CHAPTER 103. IMPOSITION AND DETERMINATION OF TAX

Subchap. A. PERSONS SUBJECT TO TAX .................................................. 103.1
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Subchapter A. PERSONS SUBJECT TO TAX

Sec. 103.1. Tax imposed on residents.
103.2. Tax imposed in nonresidents.

Cross References
This subchapter cited in 61 Pa. Code § 101.9 (relating to trusts); and 61 Pa. Code § 105.6 (relating to illustration of the provisions of this chapter).

§ 103.1. Tax imposed on residents.
(a) There shall be imposed an annual tax at the rate prescribed in Article III of the TRC (72 P.S. §§ 7301—7361) on the privilege of residents receiving specified classes of income, without set off of losses from one class against income from another class, and without carrying losses back or forward from year to year.
(b) The tax rate to be used for the computation of tax by calendar and fiscal year filers whose year begins in the following taxable years is:
1983 ..................................................... 2.45%
1984 ..................................................... 2.40%
1985 ..................................................... 2.35%
1986 ..................................................... 2.16%
1987 ..................................................... 2.10%

Authority
The provisions of this § 103.1 amended under section 354 of the Tax Reform Code of 1971 (72 P.S. § 7354).

Source

Cross References
This section cited in 61 Pa. Code § 101.9 (relating to trusts); and 61 Pa. Code § 105.6 (relating to illustration of the provisions of this chapter).
§ 103.2. Tax imposed on nonresidents.

The tax imposed by this section is the same as that imposed on residents, and it applies to the income of a nonresident as set forth in Chapter 109 (relating to nonresident individuals).

Cross References
This section cited in 61 Pa. Code § 105.6 (relating to illustration of the provisions of this chapter).

Subchapter B. DETERMINATION OF TAX

Sec.
103.11. Compensation.
103.13. Net gains or income from disposition of property.
103.15. Dividends.
103.16. Interest.
103.17. Gambling and lottery winnings.
103.18. Net gains or income derived through estates or trusts.
103.19. Utilities—return of capital distributions.

Cross References
This subchapter cited in 61 Pa. Code § 101.8 (relating to income tax sources within this Commonwealth); and 61 Pa. Code § 105.4 (relating to income of estates, trusts and their beneficiaries).

§ 103.11. Compensation.
Reference should be made to § 101.6 (relating to compensation).


(a) Net profits shall be the net income from the operation of a business, profession or other activity after provision for all costs and expenses incurred in the conduct thereof. They shall be determined either on a cash or accrual basis in accordance with accepted accounting principles and practices.

(b) To constitute net profits, all of the following must apply:

(1) The gross profits shall be derived from one of the following:

(i) The marketing of a product or service to customers on a commercial basis or from securities employed as working capital in the business operations.

(ii) Accounts and notes receivable from sales of products or services sold in the ordinary course of the business operations.

(iii) Assets which serve an operational function in the ordinary course of business operations.

(2) The marketing activity shall be conducted with the manifest objective of achieving profitable operations.
(3) The marketing activity shall be conducted with regularity and continuity and may not be limited or exclusive.

(c) In computing net profits, a deduction will not be allowed for any item of cost, expense or liability derived or incurred in connection with, or attributable to any of the following:
   (1) The ownership or disposition of assets that are held for investment purposes or otherwise serve an investment function.
   (2) The trading in securities for personal purposes and not for the accounts of customers.
   (3) The sale, discontinuation or abandonment of a business or segment thereof.
   (4) Any tax imposed on, or measured by, gross or net earned or unearned income.
   (5) An isolated or nonrecurring transaction which is not a normal or routine business activity.

(d) Choosing to form a partnership or other entity or to associate with others, receiving and reporting income or gain as the income of the partnership, entity or associates or dividing the same among its partners, beneficial owners or associates or the trading in securities for the benefit of shareholders, partners, members or associates does not of itself make the income of the partnership, entity or associates net profits.

(e) For purposes of this section, only the following participants in the stock, securities, options, derivatives, futures or commodities market are engaged in marketing of a product or service to customers:
   (1) Those who maintain or provide a market place or facilities for bringing together purchasers and sellers of these financial investment products.
   (2) Those who are licensed to act as their customer’s agents and charge a negotiated commission for executing transactions and do not take title to the particular positions they buy or sell.
   (3) Those who devote managerial attention to the financial investment products holdings of others, or who employ other persons to assist them in that management, in the capacity of a licensed investment advisor.
   (4) Licensed dealers, including financial investment product specialists and market makers, if the conditions in subparagraphs (i)—(iv) are met:
      (i) The dealer maintains an inventory of financial investment products with the objective of reselling his inventories at a profit to customers or operates as a specialist or market maker.
      (ii) The dealer makes market by quoting the bid and asked prices at which he is willing to buy and sell the financial investment products and by buying directly from or selling directly to customers.
      (iii) The dealer’s profit is determined in whole or in part by a markup based on cost.

