Bill Number:	H. 5341	Amended by Senate Finance Subcommittee on Conformity on September 18, 2018
Author:	Lucas	
Subject:	IRC Conformity	
Requestor:	Senate Finance	
RFA Analyst(s):	Jolliff and Shuford	
Impact Date:	September 19, 2018	

Estimate of Fiscal Impact

	FY 2018-19	FY 2019-20
State Expenditure		
General Fund	$0	$0
Other and Federal	$0	$0
Full-Time Equivalent Position(s)	0.00	0.00
State Revenue		
General Fund	$0	($4,000,000)
Other and Federal	$0	$0
Local Expenditure	$0	$0
Local Revenue	$0	$0

Fiscal Impact Summary
This bill does not have an expenditure or revenue impact on the General Fund, Other Funds, or Federal Funds in FY 2018-19 from updating conformity to the Internal Revenue Code, adopting additional non-conforming items, and implementing dependent exemptions. General Fund individual income tax revenue will decrease by $4,000,000 in FY 2019-20 due to adjusting the individual income tax brackets by full inflation beginning in tax year 2019.

Explanation of Fiscal Impact

Amended by Senate Finance Subcommittee on Conformity on September 18, 2018
State Expenditure
This bill is not expected to impact expenditures for the Department of Revenue (DOR) or the Revenue and Fiscal Affairs Office (RFA). DOR will update the individual and corporate income tax forms and instructions to reflect the federal tax changes affecting South Carolina. While these changes are more extensive than in most years, the agency expects to complete the changes with existing resources. Additionally, the bill as amended requires DOR, in coordination with RFA, to provide a report by January 15, 2025, detailing the tax provisions that will expire after tax year 2025. We expect the report will be completed with existing staff, and this requirement will not impact expenses for either agency.

State Revenue
H. 5341 updates South Carolina's conformity to the Internal Revenue Code (I.R.C.) through February 9, 2018, and any provisions that expired on December 31, 2017, that are extended but

not amended by congressional enactment during 2018. Conforming to changes to the I.R.C. through February 9, 2018, will incorporate the changes in both the Tax Cuts and Jobs Act of 2017 (H.R.1) and the Bipartisan Budget Act of 2018 (H.R.1892). The bill as amended specifies additional I.R.C. sections not adopted by the State and adds a state deduction for dependents in South Carolina that equals $4,110 for tax year 2018, with dependents under six receiving a total exemption of $8,220.

This revenue impact includes a recalculation of South Carolina individual income tax returns with the proposed changes and incorporates our analysis on the impact of the federal Tax Cuts and Jobs Act (TCJA) with adjustments for the altered provisions. Due to the interactions between the many provisions modified in this bill, RFA is unable to isolate the revenue impact of each individual provision, and we have reported the impact in total. The interactions previously estimated for the TCJA in its entirety relied upon analysis of the individual components by the federal Joint Committee on Taxation that we are unable to replicate separately.

Pursuant to the bill as amended, all provisions of TCJA and the Bipartisan Budget Act are enacted except for state specific modifications contained in this bill as amended. The following summary is limited to provisions expected to have an impact on South Carolina of at least one-tenth (±0.1) percent of income tax revenue. All provisions are applicable beginning in tax year 2018 unless otherwise specified. The numbered paragraphs below conform to the line numbers in enclosed Table 1.

1. Standard deduction: The basic standard deduction is increased to $12,000 for singles, $24,000 for married joint filers, and $18,000 for head of household filers for tax year 2018 and adjusted for inflation in subsequent tax years.

2. Itemized deductions: Itemized deductions are adjusted to limit the deduction for taxes paid to up to $10,000 of property taxes. (South Carolina does not conform to the deduction for state and local income or sales taxes subject to the limitation at the federal level.) Deductions for expenses subject to the 2 percent AGI floor are eliminated, and include unreimbursed employee expenses, investment expenses, and tax preparation expenses, among others. The deduction for home interest expense is limited to $750,000 of acquisition debt (as opposed to $1,000,000) for mortgages acquired after December 31, 2017.

    a. The deduction for medical expenses is modified to lower the expense limitation from the excess above 10 percent of AGI to 7.5 percent above AGI for all taxpayers and applies for tax year 2018 and retroactively for tax year 2017. This provision applies to all taxpayers for two years only. In tax year 2016, the 7.5 percent floor only applied to taxpayers age 65 or over. All taxpayers will be subject to the 10 percent floor beginning in tax year 2019.

