

Instructions for PA-20S/PA-65 Schedule M

Reconciliation of Federal-Taxable Income (Loss) to PA-Taxable Income (Loss)

What's New

For tax year 2012, REV-1190 replaces Schedule M Worksheet in Chapter 16, Page 78. REV-1190 must be attached to PA-20S/PA-65 Schedule M when reporting non-Pennsylvania taxes paid on income reported on PA-20S/PA-65 Schedule M, Part B, Section E, Line a.

General Information

Purpose of Schedule

The purpose of PA-20S/PA-65 Schedule M is to determine Pennsylvania business net income (loss) or rental/royalty income (loss). The PA-20S/PA-65 Schedule M includes specific lines to reconcile federal income to Pennsylvania income. All entities file PA-20S/PA-65 Schedule M whether there are adjustments to federal income (loss) amounts or not.

The entity should complete the appropriate PA-20S/PA-65 Schedules A, B and D for these classes. Using PA-20S/PA-65 Schedule M for the other income classes results in the improper classification of income and reporting errors.

PA-20S/PA-65 Schedule M, Part A

Part A must be used to classify taxable income (loss) as shown on federal Form 1120S or federal Form 1065 for Pennsylvania personal income tax purposes. The entity must classify federal amounts using Pennsylvania personal income tax rules. Refer to the PA PIT Guide, Chapter 16, Table 16-8, Classifying Federal Schedule K Lines for Pennsylvania Personal Income Tax Purposes.

PA-20S/PA-65 Schedule M, Part B

Part B must be used:

- To reconcile the entity's federal business income (loss) and

rental/royalty income (loss) to Pennsylvania income (loss). If the entity is separately allocating income, keeps separate books and records for financial statement purposes, and there are no business transactions between multiple businesses, the "Pennsylvania-Allocated Income (Loss)" Column and the "Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment" Column will be completed. If the entity is apportioning its income, complete only the "Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment" Column; and

- Rental income must be allocated between inside Pennsylvania and outside Pennsylvania. Apportionment is not allowed.

Completing PA Schedule M Part A

Business Name

Enter the complete name of the entity or business as shown on the PA-20S/PA-65 Information Return.

FEIN

Enter the nine-digit federal employer identification number (FEIN) of the entity or business as shown on the PA-20S/PA-65 Information Return.

Line Instructions

PART A

Classifying Federal Income (Loss) for Pennsylvania Personal Income Tax Purposes

Classify, without adjustment for Pennsylvania personal income tax rules, the federal income (loss) from federal Form 1120S, Schedule K or

federal Form 1065 Schedule K. The entity must allocate or apportion the amounts from the federal categories to the reportable Pennsylvania personal income tax classes of income. The total of the specific federal line items should equal the total of the federal schedule.

Refer to the PA PIT Guide, Chapter 16, Table 16-8, Classifying Federal Schedule K Lines for Pennsylvania Personal Income Tax Purposes.

For each line in Column (a), federal income (loss), analyze the components of the federal amounts. Then classify the federal amounts to the applicable Pennsylvania income class in its entirety or the appropriate portion of each amount, without adjustment for Pennsylvania personal income tax rules. If the entity does not have to allocate an income (loss) amount, place that amount in the appropriate column for the Pennsylvania income class. The PA S corporation or partnership will reflect federal and state differences from Column (c) through (e) on the corresponding Pennsylvania schedules. Columns (b) and (f) are reported on PA-20S/PA-65 Schedule M, Part B for further adjustment as required.

Line 1

Ordinary Income (Loss) from Trade or Business Activities

Column a

Federal Income (Loss)

Enter the amount of ordinary business income (loss) from the federal Schedule K, Line 1 without any adjustment for Pennsylvania personal income tax purposes.

Column b

Pennsylvania Business Income (Loss)

Enter the amount of ordinary business income (loss) from Line 1,

Column (a) received from the operation of the entity's business, profession or farm.