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(iv) The dealer elects to inventory securities held for resale to customers or uses the mark-to-market system of accounting.

(5) Underwriters who facilitate initial sales of financial investment products by acting either as licensed dealers in a principal capacity or as brokers in an agency capacity.

(f) When a person operates as an investor or trader with respect to a portion of that person’s activities and as a market establishment, broker, investment counselor or dealer with respect to the rest, this section applies only to the operations as a market establishment, broker, investment counselor or dealer.

Authority
The provisions of this § 103.12 amended under section 354 of the Tax Reform Code of 1971 (72 P. S. § 7354).

Source

Notes of Decisions
The losses of a real estate partnership which were made up of partners in a law firm, were rents rather than business profits and thus could not be set off against the profits from a law firm partnership. As such, an upward adjustment of a taxpayer’s income was upheld. Wettach v. Commonwealth, 620 A.2d 730 (Pa. Cmwlth. 1993); affirmed 677 A.2d 831 (Pa. 1995).
§ 103.13. Net gains or income from disposition of property.

(a) Gain or loss. A gain on the disposition of property is recognized in the taxable year in which the amount realized from the conversion of the property into cash or other property exceeds the adjusted basis of the property. A loss is recognized only with respect to transactions entered into for gain, profit or income and only in the taxable year in which the transaction, in respect to which loss is claimed, is closed and completed by an identifiable event which fixes the amount of the loss so there is no possibility of eventual recoupment.

(b) Stock dispositions. Corporate reorganizations, acquisitions and recapitalizations shall be a sale, exchange or disposition resulting in a taxable gain or loss to the shareholders whether or not the gain or loss is recognized for purposes of the Federal income tax, except as provided in the TRC. The transfer of property or anything else of value to a corporation in exchange for an interest therein is a sale, exchange or disposition resulting in a taxable gain or loss. A resident shareholder shall report as taxable gain in the taxable year in which it was received or credited the excess of the fair market value of any “return of capital” distribution over the adjusted basis of his stock. A “return of capital” distribution is a distribution which is not made or credited by a business corporation or association out of its earnings and profits. The basis of stock or shares held by a resident shareholder shall be decreased, but not below zero, by a distribution which is not taxable dividend income.

Example. B Corporation distributed from its capital account $100,000 to its sole stockholder, S, a resident of Pennsylvania. The adjusted basis of S’s stock was $75,000. As the distribution is not made out of earnings and profits, the $100,000 does not represent taxable dividend income to S. S must, however, decrease the adjusted basis of the stock from $75,000 to zero and report the remaining $25,000 of the $100,000 “return of capital” distribution as a taxable gain.

(c) Basis. If property is acquired by a taxpayer by inheritance, the basis shall be the fair market value at the date of death. If property is acquired by a taxpayer by gift, the basis shall be the same as it would be if the property had remained in the hands of the donor. Otherwise, the basis shall be the cost.

(d) Sales made before June 1, 1971. Payments received pursuant to an installment sale made before June 1, 1971, are not subject to tax except as to separately stated interest payments.

(e) Gain or loss on property acquired on or after June 1, 1971. The amount subject to tax shall be the net gains or net income less net losses derived from the sale, exchange or other disposition of property—real or personal, tangible or intangible—to the extent that the value of that which is received or receivable is greater than or, in the case of a loss, less than the basis of the taxpayer. The basis
(f) Gain or loss on property acquired prior to June 1, 1971. If the property was acquired prior to June 1, 1971, the amount subject to tax shall be the net gains or net income less net losses derived from the sale, exchange or other disposition of property—real or personal, tangible or intangible—to the extent that the value of that which is received or receivable is greater than or, in the case of a loss, less than the basis of the taxpayer determined as follows:

1. The basis as of June 1, 1971, for determining gain shall be the cost or other basis as adjusted or its fair market value as of June 1, 1971, whichever is greater.

2. The basis as of June 1, 1971, for determining loss shall be the cost or other basis as adjusted without reference to the fair market value as of June 1, 1971.

3. The application of paragraphs (1) and (2) may be illustrated by the following example:

(i) On June 1, 1966, a taxpayer purchased for $50,000 property having a useful life of 50 years. Assuming that there were no capital improvements to the property before June 1, 1971, the depreciation allowed or allowable on the property before June 1, 1971, was $5,000 (5 years at $1,000), so that the original cost adjusted, as of June 1, 1971, for depreciation allowed or allowable prior to that date is $45,000. On that date the property had an appraised fair market value of $90,000 with a remaining life of 45 years. The property was sold on June 1, 1980, for $120,000.

