

Pennsylvania lawmakers approved a \$45.2 billion spending plan, including a tax code reform package

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On Friday July 8, 2022, Pennsylvania lawmakers approved a \$45.2 billion spending plan. The bill, signed by Governor Tom Wolf, includes a tax code reform package with the following notable changes:

- Gradual reduction of the state's corporate net income tax ("CNIT") rate;
- Deferral of gain recognition through like-kind exchanges;
- Deductible expenses for businesses; and
- New child care tax credit.

The change to Pennsylvania's CNIT rate is the first change to the rate since 1995. At 9.99 percent, the CNIT rate was one of the highest in the country. In an effort to make Pennsylvania a more business friendly and competitive state, lawmakers reduced the rate from its current 9.99 percent by a full percentage point to 8.99 percent effective January 1, 2023, and then a half-percentage point annually until reaching 4.99 percent in 2031.

The tax reform package provides for the deferral of gain recognition in connection with like-kind exchange transactions. Prior to the enactment of the legislation, Pennsylvania was the only state in the country that did not specifically allow deferral of income tax liabilities on gains from similar property exchanges. Internal Revenue Code ("IRC") Section 1031 provides that no gain or loss shall be recognized on the exchange of like-kind property held for productive use in a trade of business or for investment. Effective for tax years beginning after December 31, 2022, Pennsylvania will now follow the federal like-kind exchange rules.

The package also aligns the state tax code with IRC Section 179, allowing businesses to treat Section 179 property as a deductible expense to the extent allowable under IRC 179. This provision will make it easier for business owners to purchase and invest in equipment, vehicles, and software while providing an immediate income tax deduction for such investments.

The new child care tax credit is modeled after the federal Child Tax Credit. Pennsylvania's Child and Dependent Care Enhancement Program will return up to 30% of child care related expenses that taxpayers claim on their federal return in the form of an income tax credit. Taxpayers with incomes below soon-to-be determined levels are eligible to claim these expenses. Effective for tax years beginning in 2023, taxpayers with one dependent may claim child care expenses up to \$3,000 and taxpayers with two or more dependents may claim expenses up to \$6,000.

We anticipate further guidance from the Pennsylvania Department of Revenue in the weeks and months ahead on the tax provisions summarized above.