

GENERAL INSTRUCTIONS

Purpose of Form

The purpose of PA-20S/PA-65 Schedule M is to determine Pennsylvania business net income (loss) or rental/royalty income (loss). The PA-20S/PA-65 Schedule M includes specific lines to reconcile federal income to Pennsylvania income. All entities file PA-20S/PA-65 Schedule M whether there are adjustments to federal income (loss) amounts or not.

The entity should complete the appropriate PA-20S/PA-65 Schedules A, B, and D for all other income classes. Using PA-20S/PA-65 Schedule M for the other income classes' results in the improper classification of income and reporting errors.

PA-20S/PA-65 Schedule M, Part A must be used:

- To classify taxable income (loss) as shown on federal Form 1120S or federal Form 1065 for Pennsylvania personal income tax purposes. The entity must classify federal amounts using Pennsylvania personal income tax rules.

Refer to Table 4, Classifying Federal Schedule K Lines for Pennsylvania Personal Income Tax Purposes, in the PA-20S/PA-65 general instructions.

PA-20S/PA-65 Schedule M, Part B must be used:

- To reconcile the entity's federal business income (loss) and rental/royalty income (loss) to Pennsylvania income (loss). If the entity is separately allocating income, keeps separate books and records for financial statement purposes, and there are no business transactions between multiple businesses, the "Pennsylvania-Allocated Income (Loss)" Column and the "Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment" Column will be completed.

If the entity is apportioning its income, complete only the "Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment" Column.

SPECIFIC INSTRUCTIONS

PART A

Classifying Federal Income (Loss) for Pennsylvania Personal Income Tax Purposes

Classify, without adjustment for Pennsylvania personal income tax rules, the federal income (loss) from federal Form 1120S, Schedule K or federal Form 1065 Schedule K. The entity must allocate or apportion the amounts from the federal categories to the reportable Pennsylvania personal income tax classes of income. The total of the specific federal line items should equal the total of the federal schedule.

Refer to Table 4, Classifying Federal Schedule K Lines for Pennsylvania Personal Income Tax Purposes, in the PA 20S/PA-65 general instructions.

For each line in Column (a), federal income (loss), analyze the components of the federal amounts. Then classify the federal amounts to the applicable Pennsylvania income class in its entirety or the

appropriate portion of each amount, without adjustment for Pennsylvania personal income tax rules. If the entity does not have to allocate an income (loss) amount, place that amount in the appropriate column for the Pennsylvania income class. The PA S corporation or partnership will reflect federal and state differences from Column (c) through (e) on the corresponding PA schedules. Columns (b) and (f) are reported on PA-20S/PA-65 Schedule M, Part B for further adjustment as required.

Line 1. Ordinary Income (Loss) from Trade or Business Activities

Column a. Federal Income (Loss)

Enter the amount of ordinary business income (loss) from the federal Schedule K without any adjustment for Pennsylvania personal income tax purposes.

Column b. Pennsylvania Business Income (Loss)

Enter the amount of ordinary business income (loss) from Line 1, Column (a) received from the operation of the entity's business, profession or farm.

IMPORTANT: For federal purposes, the entity includes estate/trust income and gambling/lottery winnings in ordinary income. The entity must classify such income and subtract it from ordinary income on PA-20S/PA-65 Schedule M, Part B, Section C, Line d. The entity then reports the income on the PA-20S/PA-65 Information Return, Part III. The entity supports this adjustment with a supplemental statement that is submitted with the PA-20S/PA-65 Schedule M.

Line 2. Net Income (Loss) from Rental Real Estate Activities

Column a. Federal Income (Loss)

Enter the amount of net rental real estate income (loss) from federal Schedule K without any adjustment for Pennsylvania personal income tax purposes.

Column b. Pennsylvania Business Income (Loss)

Enter the amount of net rental real estate income (loss) from Part A, Line 2, Column (a) that represents business income for Pennsylvania personal income tax purposes.

Refer to the Pennsylvania Personal Income Tax Guide to determine if rental income should be classified as Pennsylvania-business income.

Column f. Rent & Royalty Income (Loss) - PA Schedule E

Enter the amount of net rental real estate income (loss) from Part A, Line 2, Column (a) received from the entity's ownership of rental property.

Line 3. Other Gross Rental Income (Loss)

Column a. Federal Income (Loss)

Enter the amount of other gross rental income (loss) from federal Schedule K without any adjustment for Pennsylvania personal income tax purposes.

