

Earned Income Taxes

Local income taxes, also known as earned income taxes, wage taxes, net profits taxes, or a combination of these terms, provide the chief source of non-property tax revenue for municipalities and school districts. Act 511 of 1965, the Local Tax Enabling Act,¹ authorizes local earned income taxes for most municipalities and school districts.² The tax is levied on wages, salaries, commissions, net profits, or other compensation of people subject to the jurisdiction of the taxing body. Municipalities and school districts levying earned income taxes may exempt people whose income from all sources is less than \$12,000 per year from payment of the earned income tax. The exemption must be adopted as part of, or as an amendment to, the municipal tax ordinance or the school district's resolution authorizing the tax.

With some exceptions, municipalities and school districts subject to Act 511 may, by ordinance or resolution, enact an earned income tax limited to 1 percent.³ Where both a municipality and a school district impose the tax on the same wage earner, the 1 percent maximum rate is divided evenly between the two taxing districts unless they agree otherwise.

Municipalities may tax residents as well as nonresidents employed in their municipality subject to the crediting provisions of Act 511, which require the place of employment to grant a credit for any earned income tax levied at the place of residence.⁴ Because there is often a tax imposed at a

¹ 53 P.S. §§ 6924.101 et seq.

² Local income taxes were first adopted by Philadelphia in 1939, making it the first municipality in the United States with a local income tax. The Sterling Act, Act 45, Special Session 1, of 1932 (53 P.S. § 15971 et seq.), is the general tax enabling law for the City of Philadelphia. It is the source of the city's authority to impose the wage and net profits tax, as well as other taxes. A restriction has been placed on Philadelphia's power to tax wages of nonresidents. The Pittsburgh School District is authorized by Section 652.1 of the Public School Code, Act 14 of 1949 (24 P.S. § 1-101 et seq.), to impose an earned income and net profits tax. This authorization also gives the school district access to certain tax subjects authorized by Act 511, but the district may not use this authority to increase its earned income tax above the limit established in Act 14. The earned income tax rate is limited to 2 percent for the Pittsburgh School District as provided by Section 652.1 of Act 14. A special provision of Act 511 allows the Scranton School District to levy the tax at 1 percent without the sharing requirement mandated for other school districts under Act 511.

³ Earned income taxes also are subject to the overall limits on taxes enacted under Section 320 of Act 511 (53 P.S. § 6924.320). Not all taxing jurisdictions are limited to the 1 percent limit on the rate of the earned income tax. Other laws and provisions allow the Act 511 limit for earned income taxes to be exceeded under seven circumstances:

- (1) Home rule municipalities.
- (2) Financially distressed municipalities.
- (3) Municipalities with financially distressed pension systems.
- (4) Municipalities that purchase open space.
- (5) School districts that have adopted an increased earned income tax (EIT) under Act 50 of 1998 (53 Pa.C.S. § 8581 et seq.) prior to the repeal of Act 50's provisions addressing the levy of the EIT by Act 72 of 2004 (53 P.S. § 6925.101 et seq.), which was subsequently repealed by Special Session Act 1, Special Session 1, of 2006 (53 P.S. § 6926.101 et seq.).
- (6) Municipalities and school districts that adopt the provisions of Chapter 4 (Optional Occupation Tax Elimination) of Act 511 (53 P.S. §§ 6924.401 et seq.).
- (7) School districts that adopt Act 1, Special Session 1, of 2006 provisions to levy or increase earned income taxes.

⁴ The exception to the priority given to the place of residence is persons subject to the Philadelphia wage tax. Act 511 requires municipalities to credit their residents for taxes paid to Philadelphia on income earned within the city. This

wage earner's place of residence, municipalities do not derive significant revenue from nonresidents. School districts are not permitted to tax nonresidents. A resident is defined as a taxpayer domiciled within the taxing district. "Domicile" is defined as "[t]he place where a person lives and has a permanent home and to which the person has the intention of returning whenever absent. Actual residence is not necessarily domicile, for domicile is the fixed place of abode which, in the intention of the taxpayer, is permanent rather than transitory. . . ."⁵

When Pennsylvania residents are employed in another state and pay a state or local income tax in that other state, they are entitled to a credit against any earned income tax imposed by any political subdivision where they reside. The same dollar of the out-of-state tax cannot be credited against both state and local taxes in Pennsylvania, but courts have held that the credit can be divided between the state and the municipality. Thus, a Pennsylvania resident paying a 5 percent tax to another state could apply a credit first against the Pennsylvania income tax of 3.07 percent with part of the remainder being credited against the 1 percent local wage tax. Tax payments made voluntarily to another state do not qualify for the credit, and this credit does not extend to taxes paid to foreign countries.⁶ Commonwealth political subdivisions are required to credit an out-of-state resident for the payment of any earned income tax to their state or political subdivision thereof if residents of the political subdivision in Pennsylvania receive a similar credits on income taxes imposed by the other state or political subdivision.

The definitions of "earned income" and "net profits" in Act 511 reference the definitions of "compensation" and "net profits" that are used for the personal income tax in state law⁷ and regulations,⁸ and include all taxes on earned income or net profits authorized by Act 511 or any other law of the Commonwealth unless the law expressly provides otherwise.⁹ Earned income taxpayers are permitted to deduct from compensation the same employee business expenses that are deductible from compensation for state income tax purposes.

