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## **2019 Tax Preparer Seminar** **Supplemental Information**

### **W2's and Expenses**

- When rounding income amounts reported – total all w-2 income and local tax withheld, then round to nearest dollar.
- Local Income Tax is based on gross compensation – if there are different amounts on a W-2 form, use the “Which Wage Figure...” handout to determine what the taxpayer’s taxable income should be. If our calculations differ from what is filed by the taxpayer, we will send a Request for Information letter for documentation to explain how they calculated their income and/or why income should be considered non-taxable.
- Clergy Housing allowance is Not Taxable.
- Personal Use of Vehicle is Not Taxable.
- UE Expenses are allowed to reduce income under the ACT. The ACT also allows the tax officer to verify expenses. If expenses are listed on the form and no UE form is submitted, we must deny the expense, correct the return and notify the t/p. The notification may be a bill for tax due or a denial of refund and will have a statement requesting a copy of the UE. There should also be a note stating that there will be no balance due if the UE is provided. When the UE is provided and found to be satisfactory, a refund will be issued if one is due.
- If expenses are excessive we may deny the expenses and request receipts, mileage log, etc. (remember that 24,000 miles is once around the world at the equator and would take 400 hours at 60 miles per hour).
- Per Diem expenses are not allowed on a PA UE (only Federal taxes).

### **Which wage figure do I use from my W-2 to file my local return?**

- Pennsylvania Local Income Tax is calculated on gross taxable wages.
- There are many situations where the highest gross wage figure on the W-2 form is not listed in the local wage box. In these situations the York Adams Tax Bureau will assess the tax based on the highest gross wage figure listed on the W-2 form, less any non-taxable income shown on the W-2 form.
- When reviewing your W-2 to determine the taxable gross wages for local tax purposes, use the following steps:
  - 1) Compare the wages reported in boxes 16 (state wages-PA) and 18 (local wages). If the wages are the same, **AND** there is no higher wage figure listed in any other income boxes, this should be your locally taxable wage.
  - 2) If the PA state wages and local wages are not the same or if no local wage (box 18) is reported or there is a higher wage figure listed in another income box, compare the wages reported in box 5 (Medicare wages) with box 16 (state wages-PA). If these figures are the same, this is your taxable wage.
  - 3) If the box 5 and box 16 figures are different, check box 12 for a code C deduction. If the code C deduction in box 12 is the difference between the Medicare and PA State wages, the PA state wage figure (box 16) is your taxable wage.

- Another way to determine locally taxable wages, **if there is no wage amount in the local wage box**, is to begin with box 1 (Federal wages), then add any 12D reported in box 12 and subtract any 12C reported in box 12. The end result should match the PA state wage figure in box 16 and is the taxable wage.
- In some cases the gross wages listed in the local wage box will be greater than the gross wages listed in the PA state wage box. In this situation the York Adams Tax Bureau will assess the tax based on the amount listed in the local wage box. If you feel that your W-2 was prepared in error you should contact your employer for a corrected W-2 form (W-2c) or for a written explanation as to why the PA state and local wages do not agree.
- **In the event that none of the above methods work and there is no clearly identifiable non-taxable earnings listed on the W-2, the highest gross wage figure reported on the W-2 should be used as the taxable wage.**

### **Other Income/1099's/3<sup>rd</sup> Party Sick Pay**

- When a taxpayer lists other income on LINE 3, please provide documentation.
- 1099-R codes that we see most are 1, 2, 3, 4 and 7.
- Codes 3, 4 and 7 are Not Taxable.
- Code 1 is Taxable if the taxpayer does not give a “Cost Recovery Worksheet” as required by PA DOR. (Cost Recovery Worksheet would show the amount the employee contributed, which is not taxable, **AND** the amount the employer contributed and any interest earned, both of which are taxable). If there is “PA” and an amount in Boxes 13 and 14 it means the employer did the breakdown and provided the taxable amount.
- Code 2 may be Taxable or Not Taxable. It is Not Taxable if the taxpayer met the employer’s retirement plan’s length of service or minimum age requirements. (State workers may meet the length of service requirement but not the age – would be Not Taxable).
- Box checked IRA/SEP/SIMPLE - if this box is checked, we will use the amount as taxable unless there is documentation stating otherwise. This box is checked if the taxpayer may not have met retirement eligibility according to the plan set up.
  - Personal IRA’s are not taxable as the taxpayer contributed already taxed dollars to it, however; if you take out money early, the amount over which the taxpayer contributed would be taxable.
  - SEP (Simplified Employee Pension) - set up by the employer (less than 101 employees). The employer and the employee are contributors.
  - SIMPLE IRA - set up by the employer (less than 101 employees). The taxpayer is primarily responsible for contributions.
- 3<sup>rd</sup> Part Sick Pay is Not Taxable (will be coded “J”). If the employer pays sick pay it is considered regular wages and is taxable.