Important. For federal purposes, the entity includes estate/trust income and gambling/lottery winnings in ordinary income. The entity must classify such income and subtract it from ordinary income on PA-20S/PA-65 Schedule M, Part B, Section C, Line d. The entity also is required to include estate/trust income on PA 20S/PA-65 Schedule J and gambling/lottery winnings on PA 20S/PA-65 Schedule T. The entity then reports the income on the PA-20S/PA-65 Information Return, Part III in the appropriate class of income. The entity supports this adjustment with a supplemental statement that is submitted with the PA-20S/PA-65 Schedule M.

Column e
Gain (Loss) from Sales
PA Schedule D

Enter the gain (loss) amount on the disposition of assets in which the proceeds were not reinvested in similar property.

Line 2
Net Income (Loss) from
Rental Real Estate Activities

Column a
Federal Income (Loss)

Enter the amount of net rental real estate income (loss) from federal Schedule K, Line 2 without any adjustment for Pennsylvania personal income tax purposes.

Column b
Pennsylvania Business
Income (Loss)

Enter the amount of net rental real estate income (loss) from Part A, Line 2, Column (a) that represents business income for Pennsylvania personal income tax purposes.

Refer to the Pennsylvania Personal Income Tax Guide to determine if rental income should be classified as Pennsylvania business income.

Column f
Rent & Royalty Income
(Loss) - PA Schedule E

Enter the amount of net rental real estate income (loss) from Part A,

Line 2, Column (a) received from the entity's ownership of rental property.

Line 3
Other Gross Rental Income
(Loss)

Column a
Federal Income (Loss)

Enter the amount of other gross rental income (loss) from federal Schedule K, Line 3c without any adjustment for Pennsylvania personal income tax purposes.

Column b
Pennsylvania Business
Income (Loss)

Enter the amount of other gross rental income (loss) from Part A, Line 3, Column (a) that represents business income for Pennsylvania personal income tax purposes.

Refer to the Pennsylvania Personal Income Tax Guide to determine if other net rental income (loss) should be classified as Pennsylvania business income.

Column f
Rent & Royalty Income
(Loss) - PA Schedule E

Enter the amount of other gross rental income (loss) from Part A, Line 3, Column (a) received from the entity's other rental activities.

Line 4
Interest Income

Column a
Federal Income (Loss)

Enter the amount of interest income from federal Schedule K, Line 5 (federal Form 1065) or Line 4 (federal Form 1120S) without any adjustment for Pennsylvania personal income tax purposes.

Column b
Pennsylvania Business
Income (Loss)

Enter the amount of interest income from Part A, Line 4, Column (a) received from investments and deposits for the purpose of generating working capital and other interest used in the operation of the entity's business, profession or farm.

Column c
Interest Income
PA Schedule A

Enter the amount of interest income from Part A, Line 4, Column (a) received from the entity's non-business investments and deposits (i.e., long-term investments, savings, set-aside interest for owners, etc.).

Column f
Rent & Royalty Income
(Loss) - PA Schedule E

Enter the amount of interest income from Part A, Line 4, Column (a) received from investments and deposits for the purpose of maintaining the entity's rental property or activities.

Line 5
Dividends

Column a
Federal Income (Loss)

Enter the amount of dividends from the federal Schedule K, Line 6a (federal Form 1065) or Line 5a (federal Form 1120S) without any adjustment for Pennsylvania personal income tax purposes.

Column b
Pennsylvania Business
Income (Loss)

Enter the amount of dividends from Part A, Line 5, Column (a) received from investments and deposits for the purpose of generating working capital and other dividend income used in the operation of the entity's business, profession, or farm.

Column d
Dividend Income - PA
Schedule B

Enter the amount of dividends from Part A, Line 5, Column (a) received from the entity's non-business investments and deposits (i.e. long-term investments, stocks held for investments etc.).

Column f
Rent & Royalty Income
(Loss) - PA Schedule E

Enter the amount of dividends from Part A, Line 5, Column (a) received from investments or deposits for the purpose of maintaining the entity's rental property.

