NRK-1 for the other entity the amount of the net profits or losses allocable to Pennsylvania. Enter the amount on Line 2b.

**Line (2c).** Multiply Line 1b by the applicable apportionment decimal(s) for the year(s) in which the deduction was disallowed. The corporation's CNI three-factor apportionment decimal for the year in which the deduction was disallowed may be used. The total of such calculations is to be reported on Line 2c.

**Line (2d). Apportioned Business, Profession or Farm Income.** Add Lines 2a and 2b and subtract Line 2c. Enter this amount on Line 2d. Negative numbers should be treated as such for this line.

## **PART IV. (PA-20S) OTHER PERSONAL INCOME**

Other personal income is a term describing all remaining income classes on the PA-20S. Refer to PA-40 Personal Income Tax Instructions for a detailed explanation of other personal income classes. If the corporation is a member of a partnership, the corporation must report its share of the income of the partnership, whether the income was distributed or not. Report the share of other personal income of the partnership in the same class in which the partnership received the income.

**Line (3). Interest.** Any amount received for the use of the corporation's money which was not reported on Line 1a of Schedule C-F Reconciliation must be reported on Line 3. Any interest received by the corporation which is statutorily free from state taxation is not required to be reported by the corporation on this line.

**Line (4). Dividends.** Dividend income is any distribution to the corporation of cash or property (other than a distribution of stock dividends) from the accumulated earnings and profits or current earnings and profits of a corporation, association or business trust.

**Line (5). Net Gains or Income, Less Net Losses, From the Sale, Exchange or Disposition of Property.** Each transaction under this income class must be identified on federal Schedule D and/or federal Form 4797 with appropriate Pennsylvania reconciliation's made on a rider which the corporation must provide. Attach the federal form and the rider to the PA-20S. Unlike gross receipts in Part I, Section II, Page 7, losses on the sale or exchange of stock or other securities are included on Line 5 of Part IV. Include any interest received under purchase money mortgages or installment land contracts on Schedule D.

**Line (6). Net Gains or Income Derived from Rents, Royalties, Patents and Copyrights.** Complete and attach form REV-1680, Schedule E.

Each transaction which produces income described in this class must be stated separately on REV-1680, Schedule E. Enter this amount on Line 6. Include any interest income incidental to the production or collection of rents and royalties, such as interest from past due rent or royalty payments and interest from escrowed security deposits, on Line 3, Schedule E. (See instructions for REV- 1680, Schedule E.)

**Line (7). Net Gains or Income Derived from Estates or Trusts.** Complete and attach form REV-1680, Schedule J. (See instructions for REV-1680, Schedule J.)

**Line (8). Total Other Personal Income.** Add Lines 3 through 7. Negative numbers (losses) should be treated as such in this addition. Enter this amount on Line 8.

#### **PART V. (PA-20S) ALLOCABLE OTHER PERSONAL INCOME**

If the PAS Corporation has other personal income (income other than business, profession or farm income) which is not Pennsylvania source income and the corporation has at least one nonresident or part-year resident shareholder, the corporation is required to complete this Part. If so, continue reading these instructions which follow. If not, proceed to Part VI.

Non-Pennsylvania source income is not taxable to nonresident shareholders in Pennsylvania. It is taxable, however, to resident shareholders.

**Line (9). Net Gains or Income, Less Net Losses, from the Sale, Exchange or Disposition of Tangible Personal Property or Real Property Within Pennsylvania.** If the real property being disposed of is located within this state, the gain or income or the loss is allocable to this state. The gain, income or loss is allocable to this state if tangible personal property is being sold and the property was in the state at the time of sale. From information on the corporation's federal Schedule D or its records, determine the amount to be entered on Line 9. Losses on sale or exchange of stock or other securities are included in Line 9 of Part V.

**Line (10). Net Gains or Income Derived from Rents, Royalties, Patents and Copyrights Within Pennsylvania.**

**1. Net Rents and Royalties from Real Property or Tangible Personal Property.**

Net rents and royalties from real property located in this state are allocable to this state. Net rents from tangible personal property are allocable to Pennsylvania to the extent that the tangible personal property is used in this state.

**2. Net Gains or Income Derived from Patents and Copyrights.**

Patent and copyright royalties are allocable to this state if and to the extent that the patent or copyright is used by the payer of such income in this state. A patent is used in a state to the extent that it is employed in production, fabrication, manufacturing or other processing in the state or to the extent that a patented product is produced in the state. A copyright is used in a state to the extent that printing or other publication originates in the state.

Form REV-1680, Schedule E, or corporate records, determine the dollar amount attributable to (1) and (2). Enter this amount on Line 10.

**Line (11). Net Pennsylvania Source Income Derived from Estates or Trusts.** (See instructions for REV- 1680, Schedule J, and enter on Line 11 the portion allocable to Pennsylvania.)

