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This Week in State Tax (TWIST)

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Pennsylvania: Commonwealth budget contains changes to certain Philadelphia taxes

Pennsylvania's 2025-2026 budget bill, signed into law by Governor Shapiro, makes several changes in the computation of the net income tax base of the Philadelphia Business Income and Receipts Tax (BIRT). Under the new provisions, the BIRT follows the Pennsylvania Corporate Net Income Tax (CNIT) treatment for: Internal Revenue Code (IRC) sections 59(e), 174 and 174A (research and experimental expenditures); IRC section 481 (accounting-method adjustments relating to R&E expenditures); IRC section 168(n) (bonus depreciation for qualified production property); and IRC section 163(j) (business interest limitation).

As a result, Philadelphia effectively decouples from the federal R&E provisions enacted by OB3. In practical application, this means that current year domestic R&E expenses must be capitalized and deducted at 20 percent per year over five years for BIRT purposes; previously capitalized 2022–2024 domestic R&E costs are not immediately deductible for BIRT; and foreign R&E expenditures are subject to a five-year recovery period for BIRT purposes.

Recall that Pennsylvania CNIT also has a unique approach to IRC section 163(j) conformity, which the Philadelphia BIRT will now follow. For a Commonwealth taxpayer filing as a member of a federal consolidated group, the IRC 163(j) limitation does not apply for Pennsylvania CNIT (and thus Philadelphia BIRT) purposes unless a limitation exists for the federal consolidated group. If so, then the taxpayer computes the IRC section 163(j) limitation on an "as-if separate" basis for Pennsylvania CNIT purposes, based on IRC section 163(j) as it existed on December 31, 2024.

The legislation expressly states that it applies retroactively to tax years beginning after December 31, 2024. Additionally, the legislation includes a provision that any future changes to Pennsylvania CNIT related to the IRC would automatically flow to the computation of the Philadelphia BIRT.

Please contact Robert Weyman with questions about S.B. 146.

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