Column b. Pennsylvania Business Income (Loss)

Enter the amount of other gross rental income (loss) from Part A, Line 3, Column (a) that represents business income for Pennsylvania personal income tax purposes.

Refer to the Pennsylvania Personal Income Tax Guide to determine if other net rental income (loss) should be classified as Pennsylvania business income.

Column f. Rent & Royalty Income (Loss) - PA Schedule E

Enter the amount of other gross rental income (loss) from Part A, Line 3, Column (a) received from the entity's other rental activities.

Line 4. Interest Income

Column a. Federal Income (Loss)

Enter the amount of interest income from federal Schedule K without any adjustment for Pennsylvania personal income tax purposes.

Column b. Pennsylvania Business Income (Loss)

Enter the amount of interest income from Part A, Line 4, Column (a) received from investments and deposits for the purpose of generating working capital and other interest used in the operation of the entity's business, profession or farm.

Column c. Interest Income - PA Schedule A

Enter the amount of interest income from Part A, Line 4, Column (a) received from the entity's non-business investments and deposits (i.e., long-term investments, savings, set-aside interest for owners, etc.).

Column f. Rent & Royalty Income (Loss) - PA Schedule E

Enter the amount of interest income from Part A, Line 4, Column (a) received from investments and deposits for the purpose of maintaining the entity's rental property or activities.

Line 5. Dividends

Column a. Federal Income (Loss)

Enter the amount of dividends from the federal Schedule K without any adjustment for Pennsylvania personal income tax purposes.

Column b. Pennsylvania Business Income (Loss)

Enter the amount of dividends from Part A, Line 5, Column (a) received from investments and deposits for the purpose of generating working capital and other dividend income used in the operation of the entity's business, profession, or farm.

Column d. Dividend Income - PA Schedule B

Enter the amount of dividends from Part A, Line 5, Column (a) received from the entity's non-business investments and deposits (i.e. long-term investments, stocks held for investments etc.).

Column f. Rent & Royalty Income (Loss) - PA Schedule E

Enter the amount of dividends from Part A, Line 5, Column (a) received from investments or deposits for the purpose of maintaining the entity's rental property.

Line 6. Royalty Income

Column a. Federal Income (Loss)

Enter the amount of royalties from the federal Schedule K without any adjustment for Pennsylvania personal income tax purposes.

Column b. Pennsylvania Business Income (Loss)

Enter the entire amount of royalties from Part A, Line 6, Column (a) if the entire amount was used in funding the entity's operation of another business.

Column f. Rent & Royalty Income (Loss) - PA Schedule E

Enter the entire amount of royalties from Part A, Line 6, Column (a) if the entire amount was received for the use of the entity's property.

Line 7. Net Short-Term Capital Gain (Loss)

Pennsylvania does not distinguish between long-term and short-term gain (loss). Read the instructions to determine if a sale, exchange or disposition is a business transaction in the ordinary course of operating a business, profession, farm or a disposition of property.

Column a. Federal Income (Loss)

Enter the amount of net short-term capital gain (loss) from the federal Schedule K without any adjustment for Pennsylvania personal income tax purposes.

Column b. Pennsylvania Business Income (Loss)

Enter the amount of net short-term capital gain (loss) from Part A, Line 7, Column (a) received from the entity's sales of business assets/investments used in operating its business, profession or farm.

Column d. Dividend Income

Enter the amount of short-term capital gain distributions taxable as dividends for Pennsylvania personal income tax purposes.

NOTE: The proceeds from the sale must be reinvested back into the business operations to be classified as working capital.

Column e. Gain (Loss) From Sales - PA Schedule D

Enter the amount of net short-term capital gain (loss) from Part A, Line 7, Column (a) received from the entity's disposition of land, buildings, investments, and other assets where the proceeds of the transaction were not used in the operation of its business, profession or farm.

Line 8. Net Long-Term Capital Gain (Loss)

Pennsylvania does not distinguish between long-term and short-term gain (loss). Read the instructions for determining if a sale, exchange, or disposition is a business transaction in the ordinary course of operating a business, profession, farm, or a disposition of property.

Column a. Federal Income (Loss)

Enter the amount of net long-term capital gain (loss) from the federal Schedule K without any adjustment for Pennsylvania personal income tax purposes.

Column b. Pennsylvania Business Income (Loss)

Enter the amount of net long-term capital gain (loss) from Part A, Line 8, Column (a) received from the entity's sales of business assets/investments used in operating its business, profession or farm.