#### **PART VI. (PA-20S) TOTAL CORPORATE INCOME/LOSS**

**Line (12). Corporate Book Income/Loss.** Enter on Line 12, the total corporate book income/loss for the taxable year. Negative amounts must be shown in parentheses.

Interest and gains derived by the corporation from government obligations which are exempt from state taxation are not income which must be passed through to the corporation's shareholders for them to report. Conversely, losses on tax exempt obligations cannot be used to offset taxable income. However, such interest, gains and losses must be reported on Line 12 of the PA-20S because it does affect the basis of each shareholder's stock. Accordingly, each shareholder's pro rata share of this tax exempt income will be passed through to the shareholders.

For additional information, review the sections in the PA-40 Instruction Booklet on "Interest" and "Tax Exempt Obligations" to determine the corporation's total nontaxable income.

**Line (13). Total Reportable Corporate Income/Loss.** Add Lines 1c and 8. Negative numbers (losses) should be treated as such for this line.

**Line (14). Nonreportable Corporate Income/Loss.** Subtract Line 13 from Line 12 and enter the difference on Line 14.

#### **PART VII. (PA-20S) DETERMINING PASS-THROUGH TAX CREDITS**

**Line (15a). Resident Shareholders Tax Credit. (Credit is Available only to Resident Shareholders)** To receive a tax credit on Line 15a, you must attach REV-1680, Schedule G, to the PA-20S. (See instructions for REV-1680, Schedule G.)

**Line (15b). Employment Incentive Payment Credit.** A PA S Corporation can claim such benefits on behalf of all its shareholders by completing and attaching PA-40 Schedule W and copies of certificates for all appropriate employees to the PA-20S. No credit will be granted unless a Schedule W and certificates accompany the PA-20S. Enter the allowable credits from Line 19 of Schedule W and also include the Jobs Creation, Waste Tire Recycling Act, and Pennsylvania Research and Development Tax Credit on Line 15b of the PA-20S.

**Line (15c). PA S Corporation Tax Withholding for Nonresident Shareholders.** Enter on this line the total tax withheld and paid to the Department based on the taxable income distributable to the PA S Corporation shareholders who are not residents of Pennsylvania.

#### **PART VIII. (PA-20S) SHAREHOLDERS' DIRECTORY**

The corporation must supply the following information concerning all of its shareholders. List resident shareholder's first, then nonresident shareholders by individuals, trusts and estates. See Part D on next page.

(If additional space is necessary, attach a conforming directory of the remaining shareholders.)

**Part A-** Number the shareholders.

**Part B -** List each shareholder's social security number (or Entity ID (EIN) for an estate or trust).

**Part C -** Provide the full last name, first name and middle initial of each shareholder, and their home address, including ZIP code. (If the shareholder is an estate or trust, also provide the name and address of its personal representative or trustee.)

**Part D** - Depending on the residency status and type of shareholder involved, place one of the following notations next to each shareholder's name.

List shareholders in the order stated below:

1. **RI** . . . Resident Individual
2. **NRI** . . . Nonresident Individual
3. **PRI** . . . Part-year Resident Individual (In this case indicate the dates of residency during the tax year e.g., 9/15/97- 12/31/97).
4. **RT** . . . Resident Trust
5. **RE** . . . Resident Estate
6. **NRT** . . . Nonresident Trust
7. **NRE** . . . Nonresident Estate

Definitions of the above are in the PA-40 Instruction Booklet and the PA-41 Fiduciary Instruction Booklet.

**Part E** - Enter the number of shares owned by each shareholder and the percentage that these shares represent in relationship to the corporation's total outstanding stock (e.g., 20/30%). If any shareholder did not own all of the stock listed for this shareholder during the entire corporate year, note the period during which such stock was held. For example, if a shareholder of a calendar year corporation owned 100 shares of stock on January 1, but sold 40 shares on June 30, the stock should be listed as follows: 60 (100 shares 1/1/97 - 6/30/97). The percentage column shall be completed only for stock held at the end of the corporation's tax year, and the total of this column should equal 100%.

#### **PART IX. (PA-20S) CORPORATE DISTRIBUTIONS**

Distributions from a PAS Corporation which are paid from the accumulated earnings and profits of the corporation before it elected PAS status is dividend income to its corporation shareholders. All other distributions are nontaxable return of the shareholder's basis in stock. (See "Distributions to Shareholders.")

Nontaxable return of basis distributions will reduce the shareholder's basis in stock first. If such distributions exceed the shareholder's basis in stock holdings, the shareholder may apply the excess against the basis of any indebtedness of the corporation to the shareholder. If such distributions exceed the shareholder's basis in stock and indebtedness, the shareholder must report a gain from the disposition of property.

If the corporation distributes appreciated property, the corporation will be treated as if it had sold the property to the shareholders at fair market value. Such a distribution will produce gains from the sale of property which will have to be reported by the corporation as "net gains from the sale, exchange or disposition of property." To document all PAS Corporation distributions during a taxable year, Part IX of PA-20S must be completed.