(ii) For the purpose of determining gain from the sale, exchange or other disposition of the property on June 1, 1980, the basis of the property is the fair market value of $90,000 as of June 1, 1971, adjusted for depreciation allowed or allowable after May 31, 1971, computed on $90,000. Thus, the basis of $90,000 is reduced by the depreciation adjustment from June 1, 1971, to May 31, 1980, in the aggregate of $18,000 (9 years at $2,000—$90,000 ÷ 45), leaving an adjusted basis for determining gain of $72,000 ($90,000 less $18,000). Taxpayer would be subject to tax on a gain of $48,000 ($120,000 less $72,000).

(iii) Assume the same facts as in subparagraph (i) except that the taxpayer purchased the property for $90,000 on June 1, 1966, and the property had a fair market value of $30,000 on June 1, 1971. The depreciation allowed or allowable on the property before June 1, 1971, was $9,000 (5 years at $1,800) so that the original cost adjusted, as of June 1, 1971, for depreciation allowed or allowable prior to that date is $81,000. For the purpose of determining gain the basis of the property is its cost of $90,000 reduced by the depreciation adjustment allowed or allowable in the aggregate of $25,200 (14 years at $1,800—$90,000 ÷ 50), leaving an adjusted basis for determin-
ing gain of $64,800 ($90,000 less $25,200). Taxpayer would be subject to tax
on a gain of $55,200 ($120,000 less $64,800).

(iv) Assume the same facts as in subparagraph (i) except that the prop-
erty was sold on June 1, 1980, for $20,000. For the purpose of determining
loss from the sale, exchange or other disposition of the property on June 1,
1980, the basis of the property is its cost, adjusted for depreciation allowed
or allowable. In this example, the amount of depreciation allowed or allow-
able is $15,000 (15 years at $1,000). Therefore the adjusted basis for deter-
mining loss on June 1, 1980, is $35,000 ($50,000—$15,000). The taxpayer
would report a loss of $15,000.

(4) If the selling price is greater than cost but less than the June 1, 1971,
value, there is neither taxable gain nor loss. The application of this paragraph
may be illustrated by the following example:

Example: Assume that acquisition cost is $10,000, June 1, 1971, value is
$30,000 and the selling price is $20,000. If the rules in paragraph (1) for deter-
mining the basis for gain were applied, the result would be a loss—($30,000 less
$20,000). If the rule in paragraph (2) for determining the basis for loss were
applied, the result would be a gain—($20,000 less $10,000). However, the rule in
this paragraph provides that there is neither taxable gain nor loss.

(5) Determination of fair market value as of June 1, 1971, shall be as fol-
lows:

(i) If the property on which a taxpayer is reporting was not listed on an
established market or exchange, the fair market value as of June 1, 1971,
shall be the opening price on Tuesday, June 1, 1971. If the property was not
traded on that day, the price of the last sale during the preceding week shall
be the fair market value as of June 1, 1971, for computing gain or loss. If
the property was not traded during the previous week or in the absence of an
opening price for Tuesday, June 1, 1971, the average of the high and low
price or the average of the bid and asked quotations on Tuesday, June 1,
1971, whichever is appropriate, shall be used to ascertain the fair market
value as of June 1, 1971. When a return is filed involving property acquired
prior to June 1, 1971, an explanation of the method utilized in computing the
June 1, 1971, fair market value shall be attached to Schedule D.

(ii) If the property on which a taxpayer is reporting was not actively
traded in an established market or exchange, the fair market value as of June
1, 1971, may be established through a bona fide, independent, written
appraisal as of the date by a competent appraiser of recognized standing and
ability. The value as established by the appraiser shall specifically exclude
the value of improvements made subsequent to June 1, 1971. A copy of the
appraisal shall be attached to Form PA-40 when filed. When an appraisal is
utilized, an explanation of improvements made subsequent to June 1, 1971,
including the date and cost of the improvements, shall be attached to Sched-
ule D.
The following table illustrates the application of the rules for computing gain or loss as enumerated in this subsection. It may be used as a guide when securities or other nondepreciable assets are involved, assuming that no adjustments are necessary for capital additions or capital reductions.

<table>
<thead>
<tr>
<th>Cost</th>
<th>June 1, 1971 Value</th>
<th>Selling Price</th>
<th>Gain</th>
<th>Loss</th>
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<td>450</td>
</tr>
</tbody>
</table>

(6) If the fair market value of the property was not ascertained as of June 1, 1971, by the methods enumerated in paragraph (5), the gain or loss shall be computed by subtracting from the sales price selling expenses and the historic or cost basis of the property and multiplying that figure by a fraction—the numerator of which is the number of full calendar months the property was held subsequent to June 1, 1971, and the denominator of which is the number of full calendar months in the taxpayer’s entire holding period for the property. When the proration is used, an explanation shall accompany Schedule D, setting forth for each asset the date and costs of acquisition and the date and costs of any capital improvements, both prior to and subsequent to June 1, 1971. Proration fractions utilized shall be included in the explanation. Paragraphs (1)—(5) do not apply when this paragraph is used.