Line 6 Royalty Income

Column a

Federal Income (Loss)

Enter the amount of royalties from the federal Schedule K, Line 7 without any adjustment for Pennsylvania personal income tax purposes.

Column b

Pennsylvania Business Income (Loss)

Enter the entire amount of royalties from Part A, Line 6, Column (a) if the entire amount was used in funding the entity's operation of another business.

Column f

Rent & Royalty Income (Loss) - PA Schedule E

Enter the entire amount of royalties from Part A, Line 6, Column (a) if the entire amount was received for the use of the entity's property.

Line 7

Net Short-Term Capital Gain (Loss)

Pennsylvania does not distinguish between long-term and short-term gain (loss). Read the instructions to determine if a sale, exchange or disposition is a business transaction in the ordinary course of operating a business, profession, farm or a disposition of property.

Column a

Federal Income (Loss)

Enter the amount of net short-term capital gain (loss) from the federal Schedule K, Line 8 without any adjustment for Pennsylvania personal income tax purposes.

Column b

Pennsylvania Business Income (Loss)

Enter the amount of net short-term capital gain (loss) from Part A, Line 7, Column (a) received from the entity's sales of business assets/investments used in operating its business, profession or farm.



Note. The proceeds from the sale must be reinvested back into the business operations to be classified as working capital.

Column d

Dividend Income

Enter the amount of short-term capital gain distributions taxable as dividends for Pennsylvania personal income tax purposes.

Column e

Gain (Loss) From Sales PA Schedule D

Enter the amount of net short-term capital gain (loss) from Part A, Line 7, Column (a) received from the entity's disposition of land, buildings, investments, and other assets where the proceeds of the transaction were not used in the operation of its business, profession or farm.

Line 8

Net Long-Term Capital Gain (Loss)

Pennsylvania does not distinguish between long-term and short-term gain (loss). Read the instructions for determining if a sale, exchange or disposition is a business transaction in the ordinary course of operating a business, profession, farm or a disposition of property.

Column a

Federal Income (Loss)

Enter the amount of net long-term capital gain (loss) from the federal Form 1065 Schedule K, Line 9a or federal Form 1120S Schedule K, Line 8a without any adjustment for Pennsylvania personal income tax purposes.

Column b

Pennsylvania Business Income (Loss)

Enter the amount of net long-term capital gain (loss) from Part A, Line 8, Column (a) received from the entity's sales of business assets/investments used in operating its business, profession or farm.

Column d

Dividend Income

Enter the amount of net long-term capital gain distributions taxable as dividends for Pennsylvania personal income tax purposes.



Note. The proceeds from the sale must be reinvested back into the business operations to be classified as working capital.

Column e

Gain (Loss) From Sales PA Schedule D

Enter the amount of net long-term capital gain (loss) from Part A, Line 8, Column (a) received from the entity's disposition of land, buildings, investments and other assets where the proceeds of the transaction were not used in the operation of its business, profession or farm.

Line 9

Net Gain (Loss) From Disposal of IRC § 179 Property

Column a

Federal Income (Loss)

Enter the amount of net gain (loss) from the disposal of IRC § 179 property from the federal Schedule K, Line 20c (federal Form 1065) or 17d (federal Form 1120S) without any adjustment for Pennsylvania personal income tax purposes.

Column b

Pennsylvania Business Income (Loss)

Enter the amount of net gain (loss) from the disposal of IRC § 179 property from Part A, Line 9, Column (a) received from the entity's sale of IRC § 179 property used in operating its business, profession or farm.



Note. The proceeds from the sale must be reinvested back into the business operations to be classified as working capital.

Column e

Gain (Loss) From Sales PA Schedule D

Enter the amount of net gain (loss) from the disposal of IRC § 179 property from Part A, Line 9, Column (a) received from the entity's sale of IRC § 179 property where the proceeds of the transaction were **not** used in the operation of its business, profession, farm or rental activities.

