

Important Earned Income Tax Change for 2009

PA Act 32 of 2008, which amends Act 511 of 1965 (the “Local Tax Enabling Act”), changes the way business losses are treated. In the past, taxpayers filing a local earned income tax return were permitted to deduct a loss from an unincorporated business (for which services were rendered) against earned income (such as wages). This offset was allowed based on the PA Supreme Court decision in the O’Reilly vs. Fox Chapel School District case, decided March 16, 1989. Alternatively, a taxpayer could not offset losses from one business against profits from another, as decided in the Aronson vs. City of Pittsburgh case (Pa Cmwlth. 1985).

Effective with tax year 2009, pursuant to PA Act 32, business losses **cannot** be used to offset earned income. A loss from one business, however, **can** be used to offset net profits from another business. Please see examples below, which are taken from the “Frequently Asked Questions” section of the PA Governor’s Center for Local Government Services webpage on Act 32:

- If a taxpayer has a \$40,000 net loss from a business selling garden supplies and \$20,000 of earned income from his job at the local grocery store, the business loss may not be used to offset his earnings and so taxes will be due on the full \$20,000 of earned income.
- If a taxpayer has a net loss of \$30,000 from a business selling garden supplies and a net profit of \$50,000 from a business selling used cars, and earned income of \$60,000 from his job as an accountant, the taxpayer’s local income tax liability will be based on \$20,000 of net profits and \$60,000 of earned income because the taxpayer can offset one business loss against the second business profit.
- If a taxpayer has a net loss of \$50,000 from his garden supply business, a profit of \$30,000 from his used car business and income of \$60,000 from his job as an accountant, the taxpayer’s local income tax liability will be based on \$60,000 of earned income. The loss from the first business may be used to offset the gain from the second but the net loss from the combined businesses cannot be used to offset earned income.