The application of this paragraph may be illustrated by the following examples:

(A) Taxpayer purchased his home on June 1, 1960, at a cost of $20,000. He sold the home on June 1, 1980, for $100,000. He incurred selling expense of $5,000. The taxable gain is computed by subtracting from the sale price of $100,000 selling expenses of $5,000, leaving a net sale price of $95,000. Next the $20,000 cost basis is subtracted from the net sale price of $95,000. This $75,000 gain is multiplied by the fraction of 108/240 resulting in a taxable gain of $33,750.

(B) A tract of land is acquired on June 1, 1960, at a cost of $10,000. As of June 1, 1965, a building at a cost of $50,000 is constructed on the land. The building has a useful life of 50 years and is depreciated using the straight line method. On June 1, 1980, the asset is sold for $100,000. Assuming the value of the land was $25,000 and the value of the building was $75,000 at the time of sale, the following would be the method for determining the net gain for Pennsylvania tax purposes, utilizing the pro-
ration method. Since the land was held for a period of 20 years, 9 of which were subsequent to June 1, 1971, the applicable fraction would be 108/240 times the net gain of $15,000. Since the structure was held for 15 years, of which 9 were subsequent to June 1, 1971, the applicable fraction would be 108/180 times the net gain of $40,000 ($50,000 cost less $15,000 depreciation equals $35,000 adjusted basis; $75,000 sale price less $35,000 adjusted basis equals $40,000 gain). Thus, the total taxable gain for this transaction would be $30,750 ($6,750 + $24,000).

(ii) For the Department to determine the proper proration fraction applicable, data similar to that outlined in subparagraph (i) shall be provided.

(g) Exclusion of gain from sale of principal residence before January 1, 1998.

(1) Eligible individuals. In determining whether an individual is eligible to claim the exclusion of gain from the sale of a principal residence, the individual shall comply with the following:

(i) Subject to the limitations of paragraph (2), and except as provided in subparagraph (iii), paragraph (3) or paragraph (5), a taxpayer may elect to exclude the taxpayer’s portion of the aggregate gain realized on the sale of a residence only under the following conditions:

(A) The taxpayer is at least 55 years of age on the date of sale.
(B) The taxpayer used the residence as his principal residence for periods aggregating 3 years or more, during the 5-year period ending on the date of sale.
(C) The taxpayer owned the residence for periods aggregating 3 years or more, during the 5-year period ending on the date of sale.
(D) The date of sale of the residence is after June 30, 1987, and before January 1, 1998.
(E) The taxpayer has not previously made an election under this subparagraph for Pennsylvania tax purposes or has revoked previous elections.

(ii) When a taxpayer holds title to a residence with a spouse or other person as joint tenants, tenants in common or tenants by the entireties, it is not necessary that each co-owner make an election or that a co-owner consent to the election of another co-owner. Except as provided in subparagraph (iii) or paragraph (3), the age, ownership and use conditions in subparagraph (i) apply separately to each co-owner and only the co-owner who meets age, ownership and use conditions may make an election. A taxpayer is not precluded from making the election merely because the taxpayer or a spouse has already made the Federal election.

(iii) When a joint return of income is made with respect to the sale of a married couple’s jointly owned residence, it is not necessary that both spouses satisfy the age, ownership and use conditions of subparagraph (i). If one spouse satisfies the three conditions, both spouses shall be considered to satisfy requirements. If separate returns of income are made, the general rule

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that the age, ownership and use conditions apply separately to each spouse is applicable and only the spouse who meets age, ownership and use conditions may make an election.

(2) **Dollar limitations.** Dollar limitations for the exclusion are as follows:

(i) If the residence sold was owned solely by the taxpayer, the amount of gain excluded by the taxpayer under the election cannot exceed the first $100,000 of taxable gain realized by the taxpayer on the sale.

(ii) The aggregate amount of gain excluded on a sale cannot exceed $100,000, regardless of the number of owners. If the residence sold is owned by more than one owner, the amount of gain excluded by an owner cannot exceed that owner’s pro rata part of $100,000 determined by multiplying the owner’s fractional ownership interest in the residence sold by $100,000.

Example 1. H and W, a married couple, each owned a one-half interest in their residence. As H and W each owned a one-half interest, the amount of gain excluded by H cannot exceed the first $50,000 of taxable gain realized by H and the amount of gain excluded by W cannot exceed the first $50,000 of taxable gain realized by W.

Example 2. H and W, a married couple, jointly own a one-half interest in their residence. The remaining one-half interest is owned by S. As H and W own one-half interest, the amount of gain excluded by H, W and S cannot exceed the first $25,000, $25,000 and $50,000 of taxable gain realized by H, W and S, respectively, on the sale.

(3) **Unmarried widow or widower.** If a decedent, during the 5-year period ending on the date of sale, satisfied both ownership and use requirements with respect to the property sold, the surviving spouse is also treated as satisfying ownership and use requirements if not remarried.

