



Road to Educational Achievement through Choice

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YOUR CHILD

YOUR CHOICE

OUR FUTURE



A Step-by-Step Guide for Accountants

Understanding the Educational Improvement Tax Credit Program

ABOUT REACH

The REACH (Road to Educational Achievement through Choice) Foundation and its sister organization, the REACH Alliance, are Pennsylvania's leading grassroots coalition dedicated to ensuring parental choice in education.

In 1991, the REACH Alliance was founded to coordinate the efforts to pass school choice legislation in Pennsylvania. Since then, REACH has grown into a broad, diverse coalition that includes members from the business community, ethnic and religious organizations, parents and taxpayer groups. As a nonprofit, the REACH Foundation is governed by an independent Board of Directors and funded through generous contributions of Pennsylvania citizens, churches and foundations.

The REACH Alliance was instrumental in drafting and passing Pennsylvania's landmark Educational Improvement Tax Credit (EITC), as well as its subsequent expansions. Since passing the EITC Program, the REACH Foundation has worked with the state department of Community and Economic Development to create user-friendly guidelines for the Program. REACH has also assisted scholarship organizations with start up money and technical assistance.

REACH continues to educate Pennsylvania citizens and the General Assembly to ensure that parents have a true choice in their children's education.

Founded in 1993, the REACH Foundation is the Commonwealth's leading grassroots coalition seeking to educate the public on the benefits that school choice can bring to Pennsylvania's children. The REACH Foundation represents business, religious, civic, taxpayer and nonprofit organizations committed to educational achievement through choice. The REACH Foundation receives no government grants, but instead relies on the generosity of individuals and foundations for support. Support for the Foundation can be sent to : The REACH Foundation - P.O. Box 1283 - Harrisburg, PA 17108. The REACH Foundation is a nonprofit, nonpartisan educational organization (Federal ID # 25-1744411) under Section 501 (c) (3) of the IRS Code and contributions are therefore tax deductible. For more information, visit www.paschoolchoice.org.

UNDERSTANDING THE EITC PROGRAM

The EITC Program has accomplished what many in Pennsylvania have been advocating for years - a way for the business community to be directly involved in education. The EITC enables companies to support local nonprofit charities, at minimal cost, instead of sending their tax dollars to Harrisburg. It's that simple!

Over 3,300 companies have pledged nearly \$260 million to programs all over Pennsylvania since its inception in 2001.

During the 2005-2006 school year, 1,510 businesses participated in the Program bringing in \$53 million!!



BUSINESS ENTITY CHOICES



There are 5 kinds of business entities :

- C-Corporation → taxed at corporate level
- S-Corporation
- Partnerships
- Sole Proprietors
- Limited Liability Companies (LLC's)

* S-Corps, Partnerships, Sole Proprietors and LLC's are taxed at the shareholder/member level. Their success, and ultimately their profit “flows through” to the individuals.

Entities formed as Limited Liability Companies can choose how they will be taxed:

◆ Default is based on the number of members :

- One member – taxed as sole proprietor
- Two or more members – taxed as partnership

◆ Elect to be taxed as :

- C-Corporation
- S-Corporation

TAXES BASED ON ENTITY TYPE

Entity Type	Federal Taxes		Pennsylvania Taxes			Local Tax
	Corporate Income Tax	Personal Income Tax	Corporate Net Income Tax(CNI)	Capital Stock & Franchise Tax (CS/F)*	Personal Income Tax	Personal Income Tax
C-Corporation	x		x	x		
S-Corporation		x		x	x	
Multi Member LLC (partnership)		x		x	x	x
Single Member LLC (sole prop.)		x		x	x	x
Partnerships		x			x	x
Sole Proprietors		x			x	x
Tax Rate	15% - 39%	10% - 35%	9.99%	3.89 mills	3.07	varies
Tax Base	net income	net income	net income	capital stock	net income	net income

Companies giving to the EITC Program can claim a credit against the PA Corporate Net Income Tax and the PA Capital Stock and Franchise Tax.

Some types of businesses such as banks and insurance companies are subject to additional state taxes that the EITC credit can be used against:

Bank and Trust Company Shares Tax
 Title Insurance Companies Shares Tax
 Insurance Premiums Tax
 Mutual Thrift Institutions Tax

TAX SAVINGS

Businesses participating in the EITC Program can achieve tax savings in two ways:



Special Information on S-Corporations

S-corps are subject to only one corporate level tax - PA Capital Stock Tax.

In 2006, The Capital Stock Tax was .4899% of the taxable capital stock value of the corporation

All taxes based on the income of the S-corporation are passed to the shareholders and reported on their personal income tax returns.

The EITC cannot be used to offset personal income tax liability. However, the deduction for a charitable contribution would be used to reduce taxable income.

