2006 STATE TAX SUMMARY
ACT NO. 67 of 2006
ACT NO. 116 of 2006
ACT NO. 65 of 2006
ACT NO. Act 114 of 2006
SENATE BILL 300, PN 1986
HOUSE BILL 859, PN 4509
HOUSE BILL 153, PN 4212
HOUSE BILL 185, PN 4517

Personal Income Tax

- **Qualified Tuition Programs**
  Contributions to any qualified tuition program as defined in section 529 of the Internal Revenue Code, including those offered by other states, will be deductible from taxable income. The amount deducted for each designated beneficiary cannot exceed the annual limitation on gifts permitted by the Internal Revenue Code for purposes of federal estate and gift tax, which is currently $12,000. The deduction cannot result in taxable income being less than zero.

  Distributions used for qualified higher education expenses, as well as undistributed earnings in the accounts, will not be taxable. Federally qualified rollovers between accounts and beneficiary changes will also not be taxable events for Pennsylvania purposes. Distributions that are not used for qualified higher education expenses will be subject to tax. These changes will apply to tax years beginning after December 31, 2005.

- **Health Savings Accounts/Archer Medical Savings Accounts (Archer MSAs)**
  The taxation of Health Savings Accounts and Archer MSAs will generally follow federal rules. Under the federal rules, employer contributions are excluded from the employee's taxable income and employee contributions are deducted from income if they meet the criteria outlined in the Internal Revenue Code. Distributions that are not used for qualified medical expenses will be taxable as interest income. These changes will apply to tax years beginning after December 31, 2005.

- **Election of S Corporation Status**
  If a small corporation elects to be an S corporation for federal purposes, it will be recognized as a Pennsylvania S corporation unless it opts out of Pennsylvania S status. This is a change from current law, which requires a federal S corporation to elect Pa-S status. If a small corporation opts out of S status, then its choice will remain in effect for 5 years. The requirements to become an S corporation will now be consistent with the federal requirements enacted as part of the American Jobs Creation Act of 2004, which now permits S corporations of up to 100 shareholders and members of the same family to be counted as one shareholder. These changes will apply to taxable years beginning after December 31, 2005.

Corporate Net Income Tax

- **Apportionment**
  For taxable years beginning after December 31, 2006, the formula for apportionment will be 70% for sales, 15% for property and 15% for payroll. This is a change from the current formula which is 60% sales and 20% each for property and payroll.

- **Net Operating Loss**
  For taxable years beginning after December 31, 2006, the deduction for net operating loss will be the greater of 12.5% of taxable income or $3 million. This is an increase from the previous limit of $2 million.

Capital Stock and Franchise Tax

- **Single Member LLCs and RPCs**
  Single member limited liability companies and business trusts whose member is a natural person are permitted to use the deduction from net income for distributions to materially participating members. This codifies the Department's policy on this subject. This change will apply to tax years beginning after December 31, 2005.

  Single member restricted professional companies will no longer be subject to the capital stock and franchise tax unless they are classified as a corporation for federal income tax purposes. This legislative change will apply to tax years beginning after December 31, 2005.

- **Deduction from Fixed Formula Valuation**
  The fixed formula deduction used to calculate the capital stock value of a company has been increased to $150,000 from $125,000. This change will apply to tax years beginning after December 31, 2006.

- **Tax Rate Reduction**
  The phase-out of the capital stock and franchise tax has been accelerated by 0.1 mill. The rate is 4.89 mills for the 2006 tax year; 3.89 for the 2007 tax year, 2.89 for the 2008 tax year, 1.89 for the 2009 tax year and 0.89 mills for the 2010 tax year.

Tax Credits

- **Research and Development Tax Credit**
  The following changes have been made to the Research and Development tax credit:
    - A small business may receive a credit equal to 20% of the qualified research and development expense.
    - The amount of credits that may be granted in any one fiscal year has been increased to $40 million from $30 million.
    - The amount of the small business set aside has been increased to $8 million from $6 million.
    - The credit has been extended to taxable years ending before January 1, 2016.

These changes apply credits awarded after June 30, 2006.

Sales and Use Tax

- **Clean Rooms**
  The definition of manufacturing is amended to codify the Department's policy that clean rooms and related property are considered to be directly used in a manufacturer's operations and therefore are exempt from sales tax. This change will take effect immediately.

- **Investment coins and bullion**
  The sale of investment metal bullion and investment coins will be exempt from sales and use tax. This does not include jewelry or works of art made of coins nor commemorative medallions. This will be effective in 60 days.

Inheritance Tax

- **Agricultural conservation easements**
  The transfer of land or an interest in land that is part of an agricultural conservation easement as defined in the Agricultural Area Security Law (Act 43 of 1981) will be taxed on 50% of the value for inheritance tax purposes. This shall apply to estates of decedents who die on or after the effective date of this act.

Other Relevant Legislation

Act 65 of 2006, House Bill 153, PN 4212 (Organ and Bone Marrow Donor Act)
This act will permit a business entity to take a credit against personal income tax, corporate net income tax, capital stock and franchise tax, bank shares tax, title insurance company shares tax, insurance premium tax, or mutual thrift institutions tax for a leave of absence granted to employees for the specific purposes of organ or bone marrow donation. The amount of the credit is equal to the employee compensation paid during the leave of absence, the cost of temporary replacement help and any miscellaneous expenses authorized by regulation incurred with the leave of absence period. A leave of absence period cannot exceed five working days (or the hourly equivalent) and does not include a period where the employee uses any annual leave or sick leave provided by the employer. Credits cannot be applied against employer withholding tax under Article III. Credits can be carried forward for three taxable years, however, they cannot be carried back to previous taxable years and they are not refundable. The credit against PIT may be passed through proportionately to the shareholders of S corporations, members of limited liability companies or partners.

Applications for the credits are to be filed by the 15th day of the fourth month following the close of the business firms' taxable year. If credits are granted in any calendar year, the Department must provide a report to the General Assembly stating the business firms using the credit, the address, the SIC code and the amount of tax credits granted.

This act shall apply to tax years beginning on January 1, 2006, through taxable years beginning within 2010. Carryover credits may be used after 2010.

Act 114 of 2006, House Bill 185, PN 4517 (Public School Code)
This act increases the total aggregate amount of Educational Improvement Tax Credits available for a fiscal year to $54 million from $44 million for contributions to scholarship organizations and educational improvement organizations. The total aggregate amount of

credits available for a fiscal year for contributions to kindergarten organizations will remain at $5 million. This increase takes effect immediately.