**Part A**- List all distributions made to shareholders during the taxable year. List the amount and then the date distributed.

**Part B** - Determine the type of distribution.

- a. **NRC** . . . Nontaxable Return of Capital
- b. **D** . . . Dividends

At the bottom of Part IX, total and enter all nontaxable return of capital distributions on the line marked "Total NRC Distributions. The total distributions less the total NRC distributions should be the total taxable dividends. Enter this amount on the line marked "Total Dividends."

**Part C** - If each distribution was made on a pro rata share basis to the shareholders, state "Yes." If any distribution was not made on a pro rata share basis, attach a statement indicating amounts which each shareholder received. Parts A, B and C must be completed for each separate distribution.

#### **PART X. (PA-20S) CORPORATION'S PENNSYLVANIA ACCUMULATED ADJUSTMENT ACCOUNT**

All PA S Corporations must maintain a Pennsylvania Accumulated Adjustments Account. The account must be adjusted each year for net income and losses from the classes of income enumerated in Section 303 of the PA Personal Income Tax Act. After these adjustments, the account is reduced by distributions made during the year which are not taxable dividends to shareholders.

**Line (1).** For the corporation's first tax year as a PAS Corporation, enter "0." In subsequent years, enter the ending balance from the prior year's account.

**Line (2).** Enter the amount from Part VI, Line 13 of the PA-20S.

**For Purposes of Computing the Corporation's Pennsylvania Accumulated Adjustment Account,** losses are to be offset within and between the classes of income. The total gain (loss) of the corporation for purposes of adjusting the corporation's PA Accumulated Adjustment Account is designated "Total Reportable Corporate Income," Part VI, Line 13 of the PA-20S.

**Line (3).** Add Lines 1 and 2, and enter the total.

**Line (4).** Enter the total nontaxable return of capital distributions from Part IX on this page. NRC distributions reduce basis, but taxable dividends do not. Therefore, dividends are not part of the Pennsylvania accumulated adjustment account.

**Line (5).** Ending Balance. Subtract Line 4 from Line 3, and enter the total.

If a corporation reverts to being subject to the Corporate Net Income Tax Act after being a PA S Corporation, the balance of its PA Accumulated Adjustment Account may be distributed to the shareholders of the corporation as a nontaxable return of capital. Such distribution, however, will reduce the shareholder's basis in the share of the corporation. If the distribution exceeds the shareholder's basis in the stock of the PA S Corporation, the distributions are taxable as gains on the sale or exchange of property.

#### **PART XI. (PA-20S) SIGNATURE AND VERIFICATION**

##### **FINALIZING THE RETURN**

Attach all accompanying schedules to the completed PA-20S. Complete each shareholder's RK-1 and/or NRK-1 from the figures on the PA-20S. The **corporate** official who is responsible for signing the PA-20S **must sign manually**, state title, date and list telephone number on the PA-20S. Use of a corporate seal is optional. The corporation has **not filed** a valid PA-20S unless it is **signed** properly. If a preparer has completed the return, the preparer must sign and date the return and enter the preparer's name, address and telephone number in the blocks provided.

### **INSTRUCTIONS FOR REV-1680**

#### **SCHEDULE C-F RECONCILIATION**

##### **Part B.**

**Line (1a). Gross Receipts or Sales.** Determine all gross income earned, received or acquired by the corporation during the tax year from operations, transactions and activities undertaken in its regular course of business including:

- Gross income from tangible and intangible property, if the acquisition, management and disposition of the property constitute integral parts of the corporation's operations.
- Compensation earned by PA S Corporation employees which such employees must remit to the corporation.

- Interest on any obligation acquired in the corporation's ordinary course of business from the sale of inventory, stock-in-trade or property held primarily for sale to customers.
- Income derived from operating a hotel, motel, nursing home, warehouse or rent-it-center.
- Taxable lottery and gambling winnings earned, received or acquired by the PA S Corporation.
- Miscellaneous business receipts such as lottery commissions, management fees, sales commissions and fees and insurance proceeds from business interruption insurance.

Enter this total dollar amount on Line 1a of Schedule C-F Reconciliation.

**Line (1b). Returns and Allowances.** Determine all monies paid to customers, clients or patrons for returned goods or products or unperformed or unsatisfactory services, and allowances or credits given them for these same reasons. Enter the total amount on Line 1b.

**Line (1c). Realized Gross Receipts.** Subtract Line 1b from Line 1a. Enter this amount on Line 1c.

**Line (2). Cost of Goods Sold and/or Operations.** Enter the appropriate amount from your federal Form 1120S on Line 2 of Schedule C-F Reconciliation.

**Line (3). Gross Profits.** Subtract Line 2 from Line 1c. Enter this amount on Line 3.

**Line (4). Business Expenses.** Transfer the total from Line 10 below to Line 4, Part B. (See Part B, Lines 8, 9, and 10 instructions.)