Line 10 Net IRC Section 1231 Gain (Loss) From Form 4797

Column a Federal Income (Loss)

Enter the amount of net IRC § 1231 gain (loss) from the federal Schedule K, Line 10 (federal Form 1065) or Line 9 (federal Form 1120S) without any adjustment for Pennsylvania personal income tax purposes.

Column b Pennsylvania Business Income (Loss)

Enter the amount of net IRC § 1231 gain (loss) from federal Form 4797 from PA-20S/PA-65 Schedule M, Part A, Line 10, Column (a) received from the entity's sales of business assets/investments used in operating its business, profession or farm.



Note. The proceeds from the sale must be reinvested back into the business operations to be classified as working capital.

Column e Gain (Loss) From Sales PA Schedule D

Enter the amount of net IRC § 1231 gain (loss) from federal Form 4797 from PA-20S/PA-65 Schedule M, Part A, Line 10, Column (a) received from the entity's disposition of land, buildings, investments and other assets where the proceeds of the transaction **were not** used in the operation of its business, profession, or farm.

Line 11 Other Income (Loss)

Analyze amounts on this line to determine the proper Pennsylvania income classification. Expenses reported on this line are generally not deductible for Pennsylvania personal income tax purposes.

Investment Partnerships

Investment partnerships, who report income on this line for federal income tax purposes, are required to classify investment income according to Pennsylvania personal income tax rules. Interest, dividends and gains (losses) should not be classified as business income and should be

allocated to their respective classes of income. In addition, Pennsylvania does not allow deductions related to investment income. Pennsylvania does not follow the "trader in securities" concept allowed for federal income tax purposes.

Column a Federal Income (Loss)

Enter the amount of other income (loss) from the federal Schedule K, Line 11 (federal Form 1065) or Line 10 (federal Form 1120S) without any adjustment for Pennsylvania personal income tax purposes.

Classify each item of income (loss) for Pennsylvania personal income tax purposes in the applicable columns according to each source and transaction that determined the income (loss). Other business income (loss) is Column (b), other interest income is Column (c), other dividend income is Column (d), other income (loss) from the sale, exchange or disposition of the entity's property is Column (e), and other income (loss) from the use of the entity's rental property or activities is Column (f).

Column e Gain (Loss) from Sales PA Schedule D

Enter Section 1256 income (loss) from the federal Schedule K, Line 11 without any adjustment for Pennsylvania personal income tax purposes.

Line 12 Total Pennsylvania Income (Loss) by Classification

Total the amounts in columns a through f.

Completing PA Schedule M Part B

Business Name

Enter the complete name of the entity or business as shown on the PA-20S/PA-65 Information Return.

FEIN

Enter the nine-digit federal employer identification number (FEIN) of the entity or business as shown on the PA-20S/PA-65 Information Return.

Line Instructions

PART B

Specific instructions for most of the lines are provided. Lines that are not discussed are self-explanatory.

Determining Pennsylvania-Reportable Income (Loss) by Classification

Use PA-20S/PA-65 Schedule M, Part B to reconcile the entity's federal business income (loss) and rental/royalty income (loss) to Pennsylvania income (loss). If the entity is separately allocating income, keeps separate books and records for financial statement purposes, and there are no business transactions between multiple businesses, the "PA-Allocated Income (Loss)" Column and the "Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment" Column will be completed.

If the entity is apportioning its income, complete only the "Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment" Column.

Section A Federal Classification Income (Loss)

Enter the Pennsylvania-classified net income (loss) from Part A, Column (b), or enter the Pennsylvania-classified net rental income (loss) from Part A, Column (f).



Important. Part B, Section A, Box 2 must show total worldwide rental income. Rental income cannot be apportioned.

