

Pennsylvania Tax Law Changes

A number of Pennsylvania tax law changes were enacted in July 2006 that will impact both individuals and corporations in Pennsylvania. The following changes are effective January 1, 2006:

PERSONAL INCOME TAX:

Pennsylvania taxpayers may now take a deduction from their taxable income for contributions made to any qualified Section 529 tuition program, even those programs offered by other states. Such contributions may be deducted up to the limit of the federal gift tax threshold (currently \$12,000 per beneficiary). In addition, distributions and earnings from any such plan are now exempt from PA tax.

Taxpayers may also take a deduction on their personal income tax returns for their contributions to health savings accounts, and employer contributions to such accounts need not be reported as income.

S CORPORATIONS:

All federal S corporations will now automatically be treated as S corporations for PA purposes (unless an election is made to be treated as a C corporation). The maximum number of shareholders has been increased to 100.

CORPORATE NET INCOME TAX:

The maximum allowable net operating loss (NOL) which may be deducted in one year has been increased to \$3 million or 12.5% of net income, whichever is greater. The NOL cap previously had been \$2 million.

CAPITAL STOCK/FOREIGN FRANCHISE TAX:

The phase-out of the capital stock/franchise tax is accelerated by 0.1 mills.



The new rate is 4.89 mills for 2006; 3.89 mills for 2007, 2.89 mills for 2008, 1.89 mills for 2009, and 0.89 mills for 2010. The tax will be eliminated in 2011.

All Restricted Professional Companies ("RPCs") are now exempt from the capital stock tax, including single member RPCs. RPCs are limited liability companies whose activities are limited to certain specified professional services; which include law firms, public accounting firms, medical practices, etc.

RESEARCH AND DEVELOPMENT TAX CREDIT:

Applicable for credits awarded after June 30, 2006, the research and development credit against corporate net income tax, personal income tax, and capital stock/franchise tax is extended to 2015. The credit was previously scheduled to expire in 2006. The cap on the total amount of research and development credits is increased from \$30 million to \$40 million in any fiscal

year, and \$8 million of that total is allocated exclusively for small businesses.

Also applicable for credits awarded after June 30, 2006, a small business is allowed a research and development credit equal to 20% of the excess of the taxpayer's total Pennsylvania qualified research and development expense for the taxable year over the taxpayer's Pennsylvania base amount.

The following changes are effective January 1, 2007:

CORPORATE NET INCOME TAX:

For taxable years beginning after 2006, all business income will be apportioned for Pennsylvania corporate net income tax purposes by using a formula with a 70% sales factor, 15% property factor, and 15% payroll factor. The current formula has a 60% sales factor, 20% property factor, and 20% payroll factor.

CAPITAL STOCK/FOREIGN FRANCHISE TAX:

Applicable to taxable years beginning after 2006, the capital stock valuation formula is the product of one-half times the sum of the average net income capitalized at the rate of 9.5% plus 75% of net worth, from which product \$150,000 (previously, \$125,000) is subtracted.

For more information, contact your [**Alpern Rosenthal tax representative.**](#)