Example. After H’s death, W, the widow of H, sold H’s residence. W qualifies for the election, even if W personally does not satisfy ownership and use requirements, if the following apply:

H owned the residence for periods aggregating 3-years or more during the 5-year period ending on the date of sale.

H used the residence as his principal residence for periods aggregating 3-years or more during the 5-year period ending on the date of sale.

W is at least 55 years of age on the date of sale.

W has not previously made an election under this provision for Pennsylvania tax purposes or has revoked all previous elections.

W has not remarried. The date of sale is after June 30, 1987.

(4) **Tenant-stockholders in cooperative housing corporations.** An individual who holds stock as a tenant-stockholder in a cooperative housing corporation may be eligible to make an election with respect to the sale of the stock.
To determine whether a taxpayer meets requirements, the usual ownership conditions are applied to the holding of the stock and the usual use conditions are applied to the house or apartment which the taxpayer is entitled to occupy because of the taxpayer’s stock ownership.

(5) Estate as taxpayer. A sale made by an estate will not qualify for the election, unless the sale is pursuant to an executory contract made prior to death by an individual meeting the age, ownership and use requirements. The election shall be made on the decedent’s final return.

(6) Principal residence and use and ownership requirements.

(i) A residence is a house, lodging or place of habitation, including a trailer or condominium, which is physically occupied and used for residential purposes. A residence which is a principal residence for Federal income tax purposes shall be presumed to be a principal residence for State purposes. In determining whether a residence has been occupied and used for residential purposes, a taxpayer need not consider temporary absences from the principal residence if the residence was not rented during the taxpayer’s absence. A temporary absence is an absence of less than 90 consecutive days or an absence of any length when the taxpayer is convalescing in a hospital, nursing home or a personal care facility.

(ii) The ownership and use tests need not be met simultaneously. Both tests shall be met during the 5-year period preceding the date of the sale. For example, a lessee could rent a residence for 2 years, then purchase the residence and live in it for only 1 of the 3 following years and still qualify for the election.

(7) Sale and date of sale.

(i) For purposes of this subsection, the word “sale” means a sale, exchange, taking by eminent domain, destruction or other disposition of property giving rise to taxable gain. The date of sale of a principal residence is the date on which the deed is accepted by the buyer and title passes—ordinarily, the date of settlement—or, if delivery of the deed is postponed, the date on which possession and the burdens and benefits of beneficial ownership pass from the seller to the buyer under the contract of sale.

(ii) The date a taxpayer received condemnation proceeds giving rise to taxable gain will be considered the date of sale in the case of a condemnation. In the case of the destruction of a residence, the date the taxpayer receives casualty insurance proceeds or damages giving rise to taxable gain will be considered the date of sale.

(8) Farms, duplexes and other mixed use property. If the property sold includes business or rental property or the land surrounding the residence is in excess of that which is reasonably necessary for the use of the dwelling as a home, special rules apply:

(i) Where the land surrounding the residence is in excess of that which is reasonably necessary for the use of the dwelling as a home, only the por-
tion of the gain on the sale of the property allocable to the portion used as a residence is subject to the exclusion. Real estate used for commercial farming or for another commercial purpose is not reasonably necessary for the use of the dwelling as a home.

(ii) If a residence includes business or rental premises, only that portion of gain on the sale of the property allocable to the portion used as a residence is subject to the exclusion. Examples include a sole proprietor’s residence above the sole proprietor’s store, an office in home and a duplex where one unit is rented.

(9) Election. The once-in-a-lifetime elective gain exclusion shall be filed with the PA-40 tax return on a form provided by the Department.

(10) Revocation of election. To revoke an election, the taxpayer shall have completed and filed Form PA-19R, “Revocation of Election,” and paid the tax and interest due within 3 years of the date the original return was required to be filed, determined with regard to extensions. Each party to an election on a joint return shall consent to its revocation. If one of the spouses to an election on a joint return is deceased, one of the spouse’s personal representative or surviving spouse may consent to the revocation.

(h) Exclusion of all gain from disposition of principal residence after December 31, 1997.

(1) Eligible individuals. An individual may exclude from tax gain realized on the sale or other disposition of the taxpayer’s principal residence if all of the following conditions are met:

(i) The date of disposition of the residence is after December 31, 1997.

(ii) The taxpayer used the residence as his principal residence for periods aggregating 2 years or more during the 5-year period ending on the date of its disposition.

(iii) The taxpayer owned the residence for periods aggregating 2 years or more during the 5-year period ending on the date of its disposition.

(iv) One of the following applies:

(A) During the 2-year period ending on the date of disposition of the taxpayer’s principal residence, there was no prior disposition by the taxpayer of a principal residence.

(B) The disposition of the taxpayer’s principal residence is by reason of an unforeseen change in employment or health or severe financial hardship to the taxpayer resulting from a sudden and unexpected accident, loss of property due to casualty or other similar extraordinary and unforeseeable circumstance arising as a result of events beyond the control of the taxpayer.