**Line (5). Net Business Profits.** Subtract Line 4 from Line 3. Enter this amount on Line 5.

**Line (6). Partnership Income.** Partnership or joint venture net profits or losses received by the corporation as a partner or joint venturer should be entered on Line 6 to the extent such income is business income. This amount will be provided by the partnership.

**Line (7). Total Net Profits from Business, Profession or Farm.** Add Lines 5 and 6. Enter this amount on Line 7, REV-1680, and on PA-20S, Part II, Line 1a.

**Line (8). Federal Expenses from Business, Profession or Farm Activities.** Determine the corporation's Federal business expenses from federal Form 1120S, and enter the sum on Line 8 of the Schedule C-F Reconciliation.

**Line (9). PA Adjustments.** Specifically describe the corporation's Pennsylvania adjustments on Line 9. Reconcile the total of such adjustments with Line 8. Enter the reconciled amount on Line 10 and Line 4 of Schedule C-F Reconciliation.

Expenses which a Federal S Corporation can deduct as allowable business expenses are deductible by a PA S Corporation with these differences:

1. Taxes. The corporation may deduct state, local and federal taxes other than those based on the corporation's income. Do not deduct Federal Income Taxes, taxes based on income paid to other states, estate, inheritance, legacy, succession and gift taxes or assessments for any improvements or betterment. Social Security and Unemployment Compensation taxes paid for employees can be deducted.
2. If the corporation is involved in Pennsylvania's Employment Incentive Payment (EIP) credit program, wages for which an EIP credit is claimed must be reduced by the amount of the total EIP wage credit

claimed by the corporation. (If a Schedule W with instructions is needed, see Forms Ordering.) The wage deduction may be increased by the amount of the federal jobs credit taken on the federal Form 1120S.

3. Federal limits on certain business expenses are not applicable to Pennsylvania business expenses. However, all business expenses must be ordinary, necessary, reasonable, actual and are subject to audit by the Department. Charitable contributions made by the corporation and made from corporate funds are allowable business expenses. Political contributions by PAS Corporations are illegal under both federal and state law and are not deductible. Neither carryback nor carryforward of business expenses is permitted.

### Compensation and Benefit Plans:

1. Shareholder—Employee Compensation and Benefit Plans—  
A PA S Corporation may deduct, as a business expense, the payments made to its shareholders for services rendered to the corporation, regardless of their ownership interest, if the remuneration constitutes reasonable compensation for the services performed. To the extent that the remuneration is excessive, it will be disallowed as a business expense and represent a distribution to the particular shareholder. (See "Distributions to Shareholders.")

A PA S Corporation may deduct, as a business expense, payments made to programs covering shareholders/employees' hospitalization, sickness, disability, death, strike benefits, supplemental unemployment benefits, retirement and social security, if the fair market value of the benefit payments is reasonable in relation to compensation. Payments to such programs will not represent compensation to the shareholder/employee. Reasonable payments to other benefit plans also are deductible business expenses, but may constitute compensation to the particular shareholder/employee receiving the benefit from such payments.

Federal rules on "reasonable compensation" will be followed. If the IRS determines that the corporation's payments to its shareholder employees do not constitute reasonable compensation, the corporation must file an amended PA-20S reflecting the IRS change.

2. Distributions to shareholders who are not employees—  
Payments to any shareholder benefit program are not deductible business expenses. Any corporate contribution, whether in cash, property or services, to a shareholder's benefit plan will constitute a distribution to that particular shareholder. (See "Distributions to Shareholders.")

### SCHEDULE E RENT, ROYALTY, PATENT AND COPYRIGHT INCOME

Rents mean the amounts the corporation receives for the use of, or the right to use, the corporation's real or personal property. Rents do not include payments for the use or occupancy of rooms or other space if **significant services** also are provided to the occupant. Such income would be part of the corporation's net profits from business activities. For a further discussion of rents versus net profits from business activities due to significant services, see instructions for form PA-20S, Part I, Line 2b. This income class also includes mineral, oil and gas royalties and amounts the corporation receives for the use of patents, copyrights, secret processes, formulas, goodwill, trademarks, trade brands, franchises and similar property.

### SCHEDULE E FOR DEPRECIATION

Business assets may be depreciated under the method used for federal tax purposes during that tax year. ACRS and Internal Revenue Code 179 current expensing are acceptable depreciation methods.

## SCHEDULE G (RESIDENT SHAREHOLDERS ONLY)

If the corporation has resident shareholders and income which it must report to Pennsylvania, and such income also is subject to the income tax of another state or country, the corporation can claim, on behalf of its **resident** shareholders, a credit against the PA Personal Income Tax of such shareholders. The total credits claimed by the corporation cannot exceed the amount of taxes due or paid to Pennsylvania by the resident shareholders on their share of the corporation's reportable income. The tax that the corporation pays to the other state or country must be an income tax or a tax measured by gross or net earned or unearned income. Taxes paid to other states or countries by the corporation which are based on net worth or the value of the corporation's personal property cannot be credited.