Column d. Dividend Income

Enter the amount of net long-term capital gain distributions as taxable dividends for Pennsylvania personal income tax purposes.

NOTE: The proceeds from the sale must be reinvested back into the business operations to be classified as working capital.

Column e. Gain (Loss) From Sales - PA Schedule D

Enter the amount of net long-term capital gain (loss) from Part A, Line 8, Column (a) received from the entity's disposition of land, buildings, investments, and other assets where the proceeds of the transaction were not used in the operation of its business, profession or farm.

Line 9. Net Gain (Loss) From Disposal of Federal § 179 Property

Column a. Federal Income (Loss)

Enter the amount of net gain (loss) from the disposal of IRC § 179 property from the federal Schedules K without any adjustment for Pennsylvania personal income tax purposes.

Column b. Pennsylvania Business Income (Loss)

Enter the amount of net gain (loss) from the disposal of IRC § 179 property from Part A, Line 9, Column (a) received from the entity's sale of IRC § 179 property used in operating its business, profession or farm.

NOTE: The proceeds from the sale must be reinvested back into the business operations to be classified as working capital.

Column e. Gain (Loss) From Sales - PA Schedule D

Enter the amount of net gain (loss) from the disposal of IRC § 179 property from Part A, Line 9, Column (a) received from the entity's sale of IRC § 179 property where the proceeds of the transaction **were not** used in the operation of its business, profession, farm or rental activities.

Line 10. Net Gain (Loss) From Form 4797

Column a. Federal Income (Loss)

Enter the amount of net IRC § 1231 gain (loss) from the federal Schedule K without any adjustment for Pennsylvania personal income tax purposes.

Column b. Pennsylvania Business Income (Loss)

Enter the amount of net IRC § 1231 gain (loss) from federal Form 4797 from Part A, Line 10, Column (a) received from the entity's sales of business assets/investments used in operating its business, profession or farm.

NOTE: The proceeds from the sale must be reinvested back into the business operations to be classified as working capital.

Column e. Gain (Loss) From Sales - PA Schedule D

Enter the amount of net IRC § 1231 gain (loss) from federal Form 4797 from Part A, Line 10, Column (a) received from the entity's disposition of land, buildings, investments, and other assets where the proceeds of the transaction **were not** used in the operation of its business, profession, or farm.

Line 11. Other Income (Loss)

Column a. Federal Income (Loss)

Enter the amount of other income (loss) from the federal Schedule K without any adjustment for Pennsylvania personal income tax purposes.

Classify each item of income (loss) for Pennsylvania personal income tax purposes in the applicable columns according to each source and transaction that determined the income (loss). Other business income (loss) is Column (b), other interest income is Column (c), other dividend income is Column (d), other income (loss) from the sale, exchange or disposition of the entity's property is Column (e), and other income (loss) from the use of the entity's rental property or activities is Column (f).

Line 12. Total Pennsylvania Income (Loss) by Classification

Total the amounts in columns a through f.

SPECIFIC INSTRUCTIONS

PART B

Specific instructions for most of the lines are provided. Lines that are not discussed are self-explanatory.

Determining Pennsylvania-Reportable Income (Loss) by Classification

Use PA-20S/PA-65 Schedule M, Part B to reconcile the entity's federal business income (loss) and rental/royalty income (loss) to Pennsylvania income (loss). If the entity is separately allocating income, keeps separate books and records for financial statement purposes, and there are no business transactions between multiple businesses, the "PA-Allocated Income (Loss)" Column and the "Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment" Column will be completed.

If the entity is apportioning its income, complete only the "Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment" Column.

Section A. Federal Classification Income (Loss)

Enter the Pennsylvania-classified net income (loss) from Part A, Column (b), or enter the Pennsylvania-classified net rental income (loss) from Part A, Column (f).

IMPORTANT: Part B, Section A, Box 2 must show total worldwide rental income. Rental income cannot be apportioned.

Section B. Itemize Income Adjustments that Increase Pennsylvania-Reportable Income (Reduce the Loss from the Federal Form)

Follow the descriptions for Lines a through g.

Line h. Other Taxable Income for Pennsylvania Purposes the Entity Does Not Report for Federal Purposes. Submit Statement.

Include other kinds of income that are taxable for Pennsylvania purposes but the entity does not report for federal purposes. Include passive or at-risk-loss carryover amounts deducted on federal Form 8825. Pennsylvania does not allow carryover of losses.