Section B Itemize Income Adjustments that Increase Pennsylvania-Reportable Income (Reduce the Loss from the Federal Form)

Line a Deferred Income Relating to Advance Payments for Goods and Services

Pennsylvania personal income tax requires income to be taxed in the

year of receipt. Pennsylvania does not allow the deferral of income related to advanced payments for goods and services as allowed under IRC §451 and Internal Revenue Procedure 2004-34. Items reported on this line must be reversed in Section C, Line d the following tax year.

Line b
Difference in Gain (Loss) for each Business Sale of Property Where the Proceeds Were Reinvested in the Same Line of Business

The amount reported on this line is when Pennsylvania gain is higher than the federal gain or the Pennsylvania loss is less than the federal loss. The federal gain is included on federal Schedule K as ordinary income on Line 1.

Line c
Gain from Business Like-Kind Exchanges

A "like-kind exchange" refers to property that has been exchanged for similar property. For example: a taxpayer exchanged land in Pennsylvania for land in Florida. Under the Internal Revenue Code (IRC) a gain (loss) is not recognized and is deferred until the like-kind property is sold.

Pennsylvania tax law contains no such provision, the difference between the basis of the old property and the current market value of the property received in exchange is the taxable gain and reported on this line.

Line d
Gain (Loss) on Involuntary Conversions – IRC Section 1033

Pennsylvania does not follow the federal treatment for involuntary conversion allowed under IRC Section 1033. Gain must be recognized in the year of conversion.

Line e
Income from Cancellation of Debt that Pennsylvania Treats Differently from Federal Rules

The department published several bulletins which discuss the taxability

of cancellation of debt. To determine taxability, refer to PIT Bulletins 2009-04, 2009-05 and 2009-06 on the department's website.

Line f
Increases in Income in the Year of Change Resulting from Spread in the Year of Change Associated with IRC Section 481(a) Adjustment
Accounting change must be taken in the year it is adjusted.

Line g
Income from Obligations of Other States and Organizations that Is Not Exempt for PA Purposes
Interest on obligations of other states and territories, their political subdivisions and instrumentalities is taxable for Pennsylvania personal income tax purposes.

Line h
Other Taxable Income for Pennsylvania Purposes the Entity Does Not Report for Federal Purposes. Submit Statement.

Include other kinds of income that are taxable for Pennsylvania purposes but the entity does not report for federal purposes. Include passive or at-risk-loss carryover amounts deducted on federal Form 8825. Pennsylvania does not allow carryover of losses. Loss from a pass through entity is included on this line in determining net profits for personal income tax purposes. The pass through loss should be added to business income and reported on PA-20S/PA-65 Information Return, Part I, Line 1b. Submit an itemized statement describing each income.

Section B
Total

Total Lines a through h as follows:

Pennsylvania Allocated Income (Loss) Column
Add Boxes 1, 3, 5, 7, 9, 11, 13 and 15. Enter the result in Part B, Section B, Box 17.

Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment Column

Add Boxes 2, 4, 6, 8, 10, 12, 14 and 16. Enter the result in Part B, Section B, Box 18.

Section C
Itemize Income Adjustments that Decrease the Pennsylvania Reportable Income. (Increase the Loss from the Federal Form)

Line a
Difference in Gain (Loss) for each Business Sale When Proceeds Were Reinvested in the Same Line of Business

The amount reported on this line should have been reported on federal Schedule K as ordinary income on Line 1; however, the Pennsylvania gain is less than the federal gain or the Pennsylvania loss is higher than the federal loss.

Line b
Income from Obligations of the U.S. Government and Other Organizations that Is Not Taxable for PA Purposes

Interest on obligations issued by or on behalf of the U.S. government is not subject to Pennsylvania personal income tax.

See REV-1643, Tax-Exempt Obligations for Pennsylvania Personal Income Tax Purposes, for a complete listing of obligations exempt from Pennsylvania personal income tax on the department's website.

Line c
Decreases for Previously Reported Income In Prior Year Resulting from Spread Associated with IRC Section 481(a)

The amount reported on this line is the federal spread from the 481 adjustment. The entire amount should be reported in the year of the change for Pennsylvania purposes. If you did not report the entire

adjustment in the year of the change for Pennsylvania purposes, **do not** decrease Pennsylvania reportable income.