Other states, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or any foreign country is considered another "state or country" for purposes of this credit. The term does not include the United States Government or political subdivisions of Pennsylvania or of other states. No credit will be granted for taxes paid to these entities.

Schedule G is to be used by all PAS Corporations claiming credits for taxes on income subject to tax by both Pennsylvania and any other state or country. If the corporation claims a credit for taxes paid to other states or countries, then a REV-1680, Schedule G, must be completed. Attach a signed copy of the corporate income tax return filed with the other state or country without its accompanying schedules. If the tax return from the state or country listed on Line 1 of Schedule G is not attached, the credit will be disallowed.

If the corporation is claiming a credit for income taxes paid in more than one state or country (excluding Pennsylvania), a separate REV-1680, Schedule G, and corporate state tax return must be completed for each state or country. The tax credit is based on the liability as determined on the out-of-state return and not on the amount the corporation paid in estimated or tentative taxes. A corporation's check stubs or estimated or tentative tax records are not acceptable evidence of final tax liability to the other state or country. Follow the specific instructions for Schedule G in the PA-40 Instruction Booklet. Enter the allowable credits on REV-1680, Schedule G, and on Line 15a of the PA-20S, Part VII.

## SCHEDULE J INCOME FROM ESTATES OR TRUSTS

Do not report as income net gains or income derived from the corporation's pension or profit-sharing trust, if such income is not paid to the corporation, or from a trust operated by the corporation exclusively for religious, charitable, scientific, literary or educational purposes, unconnected with the corporation's business activities. All other corporate gains or income derived from estates or trusts must be reported on REV-1680, Schedule J, and on PA-20S, Part IV, Line 7. The information necessary to compute Schedule J must be obtained from the fiduciary of the estate or trust.

## INSTRUCTIONS FOR REV-1681

### SCHEDULE H APPORTIONMENT FORMULA

If the business or farm income of a PA S Corporation is derived from sources within and outside Pennsylvania, and the corporation has at least one nonresident or part-year resident shareholder and accounts and records clearly reflecting income from within Pennsylvania are not maintained, complete REV-1681, Schedule H, and attach to form PA-20S.

Instructions for completing Schedule H are on the form.

## INSTRUCTIONS FOR REV-1682

### SCHEDULES RK-1 AND NRK-1 DISTRIBUTION TO SHAREHOLDERS

Schedules RK-1 and NRK-1 show each shareholder's separate share of the corporation's income, loss and credit as reported on the PA-20S. The corporation completes a separate Schedule RK-1 for each shareholder who is a resident of Pennsylvania for PA Personal Income Tax purposes. A separate Schedule NRK-1 is completed for each shareholder who is a nonresident for PA Personal Income Tax purposes. If a shareholder is a part-year resident, the corporation will complete Schedule NRK-1 for that period during which the taxpayer is a nonresident and a Schedule RK-1 for that period during which the taxpayer is a resident.

If a shareholder is an estate or trust, the corporation should provide both Schedules RK-1 and NRK-1.

A copy of the RK-1 and/or NRK-1 for each shareholder must be filed with form PA-20S. Each shareholder must receive a copy so their individual information can be recorded on their PA-40 or PA-41. The corporation must retain a copy of each RK-1 and NRK-1.

### FIGURING SHAREHOLDER TAXABLE INCOME

Each shareholder reports the applicable pro rata share of each item of income, loss or credit that is stated separately and a pro rata share of nonseparately stated net profits from business, profession or farm from the PA-20S on the PA Personal Income Tax Return, (form PA-40), or the Fiduciary Income Tax Return (form PA-41). Refer to PA-40 or PA-41 tax forms and instructions for this reporting.

**There is no offsetting between the classes of income/losses that are passed through to the shareholder.** The character of any PA S Corporation item included in the shareholder's pro rata share is determined as if the item were realized directly by the shareholder. For more information, refer to the instructions for form PA-20S.

**Pro Rata Share.** Each shareholder's pro rata share is determined on a per day/per share basis, as follows:

1. If there is no change in shareholders or in the percentage of stock each shareholder owns during the tax year, multiply the amount of the income, loss or credit by the shareholder's percentage.
2. If there is a change in shareholders or percentage:
  - a. Determine the daily amount by dividing the income, loss or credit by the number of days in the corporation's tax year;
  - b. Determine the shareholder's daily part by multiplying the daily amount from (a.) by the percentage of stock owned by the shareholder on each day of the tax year; and
  - c. Total the shareholder's daily parts of the daily amount of the income, loss or credit.

**Limitation on Losses and Loss Carryovers.** The aggregate amount of losses taken into account by a shareholder is limited to the sum of the adjusted basis of the shareholder's stock for the tax year and the shareholder's adjusted basis of any indebtedness of the corporation to the shareholder figured before any adjustments for the tax year.

There is no provision allowing for carryover of losses by the shareholders of the corporation.