Submit an itemized statement describing each income.

Section B. Total

Total Lines a through h as follows:

Pennsylvania Allocated Income (Loss) Column

Add Boxes 1, 3, 5, 7, 9, 11, 13 and 15. Enter the result in Part B, Section B, Box 17.

Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment Column

Add Boxes 2, 4, 6, 8, 10, 12, 14 and 16. Enter the result in Part B, Section B, Box 18.

Section C. Itemize Income Adjustments that Decrease the Pennsylvania Reportable Income. (Increase the Loss from the Federal Form)

Follow the descriptions for Lines a through c.

Line d. Other Pennsylvania Nontaxable Income the Entity Reported for Federal Purposes. Submit Statement.

Include other kinds of income that are not taxable for Pennsylvania purposes but the entity had to report for federal purposes. Income from a pass through entity is included on this line in determining net profits for personal income tax purposes. Pass through income should be deducted from business income and reported on PA-20S/PA-65 Information Return, Part I, Line 1b. Submit an itemized statement describing each income item.

Section C. Total

Total Lines a through d as follows:

Pennsylvania Allocated Income (Loss) Column

Add Boxes 1, 3, 5 and 7. Enter the result in Part B, Section C, Box 9.

Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment Column

Add Boxes 2, 4, 6 and 8. Enter the result in Part B, Section C, Box 10.

Section D. Adjusted Pennsylvania-Reportable Income

Pennsylvania Allocated Income (Loss) Column

Add Box 1 in Section A and Box 17 in Section B. From this result, subtract Box 9 in Section C. Enter the result in Part B, Section D, Box 1.

Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment Column

Add Box 2 in Section A and Box 18 in Section B. From this result, subtract Box 10 in Section C. Enter the result in Part B, Section D, Box 2.

Section E. Itemize Those Expenses that Pennsylvania Law Does Not Allow that the Entity Deducted on its Federal Form

These adjustments increase Pennsylvania-reportable income (reduce the loss from the federal form). The entity should refer to the Pennsylvania Personal Income Tax Guide for Pennsylvania rules governing the expenses it may deduct for federal purposes, but may not deduct to determine its income (loss) for Pennsylvania.

Line a. Taxes Paid on Income from the Worksheet in Chapter 16 of the Pennsylvania Personal Income Tax Guide

If tax is based on net income, it is added back. If based on gross receipts, tax is not added back.

A taxpayer may not deduct taxes based on net income. A taxpayer may not deduct taxes paid to other states or foreign countries based on income. A taxpayer may not deduct estate taxes and inheritance, legacy, succession and gift taxes. Assessments for betterment and improvements are not allowable. The Philadelphia business privilege tax is an allowable deduction on this schedule if not already deducted on the

federal income tax return. Single-member limited liability companies that file as sole proprietors, limited liability companies that file as partnerships, and PA S corporations may deduct the Pennsylvania capital stock/foreign franchise tax paid. Other federal, state and local taxes are allowable deductions.

Line b. Differences in Depreciation taken for Pennsylvania and Federal Purposes

Include amount in years where there is a federal bonus depreciation expense. Pennsylvania does not allow bonus depreciation.

Follow the descriptions for Lines c through f.

Line g. Other Expenses the Entity Deducted On Its Federal Return That Pennsylvania Does Not Allow. Submit Statement.

Include other kinds of expenses that are not deductible for Pennsylvania purposes but the entity had to report for federal purposes. Loss from pass through entity is included on this line in determining net profits for personal income tax purposes. Pass through loss should be added to business income and reported on PA-20S/PA-65 Information Return, Part I, Line 1b. Submit an itemized statement describing each income item.

Section E. Total

Total Lines a through g as follows:

Pennsylvania Allocated Income (Loss) Column

Add Boxes 1, 3, 5, 7, 9, 11 and 13. Enter the result in Part B, Section E, Box 15.

Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment Column

Add Boxes 2, 4, 6, 8, 10, 12 and 14. Enter the result in Part B, Section E, Box 16.

Section F. Itemize Those Expenses that Pennsylvania Law Allows that the Entity Could Not Deduct on its Federal Form

These adjustments decrease Pennsylvania-reportable income (increase the loss from the federal form). The entity should refer to the Pennsylvania Personal Income Tax Guide for instructions for the Pennsylvania rules governing the expenses it may not deduct for federal purposes, but can deduct in determining its income (loss) for Pennsylvania. Follow the descriptions for Lines b, f and g.