### **Profit/Loss/Schedule C/S-Corporation Income**

- Documentation must be provided for all reported business profit or loss.
- Any time a loss results in a refund **AND** there is no documentation, we will not process the return and instead send a request to the taxpayer for the documentation.
  - Schedule C’s will be reviewed to see if the business in an area that has Mercantile Business Privilege Tax collected by the Bureau.
    - City of York, Springettsbury Twp, Spring Garden Twp, Conewago Twp, York Twp, West Manchester Twp, Dover Twp, North York Boro, Hanover Boro, West York Boro
    - If YES – and the taxpayer has not registered or made MBP tax payments, the Bureau will send a letter requesting filings.

- Schedule C's also be reviewed for "Wages". If wages are listed the Bureau will check to see if the individual is reporting and paying the tax withheld from their employees.
- Schedule C's should not show losses every year. If there are losses every year for three or more years our Tax Examiners may audit the individual.
- If there are expenses that look excessive or there is no income but a great deal of expenses, this may also trigger an audit.
- S-Corporation income was determined to be investment income and is not taxable for local income tax purposes by the courts in the case, *Scott v. Hempfield Area School District*, 643 A.2d 1140, Pa.Cmwlth., 1994.
- S-Corporation income, which is usually shown as a net profit or retained earnings on the RK-1, is not taxable for Local Income Tax. This is mandated in the ACT under the definition of Net Profits which states:

"Net profits." *The net income from the operation of a business, **other than a corporation**, as required to be reported to or as determined by the Department of Revenue under section 303 of the act of March 4, 1971 (P.L.6, No.2), known as the Tax Reform Code of 1971, and rules and regulations promulgated under that section. The term does not include income which:*

- (1) *is not paid for services provided; and*
- (2) *is in the nature of earnings from an investment.*

UNDER ANY OF THE FOLLOWING PARAGRAPHS:

(1) INCOME WHICH:

- (I) *IS NOT PAID FOR SERVICES PROVIDED; AND*
- (II) *IS IN THE NATURE OF EARNINGS FROM AN INVESTMENT.*

(2) INCOME WHICH REPRESENTS:

- (I) *ANY GAIN ON THE SALE OF FARM MACHINERY;*
- (II) *ANY GAIN ON THE SALE OF LIVESTOCK HELD 12 MONTHS OR MORE FOR DRAFT, BREEDING OR DAIRY PURPOSES; OR*
- (III) *ANY GAIN ON THE SALE OF OTHER CAPITAL ASSETS OF A FARM.*

### **Out-of-State Credit**

You may take a credit based upon the earnings taxed both in another state and in Pennsylvania that may be greater than the Pennsylvania state personal income tax rate. Apply credit to PA-40 return first; if unused credit remains it may be applied to local EIT. Taxpayer must provide PA 40, out-of-state return, plus completed PA Schedule G. No credit is allowed for out-of-country income taxed by a foreign country. Please note that no tax credit will be allowed for States that have reciprocating income tax agreements with Pennsylvania. The exception is when the State does not extend its income tax reciprocating agreement to net profits from a business.

Please note: "Earnings" are defined as the adjusted income figure actually **subject to tax** by the other state. For example, if a taxpayer had gross income of \$120,000.00, but was allowed to adjust that figure for dependent deductions, business expenses or other exclusions to a net taxable figure of \$84,000.00, the out-of-state credit must be calculated on \$84,000.00, because this is the income subject to tax by the other state. *Peet v. Commonwealth of Pennsylvania, 705 A.2d 497 (Pa Commonwealth Court 1998) appeal decided October 21, 1998.*

Please use the Out of State Credit worksheet found on the reverse side of the Local Income Tax return. Using the PA Schedule G or the worksheet generated by some tax preparation software may result in the Tax Bureau correcting the calculation of Out of State Credit. Please be sure to provide a complete copy of the Pennsylvania and the other state return or the credit will be disallowed.

### Penalty/Interest-waiver

- Penalty and Interest can only be waived in the following circumstances:
  - 1) If a taxpayer comes to the Tax Bureau, on their own (no delinquent or non-filer letter sent), and files all delinquent tax returns AND makes payment of the tax on that day or within 30 days of filing the returns – Penalty and Interest may be waived.
  - 2) If a taxpayer is responding to a **first** delinquent or non-filer notice and that taxpayer files all delinquent returns and makes payment of the tax on that day or within 30 days of filing the returns – Penalty may be waived (not interest).
  - 3) If the taxpayer is responding to a **first** balance due notice and the taxpayer requests that P&I are waived, we may waive off the penalty – not the interest – as long as the taxpayer pays the tax and interest due on that day or by the due date on the balance due letter. This applies to current and prior year tax returns.

### Zero/No Income Returns

Individuals who had no earned income/net profits during the year are still required to file a zero return with our office. This includes homemakers or non-working spouses/partners. The only individuals who do not need to file would be those who were permanently retired or disabled **for the full calendar year**. If they became retired or disabled during the year please file a final return with us to advise of their change in status.

Note on Retirement: If the individual retires from their full-time job but plans to continue to have part-time earned income in the future, they will need to continue to file annual returns on that income. These individuals should NOT be marked as permanently retired.