(2) Market exigencies. For purposes of paragraph (1)(iv), it shall be immaterial that a prior disposition was delayed due to market exigencies or other reason.

(3) Ownership and use conditions. For purposes of paragraph (1):
(i) Exception. Except as provided in subparagraph (ii), when a taxpayer holds title to a residence with a spouse or other person as joint tenants, tenants in common or tenants by the entitreties, the ownership and use conditions in paragraph (1) apply separately to each coowner and only the coowner who meets the conditions of paragraph (1) may claim the exclusion.

(ii) Joint return. When a joint return of income is made with respect to the disposition of a married couple’s jointly owned residence, it is not necessary that both spouses satisfy the ownership and use conditions of paragraph (1). If one spouse satisfies the conditions, both spouses shall be considered to satisfy the conditions. If separate returns of income are made, the general rule that the ownership and use conditions apply separately to each spouse is applicable and only the spouse who meets ownership and use conditions may make an election.

(iii) Unmarried widow or widower. If a decedent, during the 5-year period ending on the date of disposition, satisfied both ownership and use conditions with respect to the property sold, the surviving spouse is also treated as satisfying the ownership and use conditions if not remarried.

(iv) Tenant-stockholders in cooperative housing corporations. An individual who holds stock as a tenant-stockholder in a cooperative housing corporation may qualify for exclusion with respect to the disposition of the stock. To determine whether a taxpayer meets requirements, the usual ownership conditions are applied to the holding of the stock and the usual use conditions are applied to the house or apartment which the taxpayer is entitled to occupy because of the taxpayer’s stock ownership.

(v) Estate as taxpayer. A disposition made by an estate will not qualify for the exclusion, unless the disposition is under an executory contract made prior to death by an individual meeting the ownership and use conditions.

(vi) Principal residence; use and ownership conditions.

(A) A residence is a house, lodging or place of habitation, including a trailer or condominium, which:

   (I) Has independent or self-contained cooking, sleeping and sanitation facilities.

   (II) Is physically occupied and used for residential purposes by the taxpayer.

(B) The ownership and use conditions need not be met simultaneously. Both tests shall be met during the 5-year period preceding the date of the disposition. For example, a lessee could rent a residence for 1 year, then purchase the residence and again live in it for only 1 of the 4 following years and could still qualify for the election.

(C) The residence which the taxpayer physically occupies the most within a time period shall be his principal residence for the period. When a taxpayer alternates between homes, the home that he personally occupies the most shall be considered his principal residence. The test of physical
occupancy is not satisfied by merely moving furniture or other personal belongings into a residence without actually living there or by the taxpayer’s family’s physical occupancy.

(D) In determining whether a residence has been occupied and used for residential purposes, a taxpayer need not consider temporary absences from the principal residence if the residence was not rented during the taxpayer’s absence. A temporary absence is an absence of less than 90 consecutive days or an absence of any length when the taxpayer is convalescing in a hospital, nursing home or a personal care facility.

(vii) Disposition and date of disposition. 
(A) For purposes of this subsection, the word “disposition” means a sale, exchange, taking by eminent domain, destruction or other conversion of property into cash or other property giving rise to taxable gain. The date of disposition by sale of a principal residence is the date on which the deed is accepted by the buyer and title passes—ordinarily, the date of settlement—or, if delivery of the deed is postponed, the date on which possession and the burdens and benefits of beneficial ownership pass from the seller to the buyer under the contract of sale.

(B) The date a taxpayer received condemnation proceeds giving rise to taxable gain will be considered the date of disposition in the case of a condemnation. In the case of the destruction of a residence, the date the taxpayer receives casualty insurance proceeds or damages giving rise to taxable gain will be considered the date of disposition.

(viii) Farms, duplexes and other mixed use property. If the property sold includes business or rental property or the land surrounding the residence is in excess of that which is reasonably necessary for the use of the dwelling as a home, special rules apply:

(A) Where the land surrounding the residence is in excess of that which is reasonably necessary for the use of the dwelling as a home, only the portion of the gain on the disposition of the property allocable to the portion used as a residence is subject to the exclusion. Real estate used for commercial farming or for another commercial purpose is not reasonably necessary for the use of the dwelling as a home.

(B) If a residence includes business or rental premises, only that portion of gain on the disposition of the property allocable to the portion used as a residence is subject to the exclusion. Examples include a sole proprietor’s residence above the sole proprietor’s store, an office in home and a duplex where one unit is rented.

(ix) Depreciable property. If, at any time during the taxpayer’s holding period, any portion of the principal residence sold was ever subject to the allowance for depreciation, only that part of gain on the disposition of the principal residence that is allocable to the portion of the principal residence which has never been subject to the allowance is subject to the exclusion.
(x) **Split interests.** A taxpayer’s disposition of an immediate possessory interest, remainder interest or other interest in his principal residence shall qualify for exclusion, if the taxpayer would have qualified had he disposed of the entire interest in the property.