◆ Credit against PA taxes

- Tax reduction is dollar for dollar against tax due
- Credit is non-transferable and non-refundable

◆ Deduction against net income as a charitable donation

- Tax reduction equals the contribution amount times the tax rate of the applicable tax
- Subject to rules governing deductibility of charitable contributions

TAX CREDITS AND DEDUCTIONS

Entity Type	Federal Taxes		State Taxes		Local Taxes	
	Corporate Income Tax	Personal Income Tax	Corporate Net Income Tax (CNI)	Capital Stock & Franchise Tax (CS/F)	Personal Income Tax	Personal Income Tax
C-Corporation	X		X	X		
S-Corporation		X		X	X	
Multi Member LLC (Partnership)		X		X	X	X
Single Member LLC (Sole Proprietor)		X		X	X	X
Partnership		X			X	X
Sole Proprietors		X			X	X
Tax Rate	15-39%	10%-35%	9.99%	4.89 mills	3.07	Varies
Tax Base	Net income	Net Income	Net Income	Capital Stock	Net Income	Net Income

A C-corporation can get credit against the Corporate Net Income Tax (CNI) and the Capital Stock and Franchise Tax.

There is a deduction against income in computing the Corporate Income Tax on the federal level for C-corporations and a deduction against income in computing personal income taxes for the other entities.

SAMPLE CALCULATION: PA CAPITAL STOCK TAX

	HISTORY OF EARNINGS	MM/DD/YYYY	MM/DD/YYYY	BOOK INCOME
	Oldest Period - Start here	1/1/2002	12/31/2002	500,000
		1/1/2003	12/31/2003	450,000
		1/1/2004	12/31/2004	525,000
		1/1/2005	12/31/2005	750,000
1	Current Tax Period Book Income (Loss)	1/1/2006	12/31/2006	220,000
2	Total Book Income			2,445,000
3	Divisor			5.00000
4	Divide line 2 by line 3			489,000
5	AVERAGE BOOK INCOME - Enter line 4			489,000
6	Divide line 5 by 0.095			5,147,368
7	Sum of capital stock, paid-in capital and r.e. at end of current period			1,720,000
8	Sum of capital stock, paid-in capital and r.e. at beginning of current period			1,500,000
9	If line 7 is more than twice as great or less than half as much as line 8			1,720,000
10	NET WORTH			1,720,000
11	Mutliply line 10 by 0.75			1,290,000
12	Add line 6 and 11			6,437,368
13	Divide line 12 by line 2			3,218,684
14	\$125,000 valuation deduction			125,000
15	CAPITAL STOCK VALUE			3,093,684
16	Proportion of taxable assets			1.000000
17	TAXABLE VALUE			3,093,684
18	CAPITAL STOCK/FOREIGN FRANCHISE TAX - .4899%			15,128

SAMPLE TAX CALCULATION: C-CORP vs. S-CORP COMPARISON

		C-Corporation		S-Corporation	
		No Contribution	90% EITC	No Contribution	90% EITC
1	Net Income Before Contribution and Tax	\$220,000	\$220,000	\$220,000	\$220,000
2	EITC Contribution	- \$0	- \$10,000	- \$0	- \$10,000
3	Federal Taxable Income Before PA CNI Tax	\$220,000	\$210,000	\$220,000	\$210,000
4	PA CNI Tax - 9.99% / PA Personal Tax - 3.07%	- \$21,978	- \$20,979	\$6,754	\$6,447
5	Federal Income After PA CNI Tax	\$198,022	\$189,021	\$220,000	\$210,000
6	PA CNI Tax Savings/PA Personal Tax Savings	\$0	\$999	\$0	\$307
7	EITC (PA Capital Stock Tax Reduction)	\$0	\$0	\$0	\$9,000
8	EITC (PA CNI Tax Savings)	+ \$0	+ \$9,000	+ \$0	+ \$0
9	PA Tax Savings - Total	\$0	\$9,999	\$0	\$9,307
10	Federal Taxable Income	\$198,022	\$198,021	\$220,000	\$219,000
11	Federal Corporate Tax/Federal Personal Tax in 35% brackets	\$60,479	\$60,478	\$77,000	\$76,650
12	Federal Tax Savings	\$0	\$1	\$0	\$350
13	PA Tax Savings		\$9,999		\$9,307
14	Federal Tax Savings		+ \$1		+ \$350
15	Total Tax Savings		\$10,000		\$9,657
16	Annual Cash Required to Contribute \$10,000		\$0		\$343



THE EITC PROCESS: HOW TO BECOME APPROVED

- 1 Visit www.paschoolchoice.org to obtain a business application.
- 2 Fill out the application and submit it to DCED (Department of Community and Economic Development).
- 3 The business then receives a letter of approval from DCED for participation.
- 4 The business submits their monetary contribution within sixty days to an approved organization.
- 5 The scholarship organization provides the business with an acknowledgement of the contribution.
- 6 The business submits the acknowledgement to DCED.
- 7 DCED communicates with the PA Department of Revenue and applicable credit is applied to business tax account. A notice is provided to the business.
- 8 Credit is applied as if paid at the beginning of the tax year.
- 9 The credit is taken as a payment of taxes on the businesses annual tax return filing.

This entire process *must take no less than ninety days.*



CIRCULAR 230 DISCLOSURE



Scholarship recipient, Amory Coleman - Erie, Pennsylvania

Any advice contained in this document (including any attachments unless expressly stated otherwise) is not intended or written to be used and cannot be used, (i) for purposes of avoiding tax penalties that may be imposed on any taxpayer or (ii) for purposes of promoting, marketing or recommending to another party any tax transaction or matter addressed herein.

Special thanks to Flowers and Flowers, Certified Public Accountants for their insight.