Line a. Fifty Percent of Business Meals, Entertainment, and Club Dues that the Entity Could Not Deduct

Pennsylvania allows 100 percent of customary and reasonable amounts expensed on business meals and entertainment as opposed to the federal limit of 50 percent.

The 50 percent disallowed for federal purposes is taken as an expense on PA-20S/PA-65 Schedule M, Section F, Line a. This adjustment decreases Pennsylvania-reportable income.

Line c. Differences in Depreciation Taken for Pennsylvania and Federal Purposes

Include amount when Pennsylvania depreciation expense is greater than federal depreciation expense due to allowances of federal bonus depreciation expenses and excess IRC § 179 deductions in previous years.

Line d. IRC § 179 Expenses - The maximum for Pennsylvania purposes is \$25,000.

Partnership

Partnerships do not reduce the ordinary business income on federal Form 1065 Schedule K, Line 1 by § 179 deduction on Line 12. The PA deduction is taken when federal Form 1065 Schedule K, Line 1 is transferred to PA-20S/PA-65 Schedule M, Part B, Section F, Line d.

PA S Corporation

PA S corporations do not reduce the ordinary business income on federal Form 1120S, Schedule K, Line 1 by § 179 deduction on Line 12. The Pennsylvania deduction is taken when federal Form 1065 Schedule K, Line 1 is transferred to PA-20S/PA-65 Schedule M, Part B, Section F, Line d.

Line e. Expenses for Employees Including PA S Corporation

Shareholder-Employees

Include federal nondeductible expenses that are deductible for Pennsylvania such as health insurance for PA S corporation shareholder-employees.

Line h. Other Expenses Pennsylvania Allows that the Entity Did Not Deduct on its Federal Return. Submit Statement

Include other kinds of expenses the entity could not deduct on its federal return but Pennsylvania law allows. Submit an itemized statement describing each expense item.

Deductions for charitable gifts are not permitted unless they are publicly acknowledged. For example, the entity's name should appear in the charitable organization's newsletter or brochure.

To claim a charitable contribution, it must be from the entity's business accounts, acknowledged by the recipient, and have a business intention, such as advertising or expectation of additional business. The department may request additional information including proof of acknowledgement from the charitable organizations to support this position.

For expenses for intangible drilling costs refer to the Personal Income Tax Guide, Chapter 23, Natural Resources.

Line i. Use Tax Submitted with this Return - not previously capitalized. Submit PA-1, Use Tax Return

If you have not previously paid sales tax or use tax on current year purchase(s) subject to sales and use tax, you may deduct the use tax paid and remitted with the PA-1, Use Tax Return. Complete and remit payment with the PA-1.

CAUTION: DO NOT send one check for multiple taxes. Send a separate check for each type of tax.

Section F. Total

Total Lines a through i as follows:

Pennsylvania Allocated Income (Loss) Column

Add Boxes 1, 3, 5, 7, 9, 11, 13, 15 and 17. Enter the result in Part B, Section F, Box 19.

Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment Column

Add Boxes 2, 4, 6, 8, 10, 12, 14, 16 and 18. Enter the result in Part B, Section F, Box 20.

Section G. Total Taxable Income (Loss)

Pennsylvania Allocated Income (Loss) Column

Add Box 1 in Section D and Box 15 in Section E. From this result, subtract Box 19 in Section F. Enter the result in Part B, Section G, Box 1.

If selecting Column (b) on PA-20S/PA-65 Schedule M, Part B, Section A, enter the result on the PA-20S/PA-65 Information Return, Part II, Line 2e.

If selecting Column (f) on PA-20S/PA-65 Schedule M, Part B, Section A, enter the result on the PA-20S/PA-65 Information Return, Part III, Line 6b. If a loss, fill in the oval.

Total Rental Income (Loss) or Total Business Income (Loss) Before Apportionment Column

Add Box 2 in Section D and Box 16 in Section E. From this result, subtract Box 20 in Section F. Enter the result in Part B, Section G, Box 2.

If selecting Column (b) on PA-20S/PA-65 Schedule M, Part B, Section A, enter the result on the PA-20S/PA-65 Information Return, Part I, Line 1a.

If selecting Column (f) on PA-20S/PA-65 Schedule M, Part B, Section A, enter on the PA-20S/PA-65 Information Return, Part III, Line 6a, the difference between Line 2 and Line 1 from Part B, Section G.