(i) **Accounting methods.**

(1) **Immediately recognized gain.** If gain on disposition of property does not qualify for installment or cost recovery treatment or if the transaction does qualify but the seller chooses not to use the installment method of accounting, the excess of the face amount of the evidence of indebtedness given in exchange for the property sold or otherwise disposed of together with the value of other consideration received by the seller over the seller’s adjusted basis shall be recognized as gain in the year of the sale or disposition.

(2) **Installment sales method.** When a seller who is a cash basis taxpayer enters into an agreement for the sale of tangible personal property or real property under which agreement at least one payment is to be received in a taxable year following the year of sale, the seller may irrevocably elect to allocate the gain upon the transaction in equal proportion to each payment to be received under the following conditions:

(i) The sale was made on or after January 1, 1984.

(ii) The object of the transaction is not the lending of money or the rendition of services.

(iii) The taxpayer has not elected to exclude gains under subsection (g).

(3) **Cost recovery method.** When a seller who is a cash basis taxpayer enters into an agreement for the sale of intangible personal property under which agreement at least one payment is to be received in a taxable year following the year of sale, the seller shall use the cost recovery method of accounting if the note, contractual promise or other evidence of that obligation is not assignable.

(4) **Repossessed property.** When property is sold pursuant to a deferred payment contract, and the seller repossesses the property upon default of the buyer in a subsequent tax year, the seller shall account for the gain or loss by adjusting his basis in the property repossessed by the amount of gain previously reported on that sale.

(j) **Determination of net gain or income.** For purpose of determining net gains or income from the disposition of property, gain or loss shall be recognized on the sale, exchange or other disposition of obligations issued by the Commonwealth, a public authority, commission, board or other agency created by the Commonwealth, a political subdivision of this Commonwealth or a public authority created by the political subdivision or exempt from State taxation under the laws of the United States only with respect to obligations issued on or after February 1, 1994. Regardless of the obligation’s date of issuance, gain or loss shall be recognized on the sale, exchange or other disposition of obligations issued by this Commonwealth, a public authority, commission, board or other agency cre-
ated by the Commonwealth, a political subdivision of the Commonwealth or a public authority created by the political subdivision or exempt from State taxation under the laws of the United States for one or more of the following purposes:

1. Computing earnings and profits.
2. Adjusting basis.
3. Determining an individual’s poverty income.

(k) Adjustments to basis.

1. For taxable years beginning on or after January 1, 1993, the basis of a debt instrument in the hands of the holder shall be adjusted upward by the amount of unstated or imputed interest includible in the income of the holder and shall be adjusted downward, but not below zero, by the amount of any payment under the debt instrument other than a payment of stated interest.

2. The basis of an obligation issued by the Commonwealth, a public authority, commission, board or other agency created by the Commonwealth, a political subdivision of this Commonwealth or a public authority created by the political subdivision or an obligation exempt from tax under the laws of the United States in the hands of the holder shall be adjusted upward by the amount of unstated or imputed interest that would have been includible in income but for its statutory exemption and shall be adjusted downward, but not below zero, by the amount of any payment under the debt instrument other than a payment of stated interest.

Authority

The provisions of this § 103.13 amended under section 354 of the Tax Reform Code of 1971 (72 P. S. § 7354).

Source


Cross References

This section cited in 61 Pa. Code § 107.4 (relating to formation of a partnership of association); and 61 Pa. Code § 125.42 (relating to awards received in reparation for the seizure, theft, requisition or involuntary conversion of the property of victims of Nazi persecution).


Net gains or income shall include that which is derived from or in the form of rents, royalties, patents and copyrights.

§ 103.15. Dividends.

(a) Dividends shall be any distribution in cash or property made by a corporation, association or business trust from the following sources:
(1) Accumulated earnings and profits.
(2) Earnings and profits of the year in which such dividend is paid.
(b) Dividends shall not include a distribution of the stock of a corporation made by the corporation originally issuing such stock to its own stockholders if such distribution is not treated as personal income for Federal individual income tax purposes.