3. Personal exemption/Dependent exemption: The federal personal exemption is reduced to $0. This federal elimination is modified in H. 5341 to replace the personal exemption with a dependent exemption. The proposed dependent exemption in the bill as amended is $4,110.

4. Dependents under 6: South Carolina provides an additional deduction for each dependent under age 6 equal to the amount of the federal personal exemption that is set to $0 by TCJA. In the bill as amended, the additional exemption for dependents under six is set to the new state dependent exemption amount of $4,100, yielding total exemptions of $8,220 for dependents under age six.

5. 529 Plan: TCJA changes the restrictions on usage for funds in a 529 plan. Funds contributed to a 529 plan are not subject to federal or state taxes if the withdrawals are used for higher education currently. South Carolina taxpayers are allowed a state income tax deduction for contributions. Taxpayers will be able to use 529 plan funds to pay for K-12 education in addition to the current ability to pay for college tuition.

6. Inflation adjustment: The inflation adjustment is modified from the current indexation based upon the Department of Labor's Consumer Price Index for All Urban Consumers (CPI-U) to the Chained Consumer Price Index for All Urban Consumers (C-CPI-U). The C-CPI-U measures the changes in prices over time but also accounts for the ability of individuals to alter consumption patterns in response to price changes. This will lower the inflation adjustment amounts compared to CPI-U over time.

    a. The inflation adjustment applies to the basic standard deduction, additional standard deduction for aged and blind, thresholds for the earned income credit, and IRA contribution limits and deductible amounts, among other items.

    b. The provision retains the current inflation adjustments based upon CPI-U for all inflation adjusted tax parameters through tax year 2017 and begins adjusting based upon C-CPI-U for tax year 2018 forward.

    The bill as amended further amends the state income tax bracket inflation adjustment in Section 12-6-520 from half to full inflation beginning in tax year 2019 using the new C-CPI-U with the tax year 2018 brackets as the base.

7. Pass-through deduction for qualified business income: Business income from partnerships, S corporations, and sole proprietorships taxed as pass-through income on the individual income tax return is eligible for a 20 percent deduction subject to limitations. The deduction applies to qualified business income and the limitation on specified service businesses and the wage limit are phased-in for incomes over the threshold amounts of $157,500 for single filers and $315,000 for joint filers. This provision is specifically not adopted in this bill.

8. Pass-through loss limitation: This provision limits the amount of business losses a taxpayer may claim. Any net business loss in excess of $250,000 for single filers or $500,000 for married filers may not be claimed in the current year but may be carried forward.

9. Section 179 expensing: This section allows a taxpayer to immediately expense the cost of any qualifying property placed in service subject to limitations. TCJA increases the amount that a taxpayer may expense to $1,000,000 and increases the phase-out threshold

to $2,500,000. The amounts are indexed for inflation. TCJA also expands the definition of qualified real property.

10. Simplified small business accounting: TCJA simplifies the accounting requirements for small businesses with gross receipts of less than $25 million. These taxpayers may use the cash method of accounting, are exempt from the requirement to account for inventories under §471, are exempt from the UNICAP rules, and exempt from the requirement to use the percentage of completion accounting method for long-term construction contracts.

11. Limitation on business interest expense deduction: TCJA limits the deduction for net interest expense incurred by a business. The provision does not apply to businesses with average annual gross receipts of $25 million or less. This provision is specifically not adopted in this bill.

12. Net operating loss deduction: A net operating loss (NOL) deduction is the amount by which a taxpayer's current year business deductions exceed its gross income. Currently, these losses may not be deducted in the year generated but may be carried back two years and forward twenty under federal law. TCJA limits the deduction to 80 percent of taxable income and requires that amounts carried to other years be adjusted to account for the limitation for losses, and losses may be carried forward indefinitely. TCJA also eliminates carrybacks, but S.C. does not currently allow carrybacks.

13. Deduction for foreign-source portion of dividends: The new law provides a 100 percent deduction for the foreign-source portion of dividends received from specified 10 percent owned foreign corporations by domestic corporations that are 10 percent shareholders of those foreign corporations.

14. Treatment of deferred foreign income: TCJA imposes a one-time mandatory tax on post-1986 accumulated foreign earnings. The provision requires any U.S. shareholder of a specified foreign corporation to include in income its pro-rata share of the accumulated post-1986 deferred foreign income of the corporation. This provision is specifically not adopted in this bill.

