



COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF REVENUE
HARRISBURG, PENNSYLVANIA
17128-1100

THE SECRETARY

May 24, 2004

Kenneth Klothen, Executive Director
Governor's Center for Local Government Services
4th Floor, Commonwealth Keystone Building
Harrisburg, PA 17120

Dear Ken,

We have been advised that taxpayers and some local tax collectors are having difficulty determining the amount of net profits that should be reported for purposes of the local earned income tax. In some taxpayer's cases, the amount shown on the State Income Tax Return (PA-40) will not be the appropriate amount to report on the local earned income tax return. We would appreciate it if you would send a copy of this letter to local tax collectors to assist in clarifying this issue.

Line 4 of the PA-40, Net Income or Loss from Operation of Business, Profession, or Farm, combines an individual's net profits or losses derived through sole proprietorships with those derived from pass-thru entities such as PA S Corporations, certain limited liability companies or partnerships. Net profits passed through to a taxpayer by an S corporation are not subject to the local earned income tax. Therefore, in the case of a taxpayer(s) with an investment(s) in an S corporation(s), the amount on line 4 of the PA-40 will include some income not subject to local earned income tax.

For ease of reconciling with the State tax return, local tax collectors may wish to require taxpayers to report the amount they reported on line 4 of the state return and then separately show a deduction for income that is not taxable locally.

Thank you for the opportunity to clarify this matter.

Sincerely,

A handwritten signature in cursive script that reads "Eileen H. McNulty".

Eileen H. McNulty
Executive Deputy Secretary