Line d Other Pennsylvania Nontaxable Income the Entity Reported for Federal Purposes. Submit Statement.

Include other kinds of income that are not taxable for Pennsylvania purposes but the entity had to report for federal purposes.

Income from a pass through entity is included on this line to determine net profits for personal income tax purposes.

Pass through income should be deducted from business income and reported on PA-20S/PA-65 Information Return, Part I, Line 1b. If an itemized statement is not submitted describing each income item, the income item may be denied.

If the entity reported an adjustment in Section B, Line a in the previous tax year, then an adjustment must be reported on Line d reversing that.

Section C Total

Total Lines a through d as follows:

Pennsylvania Allocated Income (Loss) Column

Add Boxes 1, 3, 5 and 7. Enter the result in Part B, Section C, Box 9.

Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment Column

Add Boxes 2, 4, 6 and 8. Enter the result in Part B, Section C, Box 10.

Section D Adjusted Pennsylvania- Reportable Income

Pennsylvania Allocated Income (Loss) Column

Add Box 1 in Section A and Box 17 in Section B. From this result, subtract Box 9 in Section C. Enter the result in Part B, Section D, Box 1.

Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment Column

Add Box 2 in Section A and Box 18 in Section B. From this result, subtract Box 10 in Section C. Enter the result in Part B, Section D, Box 2.

Section E Itemize Those Expenses that Pennsylvania Law Does Not Allow that the Entity Deducted on its Federal Form

These adjustments increase Pennsylvania reportable income (reduce the loss from the federal form). The entity should refer to the Pennsylvania Personal Income Tax Guide for Pennsylvania rules governing the expenses it may deduct for federal purposes, but may not deduct to determine its income (loss) for Pennsylvania.

Line a Taxes Paid on Income Submit REV-1190

Use this line to report non Pennsylvania taxes paid on income.

The Philadelphia Business Privilege Tax includes two components:

- Gross receipts tax based on revenue; and
- Net income tax based on net income.

Pennsylvania personal income tax law does not allow deductions for taxes based on net income. Only the gross receipts portion of the Philadelphia Business Privilege tax is deductible for Pennsylvania personal income taxes. You may not take a deduction for the net income tax portion.

The following are not deductible for Pennsylvania personal income tax and should not be included on this line:

- Taxes based on net income;
- Taxes paid to other states or foreign countries based on income;
- Estate taxes and inheritance, legacy, succession and gift taxes; or
- Assessments for betterment and improvements.

The following are deductible for Pennsylvania personal income tax and can be included on this line:

- Taxes based on gross receipts;
- Single-member limited liability companies that file as sole proprietors, limited liability companies that file as partnerships, and PA S corporations may deduct the Pennsylvania capital stock/foreign franchise tax paid; or
- Other federal, state and local taxes are allowable deductions.



Note. The entity submitting REV-1190 must include the entity name, FEIN and tax year on the form.

Line b Differences in Depreciation taken for Pennsylvania and Federal Purposes

Include amount in years where there is a federal bonus depreciation expense. Pennsylvania does not allow bonus depreciation.

Line c Key Man Life Insurance Premiums (Owners as Beneficiaries)

If the owners are the beneficiaries, Pennsylvania does not allow the deduction of life insurance premiums.

Line d Differences in Pennsylvania Treatment of Guaranteed Payments for Capital

Please refer to Chapter 16 in the Pennsylvania Personal Income Tax Guide, Page 12, 4c.

Line e Differences in Depreciation for Bonus Depreciation

Pennsylvania law does not allow bonus depreciation. Therefore, reduce the entity's depreciation expense by the difference after subtracting the allowable Pennsylvania depreciation expense using the generally accepted method the entity elected from its federal bonus depreciation. Alternatively, subtract the entire amount of bonus depreciation and claim the Pennsylvania-allowable depreciation expense Section F, Line c.