Source

§ 103.16. Interest.
(a) Generally. Interest includes any charge for the use or detention of money or for a forbearance from enforcement of a debt that is due, whether or not payable as such or as principal, including, for taxable years beginning on or after January 1, 1993, any excess of a publicly offered obligation’s stated redemption price at maturity over the first price at which a substantial amount of the obligations included in the issue is sold to the public. For this purpose, the public does not include bond houses, brokers or other persons or organizations acting in the capacity of underwriters or wholesalers. As a general rule, interest received by or credited to the taxpayer constitutes gross income and is fully taxable. Interest income includes interest on savings or other bank deposits; interest on coupon bonds; interest on an open account, promissory note, mortgage or corporate bond or debenture; the interest portion of a condemnation award, usurious interest (unless by state law it is automatically converted to a payment on the principal); interest on legacies and life insurance proceeds held under an agreement to pay interest thereon; and interest on refunds of taxes.
(b) Bonds bought when interest defaulted or accrued. If a taxpayer purchases bonds where interest has accrued but has not been paid, interest which is in arrears but has accrued at the time of purchase is not income and may not be taxable as interest if subsequently paid. The payments are returns of capital which reduce the remaining cost basis. Interest which accrued after the date of purchase is taxable interest income for the year in which received or accrued, depending on the method of accounting used by the taxpayer.
(c) Bonds sold between interest dates. If bonds are sold between interest dates, part of the sale price represents interest accrued to the date of the sale and shall be reported as interest income.
(d) Annuities. Interest does not include amounts received under an annuity contract.
(e) Government obligations. Interest derived from obligations which are not statutorily free from state or local taxation under any other act of the General Assembly or under the laws of the United States is taxable under this section. Interest on obligations issued by or on behalf of the United States Government is...
§ 103.16. Interest on obligations issued by the Commonwealth, a public authority, commission, board or other agency created by the Commonwealth, a political subdivision of the Commonwealth, or a public authority created by a political subdivision which is for the performance of essential governmental functions and which is in all respects for the benefit of the people of this Commonwealth, for the increase of their commerce and prosperity and for the improvement of their health and living conditions is not taxable under this subsection. Interest on obligations issued by other states and territories, their political subdivisions and instrumentalities is taxable under this section.

(f) Unstated or imputed interest. Unstated or imputed interest for a taxable year beginning on or after January 1, 1993, including interest derived from government obligations, shall be computed in the same manner as it is required to be computed for Federal Income Tax purposes.

Authority
The provisions of this § 103.16 amended under section 354 of the Tax Reform Code of 1971 (72 P. S. § 7354).

Source
The provisions of this § 103.16 amended March 1, 1996, effective March 2, 1996, 26 Pa.B. 887. Immediately preceding text appears at serial pages (205359) to (205360).

§ 103.17. Gambling and lottery winnings.
Gambling and lottery winnings, other than prizes of the State Lottery won on or after July 21, 1983, shall be taxable. These consist of gains arising from gambling and lotteries. In calculating gains, the taxpayer may deduct gambling and lottery losses, other than losses incurred in the State Lottery on or after July 21, 1983, but may not deduct the costs and expenses incurred in connection with the gambling and lottery activity. In addition to the other recordkeeping requirements under Article III of the TRC of 1971 (72 P. S. §§ 7301—7361), the taxpayer shall maintain detailed records substantiating losses. The taxpayer shall have the burden of proving losses.

Authority
The provisions of this § 103.17 issued under section 354 of the Tax Reform Code of 1971 (72 P. S. § 7354).

Source
The provisions of this § 103.17 amended through January 20, 1984, effective January 21, 1984, 14 Pa.B. 222. Immediately preceding text appears at serial page (83090).

§ 103.18. Net gains or income derived through estates or trusts.
(a) This class consists of the classes of income enumerated and classified under this subchapter received by an estate or trust directly and paid, credited or otherwise required to be distributed to its beneficiary. Reference should be made
to § 105.4 (relating to income of estates, trusts and their beneficiaries). Income derived from an estate or trust shall retain the same character in the hands of the ultimate beneficiary as in the hands of the estate or trust. For example, a resident estate receives net rental income from property in this Commonwealth and distributes that income to its beneficiary, a residuary trust, under the will of the resident decedent, which in turn distributes that income to a nonresident individual beneficiary. The income is from this Commonwealth source and shall be taxable to the nonresident individual beneficiary.

(b) To the extent that income or gain is subject to tax under one of the other classes of income enumerated in this section, such income or gain shall not be subject to tax under one of the other enumerated classes.

Cross References
This section cited in 61 Pa. Code § 105.4 (relating to income of estates, trusts and their beneficiaries).

§ 103.19. Utilities—return of capital distributions.

(a) Distributions by corporations which are treated as a return of capital for Federal income tax purposes shall also be treated as a return of capital for Pennsylvania personal income tax purposes and therefore not taxable as dividends under section 303(a)(5) of the TRC (72 P. S. § 7303(a)(5)).

(b) That portion of a distribution which is a return of capital shall be applied against and shall reduce the adjusted basis of the stock. That portion of a distribution which is a return of capital, to the extent it exceeds the adjusted basis of the stock, shall be treated as gain or income from the disposition of property.

(c) To the extent that a distribution which was a return of capital was previously taxed as dividend income to the recipient under prior Department policy, the recipient need not reduce the adjusted basis of the stock.

(d) This section is effective for the 1981 tax year and all future years.

Authority
The provisions of this § 103.19 issued under section 354 of the Tax Reform Code of 1971 (72 P. S. § 7354).

Source