State Specific Modifications. Proposed state specific modifications to Section 12-6-50 contained in the bill include non-conforming to the following:

- federal limits on interest expense deductions to 30 percent of adjusted taxable income

- new rules on foreign income deductions related to foreign-derived intangible income and amounts paid pursuant to a hybrid transaction or paid by or to a hybrid entity

- federal deduction of up to 20 percent of income from partnerships, sole proprietorships, and other pass-through businesses

- federal provision that eliminated tax deductions for insurance premiums paid to the FDIC by banks and savings and loan institutions.

- amend current non-conforming statute to adopt the federal Opportunity Zone tax benefits. This federal provision allows investors to defer (up to 9 years) paying tax on gains if those gains are invested in Qualified Opportunity Funds that in turn invest in economically distressed communities designated by the governor.

Tax Year 2017.

The federal tax changes affected a number of provisions for tax year 2017. The Bipartisan Budget Act extended eleven provisions that expired on December 31, 2016, affecting approximately $11,790,000 in tax revenue. (These provisions are discussed in our impact statement for S. 250 of 2017.) In November 2017 when the Board of Economic Advisors set the initial forecast for FY 2018-19, the expectation was that Congress would extend these expiring federal tax provisions. The General Fund forecast included the revenue impact of extending these provisions as part of the income tax base since most of these provisions have been in effect for many years. Therefore, extending these provisions will have no effect on the revenue estimate. Three other miscellaneous new provisions added by the act are included in this analysis.

Further, TCJA lowered the adjusted gross income threshold for medical deductions for individuals under age 65 retroactively for tax year 2017. Based upon timing for the changes during tax year 2017 filings due in April 2018, we anticipate that taxpayers may have claimed many of these federal tax provisions since South Carolina typically conforms to them, even though technically the state has not adopted conformity. However, there may be taxpayers who will file for tax year 2017 refunds in FY 2018-19 if these provisions are adopted. At this time we do not have sufficient data to estimate the amount that may be refunded but do not expect this to have a material impact on tax collections.

Tax Year 2018 and 2019.

Table 1 outlines the impact of conforming to the federal tax changes as outlined above before the proposed additional changes to state tax law in the bill as amended. Adoption of these federal tax changes and the state non-conforming items would result in a $253,000,000 increase in General Fund individual income tax collections and no net revenue change to corporate income tax collections in FY 2018-19.

The bill as amended eliminates this potential $253,000,000 revenue impact by implementing dependent exemptions. Under current law, taxpayers receive a federal personal exemption for each tax filer and dependent on a return. TCJA set this amount to $0, effectively eliminating personal exemptions at the federal level. The bill as amended implements a state dependent exemption of $4,110 for each dependent, including both qualifying children and relatives, claimed on a tax return. This dependent exemption does not apply to tax filers, only dependents. Under current law, taxpayers also receive an additional state exemption for dependents under age 6 equal to the amount of the federal personal exemption. TCJA effectively eliminates the additional state exemption for each dependent under age 6. However, the bill as amended provides an additional $4,110 exemption for dependents under age 6, yielding total exemptions of $8,220 for dependents under age 6.

The bill as amended further amends the state income tax bracket inflation adjustment in Section 12-6-520 from half to full inflation not to exceed 4 percent beginning in tax year 2019 using the new C-CPI-U with the tax year 2018 brackets as the base.

In summary, this bill as amended is not expected to impact General Fund revenue in FY 2018-19. Table 2 provides the individual income tax impact on taxpayers by adjusted gross income range for tax year 2018. Adjusting the tax brackets for full inflation beginning in tax year 2019 will decrease General Fund individual income tax revenue by approximately $4,000,000 in FY 2019-20.

Local Expenditure
N/A

Local Revenue
N/A

Introduced on May 1, 2018
State Expenditure
The Department of Revenue will update the individual and corporate income tax forms and instructions to reflect the federal tax changes affecting South Carolina. While these changes are more extensive than in most years, the agency expects to complete the changes with existing resources. Therefore, this bill does not have an expenditure impact on the General Fund, Other Funds, or Federal Funds.

State Revenue
This bill updates South Carolina's conformity to the Internal Revenue Code (IRC) through February 9, 2018, and any provisions that expired on December 31, 2017, that are extended but not amended by congressional enactment during 2018. Conforming to changes to the IRC through February 9, 2018, will incorporate the changes in both the Tax Cuts and Jobs Act of 2017 (H.R.1) and the Bipartisan Budget Act of 2018 (H.R.1892). The bill specifies additional IRC Sections not adopted by the State and adds a state deduction for personal exemptions in South Carolina that equals $1,525 for tax year 2018.