Taxable compensation at the local level is almost identical to taxable compensation at the state level, except that housing allowances provided to members of the clergy are not taxable at the local level. The General Assembly adopted another exception through the passage of Act 6 of 2016, which amended Act 511 to exempt from the local earned income tax wages or compensation

credit, like the other credits provided in Section 317 of Act 511, is a direct reduction against the liability for tax owed by the taxpayer.

⁵ Act 511, § 501 (53 P.S. § 6924.501). (*But see* Act 18 of 2018, which added section 320(c) to provide for "domicile" as follows: "An individual who does not meet the domicile requirements for the purpose of determining and paying the tax provided under Article III of the act of March 4, 1971 (P.L.6, No.2), known as the "Tax Reform Code of 1971," shall be deemed to not meet the domicile requirements for local tax purposes."

⁶ *Id.* at § 317 (53 P.S. § 6924.317).

⁷ The Tax Reform Code of 1971, § 301 (72 P.S. § 7301). Note: Act 166 of 2002 and Act 24 of 2004 changed the definitions of "earned income" and "net profits" for purposes of the earned income tax imposed under Act 511 by adopting, with certain exceptions, the definitions of "compensation" and "net profits" for state personal income tax purposes.

⁸ 61 Pa. Code §§ 101.6, 103.11-103.12.

⁹ Act 511, § 501(3) (53 P.S. § 6924.501(3)).

paid to individuals on active military service, regardless of whether it is earned for active military service inside or outside the Commonwealth.

While the definition of “net profits” in Act 511 includes net income from the operation of a business, profession or other activity, it does not include income from corporations. In addition, net profits do not include income that is “not paid for services provided,” or that is in the nature of earnings from an investment.

For taxpayers engaged in farming, net profits do not include interest earned on the monetary accounts of the farming business and gains from the sale of farm machinery, most livestock and the capital assets of the farm.

State law provides for sharing of income tax information between the Internal Revenue Service and the state Department of Revenue. The Department of Revenue also shares state tax information with school districts. School districts are authorized to share this information with their constituent municipalities.

Act 32 of 2008 extensively amended Act 511. Among other things, the amendatory act created 69 county-wide tax collection districts for the purpose of consolidating the collection of earned income and net profits taxes. A county tax collection district exists in each county, except in Philadelphia and Allegheny Counties. The geographic boundaries of a tax collection district are coterminous with the county in which it is created, with some exceptions.¹⁰ Allegheny County is divided into four tax collection districts, as specified.¹¹ Countywide tax collection began after January 1, 2012.

The tax collection district is supervised by a tax collection committee.¹² The committee is comprised of delegates appointed by the governing body of each political subdivision within a tax collection district. Among other things, each tax collection committee was required via Act 32 to create a tax bureau and provide for its operation and administration. The committee is also charged with appointing a tax officer¹³ for the tax collection district and establishing the compensation for this officer.¹⁴ The Department of Community and Economic Development (DCED) is responsible for the oversight of all tax collection committees, tax collectors and tax collection offices.¹⁵

¹⁰ Act 511, § 504 (53 P.S. § 6924.504).

¹¹ *Id.* at § 504(b).

¹² *Id.* at § 505 (53 P.S. § 6924.505).

¹³ Two or more tax collection districts may appoint the same tax officer. If two or more tax collection districts form a joint tax collection committee, the joint tax collection committee shall appoint a single tax collection officer.

¹⁴ Act 511, § 507 (53 P.S. § 6924.507).

¹⁵ *Id.* at § 508) (53 P.S. § 6924.508).

Persons and entities seeking or maintaining appointments as tax officers are required to complete mandatory education as a prerequisite for their appointments and not less than annually for continuing appointments. The Pennsylvania Department of Community and Economic Development (DCED) is charged with providing the mandatory education and must adopt regulations, guidelines and procedures to do so.¹⁶

DCED is required to maintain a Tax Register and an Official Register.¹⁷ The Tax Register includes tax rates for all county, municipal and school taxes. The Official Register, which will be part of the Tax Register, only includes rates and tax collector information for local taxes that must be withheld by employers. The Official Register is released on June 15 for taxes that must be withheld on and after July 1 of each year, and on December 15 for taxes that must be withheld on and after January 1. Employers are permitted, but not required, to withhold based on the information in the Tax Register rather than the information in the latest Official Register.¹⁸

Act 511 requires every employer having a factory, workshop, branch, warehouse or other place of business within the taxing jurisdiction that employs one or more persons, other than domestic servants, to register with the earned income tax officer. Employers are required to withhold taxes from all of their employees and remit those taxes only to the tax collector for the tax collection district where their facility is located. Deductions from the employee's compensation will be the greater of the employee's resident tax or the employee's nonresident tax as released in the official register.¹⁹ Act 18 of 2018 added provisions governing earned income tax withholding for employees with "temporary job assignments."²⁰

DCED provides detailed information about Act 511 as amended by Act 32 on its website.²¹

¹⁶ *Id.*

¹⁷ *Id.* at § 511 (53 P.S. § 6924.511).

¹⁸ *Id.*

¹⁹ *Id.* at § 512 (53 P.S. § 6924.512).

²⁰ *Id.*

²¹ <http://dced.pa.gov/local-government/local-income-tax-information>. (accessed April 6, 2020).