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Clarifying Article II, Sections 202 and 203 of the Philadelphia School District School Income Tax Regulations entitled "Imposition and Rate of Tax".

CLARIFICATION TO THE PHILADELPHIA SCHOOL DISTRICT
SCHOOL INCOME TAX REGULATIONS

ARTICLE II Imposition and Rate of Tax

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Section 202. Persons Subject to Tax.

Any person residing in the School District of Philadelphia for a full tax year or for a period less than a full tax year shall be liable for the tax on income received, or credited to him, including income that is reinvested to him during such year or period or residency.
This list of taxpayers shall include, but is not limited to:

* * *

(c) Individual shareholders of 'S' Corporations. **[on their pro rata shares of 'S' Corporations' taxable income.]** For the purpose of this section, 'S' Corporation is a corporation that elects to be treated as an 'S' Corporation for federal tax purposes.

(d) Members of unincorporated associations with respect to the taxable income of the association received by or credited to the members.

(e) Beneficiaries of trusts and estates as to current or accumulated taxable income paid to them.

(f) Individuals treated as substantial owners or trusts and estates.

Section 203. Income Included in Tax Base

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(a) DIVIDENDS. Except as discussed in Section 206 of these regulations, all dividends reportable to the Commonwealth of Pennsylvania for Personal Income Tax purposes are subject to this tax, exclusive of flow through items addressed elsewhere in these regulations. Dividend includes distribution from the 'S' Corporation's earnings and profits (E & P) account (described under Internal Revenue Code Section 1368 (C)(2)) accumulated in prior years when the 'S' Corporation was a 'C' Corporation. **[Dividend does not include distribution from the 'S' Corporation's Accumulated Adjustment Account. Effective January 1, 2007, any distribution from the 'S' Corporation Accumulated Adjustment Account whether or not the amount was previously reported as taxable income for the purpose of the School Income Tax shall not be included in the tax base.]**

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(i) INCOME FROM LIMITED PARTNERSHIPS. The pro rata share of taxable income of Limited Partnerships from partnerships NOT otherwise subject to the Net Profits tax shall be included in the tax base with recognition of the revenue stream creating the income. Only Incomes and losses of the same revenue stream from different Limited Partnerships may be offset. Any income that is excluded under Section 206 of this regulation shall be excluded from the tax base.

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(J) INCOME FROM 'S' CORPORATIONS. <u>**For Tax Year 2007 through Tax Year 2013, the**</u> <u>**[The]**</u> pro rata share of taxable income of shareholders from an 'S' Corporation shall be included in the tax base with recognition of the revenue stream creating the income. Only Incomes and losses of the same revenue stream from different 'S' Corporations may be offset. Any income that is excluded under Section 206 of this regulation shall be excluded from the tax base.

<u>**For Tax Years 2014 and thereafter, any distribution from the 'S' Corporation Accumulated Adjustment Account ("AAA") is subject to School Income Tax ("SIT") and shall be included in the SIT base unless it is deemed attributable to previously taxed income. It is deemed attributable to previously taxed income only if such distribution is in excess of the pro rata share of income reported to the taxpayer in the current Tax Year. If so, the excess shall be excluded from the SIT base to the extent that the total pro rata share of income included by the taxpayer in the SIT base when filing Tax Years 2007 through 2013 SIT returns exceeds the total distribution made to the taxpayer in Tax Years 2007 through 2013.**</u>

Exclusions:

For Tax Years 2014 and thereafter, any excess distribution from the S-Corp's AAA as described in this subsection and illustrated in the following examples shall be attributed to previously taxed income and shall be excluded from the SIT base. Taxpayers who claim such exclusion are required to complete and submit a worksheet/form provided by the Revenue Department. The Department shall make the worksheet/form available by posting it on the Department's website.

Illustration of How the SIT Base and the Exclusion Amount is Determined:

Mrs. Z, a resident of Philadelphia, has been a shareholder of an S-Corp since Tax Year 2010. When filing Tax Years 2010 through 2013 SIT returns, Mrs. Z properly reported her pro rata share of income and paid the tax accordingly. Mrs. Z's pro rata share of income and distributions from the S-Corp's AAA in Tax Years 2010 through 2013 are as follows:

Year	Income	Distribution	Income - Distribution
2010	$40,000	$20,000	$20,000
2011	30,000	25,000	5,000
2012	50,000	25,000	25,000
2013	5,000	15,000	-10,000
Total	$125,000	$85,000	$40,000

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This means that, for Tax Years 2010 through 2013, Mrs. Z filed and paid SIT on her $125,000 pro rata share of income while in these years she received only a total of $85,000 in actual distributions from the S-Corp's AAA. As such, the $40,000 excess reflects income in excess of distributions previously taxed and shall be available for exclusion from the SIT base in Tax Years 2014 and thereafter when distributions, rather than pro rata share of income, are the subject of SIT.

Example 1: Mrs. Z's Tax Year 2014 pro rata share of income and distribution from the S-Corp's AAA are $70,000 and $80,000 respectively. Mrs. Z's SIT base for Tax Year 2014 shall be computed as follows:

The $80,000 distribution is more than the $70,000 pro rata share of income, and, as such, the $10,000 excess distribution is excluded from the 2014 SIT Tax Year base to the extent of the amount available for exclusion. Since the total amount available for exclusion is $40,000, the $10,000 excess distribution is excluded and only $70,000 of the $80,000 distribution is subject to SIT in Tax Year 2014. This also means that only $30,000 (i.e., $40,000-$10,000) shall remain available for future exclusions.

Example 2: Same fact pattern as Example 1 in regard to Tax Year 2014. Mrs. Z's Tax Year 2015 pro rata share of income and distribution from the S-Corp's AAA are $50,000 and $40,000 respectively. Mrs. Z's SIT base for Tax Year 2015 shall be computed as follows:

Since the $40,000 Tax Year 2015 distribution is less than the $50,000 Tax Year 2015 pro rata share of income, the entire $40,000 shall be included in the 2015 SIT Tax Year base. The $30,000 shall still be available for exclusion in subsequent SIT Tax Years.

Example 3: Same fact pattern as Examples 1 and 2 in regard to Tax Years 2014 and 2015. Mrs. Z's pro rata share of income and distribution from the S-Corp's AAA in Tax Year 2016 are Zero (0) and $30,000 respectively. Mrs. Z's SIT base for Tax Year 2016 shall be computed as follows:

Since Tax Year 2016 pro rata share of income is Zero (0), the $30,000 Tax Year 2016 distribution may be excluded from the 2016 SIT Tax Year base to the extent of the amount that still remains available for exclusion. We know from Example 2 above that $30,000 remains available for exclusion and, as such, the entire $30,000 distribution shall be excluded from the 2016 SIT Tax Year Base and therefore the 2016 Tax Year base shall be Zero (0) (i.e., $30,000 - $30,000).

Beginning Tax Year 2017, all distributions from the S-Corp's AAA to Mrs. Z shall be included in the SIT base because the entire $40,000 pro rata share of income previously taxed and available for exclusion has been used (i.e., $10,000 in Tax Year 2014 and $30,000 in Tax Year 2016).

[ ] Brackets and **Bold** denote deleted matter
_____ Underline and **Bold** denotes new matter

Clarena I.W. Tolson

Date October 28, 2014

Clarena I.W. Tolson
Revenue Commissioner & Chief Revenue Collections Officer