Unlike in most years, our analysis of conformity is complicated by the significant changes Congress made to the federal tax code and the retroactive provisions and extensions for 2017. Given the complexities, our analysis first discusses the details of federal tax reform. We then analyze the state specific modifications contained in the bill. Adoption of these federal tax changes and the state non-conforming items would result in a $253,000,000 increase in General Fund individual income tax collections and no net revenue change to corporate income tax collections in FY 2018-19. Table 1 provides a summary of this analysis.

However, the bill eliminates this potential $253,000,000 revenue impact by implementing a $1,525 personal exemption for South Carolina taxpayers and dependents. Table 2 provides the projected impact on taxpayers for ranges of federal adjusted gross income (AGI). We estimate that 945,595 tax returns (39.6 percent) would experience a decrease in state tax liability, 415,151 returns (17.4 percent) would experience an increase in state tax liability, and 1,024,748 returns (43 percent) would be unaffected.

We finalize this analysis by examining the fiscal impact from not adopting the recent federal tax reforms.

Federal Tax Reform. Federal tax reform in the Tax Cuts and Jobs Act of 2017 (TCJA) substantially affected both the definition and calculation of taxable income, and Congress took the additional step of lowering federal tax rates to offset potential tax increases. Please note, in this analysis there are some limitations that may affect our estimates:

- The estimates provided are determined with the interactions from all provisions included based upon estimates by the Joint Committee on Taxation. If each provision was examined individually, a different fiscal impact for that provision may result.
- Federal tax forms have not been produced to provide guidance on how many of the federal changes will be implemented. This adds to the uncertainty of the revenue estimates.

The Bipartisan Budget Act (BBA) extended eleven provisions affecting South Carolina that expired on December 31, 2017. In November 2017 when the Board of Economic Advisors set the initial forecast for FY 2018-19, the expectation was that Congress would extend these expiring federal tax provisions. The General Fund forecast included the revenue impact of extending these provisions as part of the income tax base since most of these provisions have been in effect for many years. Therefore, extending these provisions will have no effect on the revenue estimate. Three other miscellaneous new provisions added by the act are included in this analysis.

The following summary is limited to provisions expected to have an impact on South Carolina of at least one-tenth (±0.1) percent of income tax revenue. All provisions are applicable beginning in tax year 2018 unless otherwise specified. The numbered paragraphs below conform to the line numbers in Table 1.

15. Standard deduction: The basic standard deduction is increased to $12,000 for singles, $24,000 for married joint filers, and $18,000 for head of household filers for tax year 2018 and adjusted for inflation in subsequent tax years. (The current basic standard deduction for tax year 2017 is $6,350 for singles, $12,700 for married joint filers, and $9,525 for head-of-household.) The current additional standard deduction for taxpayers who are age 65 or over and/or legally blind is retained. This amount is $1,550 for single filers ($3,100 if aged and blind) and $1,250 per taxpayer for married joint filers ($2,500 per taxpayer if aged and blind).

16. Itemized deductions: Itemized deductions are adjusted to limit the deduction for taxes paid to up to $10,000 of property taxes. (South Carolina does not conform to the deduction for state and local income or sales taxes subject to the limitation at the federal level.) Deductions for expenses subject to the 2 percent AGI floor are eliminated, and include unreimbursed employee expenses, investment expenses, and tax preparation expenses, among others. The deduction for home interest expense is limited to $750,000

of acquisition debt (as opposed to $1,000,000) for mortgages acquired after December 31, 2017.

a. The deduction for medical expenses is modified to lower the expense limitation from the excess above 10 percent of AGI to 7.5 percent above AGI for all taxpayers and applies for tax year 2018 and retroactively for tax year 2017. This provision applies to all taxpayers for two years only. In tax year 2016, the 7.5 percent floor only applied to taxpayers age 65 or over. All taxpayers will be subject to the 10 percent floor beginning in tax year 2019.

17. Personal exemptions: The personal exemption is eliminated. (Estimated to be $4,150 for tax year 2018) This federal elimination is modified in the bill to allow a deduction of $1,525 for each personal exemption.

18. Dependents under 6: South Carolina provides an additional deduction for each dependent under age 6 equal to the amount of the federal personal exemption. Since the federal personal exemption is eliminated, or effectively $0, the state additional deduction for dependents under age 6 is eliminated for tax year 2018.