**Adjustments to Basis of Stock.** (Shareholders Capital Investment)

Each shareholder must adjust the basis of stock in the PA S Corporation.

1. **Increases:** Each shareholder's pro rata share of the following items increases the basis of stock:
  - a. Nonseparately stated net profits from business, profession and farm that are passed through to the shareholder.
  - b. Separately stated other personal income items passed through to the shareholder.



- c. Nontaxable income.
2. **Decreases:** Each shareholder's pro rata share of the following items decreases the basis of stock, but not below zero (0):
  - a. \*Nonseparately stated losses from business, profession or farm activities that are passed through to the shareholder.
  - b. \*Separately stated other personal loss items that are passed through to the shareholder.
  - c. Distributions that are a return of capital.

*\*Basis is reduced only to the extent that the losses reduce the shareholder's income subject to PA Personal Income Tax or a tax on or measured by income imposed on the shareholder by any other state.*

#### **Adjustments to Basis of Indebtedness.** (Shareholder's Loans to PA S Corporations)

1. **Reduction in Basis of Indebtedness.** If the shareholder's basis of stock in a PA S Corporation is decreased to zero, any amount of excess losses shall be used to reduce the shareholder's basis of indebtedness of the PA S Corporation to the shareholder, but not below zero.
2. **Restoring Basis.** If the shareholder's basis in indebtedness is reduced under ( 1.) above, the reduction shall be restored before the shareholder's basis in the stock of the PA S Corporation is increased.

#### **ESTIMATED TAX**

Individual resident shareholders are subject to the estimated tax provisions under the PA Personal Income Tax Act. Each resident individual shareholder is required to make a declaration and pay estimated tax for the tax year if their income, other than compensation on which tax is withheld, reasonably can be expected to exceed \$2,500 for tax year 1997.

See REV-413P/S, "Instructions for Estimating PIT-Partnership/Shareholders."

Under Act 22 of 1991, PAS Corporations are required to withhold PA Personal Income Tax from nonresident shareholders who are individuals, estates and trusts. This withholding is based on the nonresident shareholder's expected share of distributions of taxable Pennsylvania source income.

#### **DISTRIBUTIONS TO SHAREHOLDERS**

Each shareholder must adjust their stock and loan basis at the end of each PA S Corporation Tax year. The steps in the adjustment process are as follows:

1. Determine the year-end stock and loan basis **excluding** all tax year distributions. This is the adjusted basis figure used in the determination of the tax treatment of any distributions during the tax year.
2.
  - a. **PA S Corporations with no earnings and profits.** Distributions from a corporation with no earnings and profits for Federal Income Tax purposes is a nontaxable reduction to the basis arrived at in STEP 1 above.
  - b. **PAS Corporations with earnings and profits.** Distributions from a corporation with earnings and profits for Federal Income Tax purposes is handled as follows:
    - (1) Reduce the distribution by the pro rata share of the accumulated adjustment account. (See REV- 1682 and PA-20S, Part IX and X instructions.)
    - (1) The excess of the distribution beyond (1) above is a taxable dividend to the extent of the shareholder's pro rata share of the earnings and profits of the corporation.
    - (1) The excess of the distribution beyond (2) above is a nontaxable reduction to the basis arrived at in STEP 1 above.

3. Any distributions beyond 2a and 2b above (distributions in excess of basis) are treated as gain from the sale, exchange or disposition of property.

In summary, distributions are:

1. Nontaxable to the extent of the accumulated adjustments account;
2. Taxable as dividends to the extent of corporate earnings and profits;
3. Nontaxable return of capital to the extent of basis;
4. Taxable as a gain from the sale, exchange or distribution of property.

If the distribution is used up at any priority level, the levels below that level are ignored. For example, as long as the distribution is less than the accumulated adjustment account, there will not be a taxable dividend, return of capital, or a gain.

#### **RESIDENT SHAREHOLDERS**

##### **RK-1, Part I.**

Enter the general information requested in Part I.

##### **RK-1, Parts II-V.**

**Line 1.** Enter the shareholder's pro rata distributive share of all net profits from a business, profession or farm from Line 1c of the PA-20S.

**Line 2. through 6.** Enter each shareholder's pro rata distributive share of the separately stated items of other personal income from the appropriate lines on the PA-20S, Part IV, "Other Personal Income."

**Line 7. and 8.** Enter each shareholder's pro rata distributive share of the pass-through credits from the PA-20S, Part VII, "Determining Pass-Through Credits."

Each resident shareholder takes their pro rata share of the following credits:

- Taxes on or measured by income paid to other states or countries by the PAS Corporation.
- Employment Incentive Payment Credit.
- Jobs Creation Tax Credit.
- Waste Tire Recycling Act.
- Pennsylvania Research and Development Tax Credit.

**Line 9. and 10.** Enter each shareholder's nontaxable return of capital distribution and dividend distributions from the PA-20S, Part IX, "Corporate Distributions."