Line f Expense Adjustments to Qualify for the Pennsylvania Credits Claimed in Part V of the PA-20S/PA-65

Pennsylvania does not allow the deduction of certain expenses used to qualify for the Neighborhood Assistance Program and the Educational Improvement tax credits. If the expenses were deducted in calculating federal-taxable income, the amount should be reported as a reduction in expenses on line f. Do not reduce Pennsylvania-taxable income by amounts paid to qualify for the credit.

Line g Other Expenses the Entity Deducted On Its Federal Return That Pennsylvania Does Not Allow. Submit Statement.

Include other kinds of expenses that are not deductible for Pennsylvania purposes but the entity had to report for federal purposes. Submit an itemized statement describing each income item.

Section E Total

Total Lines a through g as follows:

Pennsylvania Allocated Income (Loss) Column

Add Boxes 1, 3, 5, 7, 9, 11 and 13. Enter the result in Part B, Section E, Box 15.

Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment Column

Add Boxes 2, 4, 6, 8, 10, 12 and 14. Enter the result in Part B, Section E, Box 16.

Section F

Itemize Those Expenses that Pennsylvania Law Allows that the Entity Could Not Deduct on its Federal Form

These adjustments decrease Pennsylvania-reportable income

(increase the loss from the federal form). The entity should refer to the Pennsylvania Personal Income Tax Guide for instructions for the Pennsylvania rules governing the expenses it may not deduct for federal purposes, but can deduct in determining its income (loss) for Pennsylvania.

Line a Fifty Percent of Business Meals, Entertainment, and Club Dues that the Entity Could Not Deduct

Pennsylvania allows 100 percent of customary and reasonable amounts expensed on business meals and entertainment as opposed to the federal limit of 50 percent.

The 50 percent disallowed for federal purposes is taken as an expense on PA-20S/PA-65 Schedule M, Section F, Line a. This adjustment decreases Pennsylvania-reportable income.

Line b Sales Tax on Depreciable Assets

Pennsylvania allows the immediate expensing of sales tax paid on depreciable assets.

Federal law requires the sales tax to be added to the basis of the depreciable asset. If the sales tax is deducted on this line, **do not** add it to depreciable basis for Pennsylvania personal income tax purposes.

Line c Differences in Depreciation Taken for Pennsylvania and Federal Purposes

Include amount when Pennsylvania depreciation expense is greater than federal depreciation expense due to allowances of federal bonus depreciation expenses and excess IRC § 179 deductions in previous years.

Line d IRC § 179 Expenses - The maximum for Pennsylvania purposes is \$25,000

Partnership

Partnerships do not reduce the ordinary business income on federal

Form 1065 Schedule K, Line 1 by IRC § 179 deduction on Line 12. The Pennsylvania deduction is taken when federal Form 1065 Schedule K, Line 1 is transferred to PA-20S/PA-65 Schedule M, Part B, Section F, Line d.

PA S Corporation

PA S corporations do not reduce the ordinary business income on federal Form 1120S, Schedule K, Line 1 by IRC § 179 deduction on Line 11. The Pennsylvania deduction is taken when federal Form 1065 Schedule K, Line 1 is transferred to PA-20S/PA-65 Schedule M, Part B, Section F, Line d.

Line e Expenses for Employees Including PA S Corporation Shareholder-Employees

Include federal nondeductible expenses that are deductible for Pennsylvania such as health insurance for PA S corporation shareholder-employees.

If shareholder health insurance expense is included on Schedule M, Part A, Line 1 a (federal income (loss)) then it cannot be deducted on Schedule M, Part B, Section F, Line e.

Also, for Pennsylvania personal income tax purposes, if the health plan is non-discriminatory, regardless of the percentage of the shareholder, it is not included in the shareholder wages and is deductible for the S corporation.

For Pennsylvania personal income tax purposes, if the health plan is discriminatory, regardless of the percentage of the shareholder, it is included in the shareholder wages and is not deductible for the S corporation.