**Line 11.** Enter each shareholder's pro rata distributive share of total nontaxable corporate income/loss from Part VI, Line 14 of the PA-20S.

#### **NONRESIDENT SHAREHOLDERS**

##### **NRK-1, Part I.**

Enter the general information requested in Part I.

##### **NRK-1, Parts II-V.**

**Line 1.** Enter the shareholder's pro rata distributive share of all apportioned business, profession or farm income from Line 2d of the PA-20S or, from Line 1c, if the corporation did not earn profits from business, profession or farm income activities outside Pennsylvania.

**Line 2. through 4.** Enter the shareholder's pro rata distributive share of the separately stated allocable other personal income

from the appropriate lines on the PA-20S, Part V, "Allocable Other Personal Income" or from the appropriate lines on the PA-20S, Part IV, Other Personal Income," if the corporation did not have other personal income from sources outside Pennsylvania.

**Line 5.** Enter each shareholder's pro rata distributive share of the Employment Incentive Payment (EIP) Credit, Jobs Creation Tax Credit, Waste Tire Recycling Act and Pennsylvania Research and Development Tax Credit, PA-20S, Part VII, Line 15b.

Each nonresident shareholder takes their pro rata share of the Employment Incentive Payment Credit, Jobs Creation Tax Credit, Waste Tire Recycling Act and Pennsylvania Research and Development Tax Credit.

The resident tax credits allowable to the PAS Corporation for income taxes paid to other states are not passed through to nonresident shareholders.

**Line 6.** Enter each nonresident shareholder's tax withheld and paid to the Department.

For taxable years beginning on or after January 1, 1992, PAS Corporation with taxable income from sources within Pennsylvania are:

- Liable jointly with their nonresident shareholders for payment of tax on such income to the extent allocable to the nonresident shareholders; and
- Authorized and required to withhold such tax from nonresident shareholders; and
- Required to remit the tax to the PA Department of Revenue.

The imposition of the withholding requirement against the PA S Corporation does not change the filing requirements nor the tax liability of its nonresident partners, members or shareholders. Nonresident partners, members or shareholders may take credit on their annual returns for their share of the withholding tax paid by the PA S Corporation. Estimated tax paid by a nonresident shareholder may not be deducted from the tax imposed on the PA S Corporation.

**Line 7. and 8.** Enter each shareholder's nontaxable return of capital distributions and dividend distributions from the PA-20S, Part IX, "Corporate Distributions."

**Line 9.** Enter each shareholder's pro rata distributive share of total nontaxable corporate income/loss from Part VI, Line 14 of the PA-20S.

## **PART-YEAR RESIDENTS**

### **RK-1**

A separate Schedule RK-1 must be filed for that period of the tax year during which the shareholder is a resident.

The shareholder's pro rata distributive share of each item reported on the PA20S, Parts II, IV, VII, IX and Part VI, Line 14 must be determined as follows:

- a. Determine the daily amount by dividing the income, loss or credit by the number of days in the corporation's tax year;
- b. Determine the shareholder's daily part by multiplying the daily amount from (a) by the percentage of stock owned by the shareholder on each day of the residency portion of the corporate tax year;
- c. Total the shareholder's daily parts for the number of days for which the shareholder was a resident.

Use these figures to complete the Schedule RK-1, following the above instructions.

### **NRK-1**

A separate Schedule NRK-1 must be filed for that period of the tax year during which the shareholder is a nonresident.

The shareholder's pro rata distributive share of each item reported on the PA-20S, Parts II, III, IV or V, IX and Part VI, Line 14 and Part VII, Line 15b must be determined as follows:

- a. Determine the daily amount by dividing the income, loss or credit by the number of days in the corporation's tax year;
- b. Determine the shareholder's daily part by multiplying the daily amount from (a) by the percentage of stock owned by the shareholder on each day of the nonresidency portion of the corporate tax year;
- c. Total the shareholder's daily parts for the number of days for which the shareholder was a nonresident.

Use these figures to complete the Schedule NRK-1, following the above instructions.

# TAX CREDITS

The following tax credits are available through the agencies and/or procedures listed at the end of each credit description.

## NEIGHBORHOOD ASSISTANCE CREDIT

Neighborhood Assistance is a program of credits which reduce state corporate taxes for businesses which contribute money or other resources to improve programs which help needy people, families or communities in an impoverished area. Credits also are available to each "private company" which makes a qualified investment to rehabilitate, expand or improve buildings or land located within portions of impoverished areas which have been designated as enterprise zones.

For further information regarding the Neighborhood Assistance Program, contact the Department of Community and Economic Development, Office of Community Empowerment & Development, Room 377, Forum Building, Harrisburg, PA 17120, or telephone (717) 787-4140.