Non-discriminatory plans include all employees.

Discriminatory plans include only some employees and the health package is enhanced.

Line f Life Insurance Premiums (PA S Corporation or Partnership as Beneficiary)

Pennsylvania allows the deductions of premiums. However, if the entity is deducting life insurance premiums for which it is a beneficiary for Pennsylvania purposes, the proceeds are taxable for Pennsylvania personal income tax purposes.

Pennsylvania does not allow an expense deduction for life insurance premiums if the life insurance proceeds are to be used to fund a buy or sell arrangement or merely free up funds to buy out a decedent's interest. The proceeds are not taxable at the owner's level.

If the exclusive purpose of the policy is to keep the business going, including insurance policies to secure business loans, the insurance premiums are deductible and the proceeds are taxable.

Include the proceeds in ordinary income when determining net income or loss from the operation of the activities of the entity.

Line g

Expenses Adjustments to Qualify for Federal Credits

If the entity has taken certain credits against federal-taxable income then certain expenses are not deductible in calculating federal-taxable income. Those expenses are allowable in calculating Pennsylvania-taxable income.

Line h

Other Expenses

Pennsylvania Allows that the Entity Did Not Deduct on its Federal Return.

Submit Statement.

Include other kinds of expenses the entity could not deduct on its federal return but Pennsylvania law allows.

If an itemized statement is not submitted, describing each expense item, the expense item may be denied.

Pennsylvania personal income law does not allow deductions for charitable contributions. A payment to a charitable organization may only be deductible if it is advertising, in which case, it would already have been deducted in calculating ordinary

business income on the federal tax return. Therefore a payment to a charitable organization is not allowed as an adjustment in calculating Pennsylvania taxable income. Refer to the Pennsylvania Personal Income Tax Guide, Chapter 11.

For expenses for intangible drilling costs refer to the Personal Income Tax Guide, Chapter 23, Natural Resources.

Line i

Use Tax Submitted with this Return – Not Previously Capitalized

If you have not previously paid sales or use tax on current year purchase(s) subject to sales and use tax, you may deduct the use tax paid and remitted with the PA-1, Use Tax Return. Complete and remit payment with the PA-1. Submit PA-1, Use Tax Return.



Caution. DO NOT send one check for multiple taxes. Send a separate check or money order for each type of tax.

Section F

Total

Total Lines a through i as follows:

Pennsylvania Allocated Income (Loss) Column

Add Boxes 1, 3, 5, 7, 9, 11, 13, 15 and 17. Enter the result in Part B, Section F, Box 19.

Total Rental Income (Loss) or Total Business Income (Loss) Before

Apportionment Column

Add Boxes 2, 4, 6, 8, 10, 12, 14, 16 and 18. Enter the result in Part B, Section F, Box 20.

Section G

Total Taxable Income (Loss)

Pennsylvania Allocated Income (Loss) Column

Add Box 1 in Section D and Box 15 in Section E. From this result, subtract Box 19 in Section F. Enter the result in Part B, Section G, Box 1.

If selecting Column (b) on PA-20S/PA-65 Schedule M, Part B, Section A, enter the result on the PA-20S/PA-65 Information Return, Part II, Line 2e.

If selecting Column (f) on PA-20S/PA-65 Schedule M, Part B, Section A, enter the result on the PA-20S/PA-65 Information Return, Part III, Line 6b. If a loss, fill in the oval.

Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment Column

Add Box 2 in Section D and Box 16 in Section E. From this result, subtract Box 20 in Section F.

Enter the result in Part B, Section G, Box 2.

If selecting Column (b) on PA-20S/PA-65 Schedule M, Part B, Section A, enter the result on the PA-20S/PA-65 Information Return, Part I, Line 1a.

If selecting Column (f) on PA-20S/PA-65 Schedule M, Part B, Section A, enter on the PA-20S/PA-65 Information Return, Part III, Line 6a, the difference between Line 2 and Line 1 from Part B, Section G.