## EMPLOYMENT INCENTIVE PAYMENT CREDIT

Act No. 48 of 1994 extended a program for tax credits to corporations for hiring eligible Public Assistance clients under an Employment Incentive Payments (EIP) program. Employers can receive as much as \$ 1,800 in tax credits for hiring an eligible employee in the first year of employment, \$ 1,200 in tax credits for the second year of employment, and \$600 in tax credits for the third year of employment. The credit for each welfare recipient hired shall be equal to, but may not exceed 30% of the first \$6,000 of qualified first year wages for the first year of employment, 20% of the first \$6,000 of qualified wages for the second year of employment, and 10% of the first \$6,000 of qualified wages for the third year of employment.

Additional tax credits for providing child care services for the child (or children) of eligible assistance clients also are available in flat amounts of \$600 per employee for the first year of employment, \$500 per employee for the second year of employment and \$400 per employee for the third year of employment.

An employer may not use credits exceeding 90% of its tax liability in any given year. Any unused credit may be applied to any of the three (3) immediate succeeding years as long as the total credits used do not exceed 90% of the tax liability for that particular year.

The tax credits can be applied against the Corporate Net Income Tax by corporations or Personal Income Tax by individuals but are not available for application against Capital Stock Tax or Foreign Franchise Tax.

Employers interested in hiring qualified Public Assistance clients and participating in the Employment Incentive Payment program should contact their nearest Commonwealth Job Service Office, County Assistance Office, or Department of Revenue District Office. The employer must forward "Copy B" of the EIP Certificate to the PA Department of Revenue for each qualified hire. These certificates must be received by the Department of Revenue within 30 days following the date of issue. To claim a credit, copies of the certificate for all appropriate employees and a copy of PA Schedule W must be attached to the PA Corporate Tax Report (RCT-101). The tax credit will not appear on the corporation's ledger in the PA Department of Revenue until the Corporate Net Income Tax has been settled by the Department and audited and approved by the PA Department of the Auditor General.

For more information call the Department of Labor and Industry Tax Credit Hotline at 1-800-553-5818.

## TAX CREDIT FOR CONTRIBUTIONS TO MORTGAGE EMERGENCY ASSISTANCE FUND

Tax credits are available against the Corporate Net Income Tax (not available for application against Capital Stock Tax or Foreign Franchise Tax) for contributions made to the Pennsylvania Mortgage

Emergency Assistance Fund. A tax credit is available equal to 70% of the corporation's contribution to the fund and any tax credit not used in the period the contribution was made may be carried over for the next succeeding calendar or fiscal year until the full credit has been allowed.

Questions relative to contributions made to the Mortgage Emergency Assistance Fund should be directed to the Pennsylvania Housing Finance Agency, 2101 North Front Street, Harrisburg, PA 17105, or telephone (717) 780-3940.

## JOBS CREATION TAX CREDIT

Tax credits are available for a Jobs Creation Tax Credit (JCTC) to help promote and secure job creating economic development in the Commonwealth. The tax credit will make it more desirable and more feasible for existing businesses to expand operations as well as attract new businesses to the state. To be eligible, a business must agree to create within the Commonwealth of Pennsylvania at least 25 new full-time equivalent jobs or to increase its number of employees by at least 20%, within three years from the "start date." (The "start date" will be the very first day of the employment/calendar quarter in which the company's application to receive Jobs Creation Tax Credit is approved by the newly formed Department of Community and Economic Development.) To be counted as a new-time employee under the program, the new employee must earn an average hourly wage rate of at least 150% of the federal minimum wage, excluding benefits. Also, the business must agree to maintain operations in the Commonwealth for a period of five years from the start date.

For more information on the Jobs Creation Tax Credit program as well as to request a program guide and/or JCTC application information, please contact the Department of Community and Economic Development, Grants Office, 494 Forum Building, Harrisburg, PA 17120, or telephone (717) 787-7120.

## WASTE TIRE RECYCLING ACT

Act 190 of 1996 will allow tax credits for the purchase of equipment used in recycling and reuse of waste tires.

1. Applies to expenditures in 1997, 98, and 99.
2. Will expire in three years if not renewed.
3. Administered by the Department of Environmental Protection, Division of Municipal and Residential Waste, 14th Floor, Rachel Carson Building, 400 Market St., Harrisburg, PA 17101-2301, or telephone (717) 787-7381.
4. Nonrefundable - can be used to pay 100% of Personal Income Tax, Capital Stock/Foreign Franchise and/or Corporate Net Income Tax for the tax year during which the cost was incurred.

## PENNSYLVANIA RESEARCH AND DEVELOPMENT TAX CREDIT

Act 7 of 1997 provides for a PA Research and Development Tax Credit.

To claim the PA Research and Development (R&D) Credit, it is necessary for a taxpayer to have qualified PA R&D expenses in the current tax year and in at least one preceding tax year.

The application for this credit is due by September 15 of each applicable year.

The application form and any additional information may be obtained by contacting the PA Department of Revenue, Bureau of Corporation Taxes, Taxing Division R&D Unit, Dept. 280703, Harrisburg, PA 17128-0703, or telephone (717) 783 -6035.