19. 529 Plan: The Act changes the restrictions on usage for funds in a 529 plan. Funds contributed to a 529 plan are not subject to federal or state taxes if the withdrawals are used for higher education currently. South Carolina taxpayers are allowed a state income tax deduction for contributions. Taxpayers will be able to use 529 plan funds to pay for K-12 education in addition to the current ability to pay for college tuition.

20. Inflation adjustment: The inflation adjustment is modified from the current indexation based upon the Department of Labor's Consumer Price Index for All Urban Consumers (CPI-U) to the Chained Consumer Price Index for All Urban Consumers (C-CPI-U). The C-CPI-U measures the changes in prices over time but also accounts for the ability of individuals to alter consumption patterns in response to price changes. This will lower the inflation adjustment amounts compared to CPI-U over time.
    a. The inflation adjustment applies to the basic standard deduction, additional standard deduction for aged and blind, thresholds for the earned income credit, and IRA contribution limits and deductible amounts, among other items.
    b. The provision retains the current inflation adjustments based upon CPI-U for all inflation adjusted tax parameters through tax year 2017 and begins adjusting based upon C-CPI-U for tax year 2018 forward.

21. Pass-through deduction for qualified business income: Business income from partnerships, S corporations, and sole proprietorships taxed as pass-through income on the individual income tax return is eligible for a 20 percent deduction subject to limitations. The deduction applies to qualified business income and the limitation on specified service businesses and the wage limit are phased-in for incomes over the threshold amounts of $157,500 for single filers and $315,000 for joint filers. This provision is specifically not adopted in this bill.

22. Pass-through loss limitation: This provision limits the amount of business losses a taxpayer may claim. Any net business loss in excess of $250,000 for single filers or $500,000 for married filers may not be claimed in the current year but may be carried forward.

23. Section 179 expensing: This section allows a taxpayer to immediately expense the cost of any qualifying property placed in service subject to limitations. The Act increases the amount that a taxpayer may expense to $1,000,000 and increases the phase-out threshold to $2,500,000. The amounts are indexed for inflation. The Act also expands the definition of qualified real property.

24. Simplified small business accounting: The Act simplifies the accounting requirements for small businesses with gross receipts of less than $25 million. These taxpayers may use the cash method of accounting, are exempt from the requirement to account for inventories under §471, are exempt from the UNICAP rules, and exempt from the requirement to use the percentage of completion accounting method for long-term construction contracts.

25. Limitation on business interest expense deduction: The Act limits the deduction for net interest expense incurred by a business. The provision does not apply to businesses with average annual gross receipts of $25 million or less. This provision is specifically not adopted in this bill.

26. Net operating loss deduction: A net operating loss (NOL) deduction is the amount by which a taxpayer's current year business deductions exceed its gross income. Currently, these losses may not be deducted in the year generated but may be carried back two years and forward twenty under federal law. The Act limits the deduction to 80 percent of taxable income and requires that amounts carried to other years be adjusted to account for the limitation for losses, and losses may be carried forward indefinitely. The Act also eliminates carrybacks, but S.C. does not currently allow carrybacks.

27. Deduction for foreign-source portion of dividends: The new law provides a 100 percent deduction for the foreign-source portion of dividends received from specified 10 percent owned foreign corporations by domestic corporations that are 10 percent shareholders of those foreign corporations.

28. Treatment of deferred foreign income: The Act imposes a one-time mandatory tax on post-1986 accumulated foreign earnings. The provision requires any U.S. shareholder of a specified foreign corporation to include in income its pro-rata share of the accumulated post-1986 deferred foreign income of the corporation. This provision is specifically not adopted in this bill.

State Specific Modifications. Proposed state specific modifications contained in the bill include non-conforming to the following:

- federal limits on interest expense deductions to 30 percent of adjusted taxable income

- new rules on the treatment of deferred foreign income to continue to the current deferment of foreign income until it is distributed to a U.S. pass-through entity or corporation
- a federal provision that would tax the fair market value of a contribution by a government entity or civic group to a corporation
- federal deduction of up to 20 percent of income from partnerships, sole proprietorships, and other pass-through businesses
- federal provision that eliminated tax deductions for insurance premiums paid to the FDIC by banks and savings and loan institutions.
- amend current non-conforming statute to adopt the federal Opportunity Zone tax benefits. This federal provision allows investors to defer (up to 9 years) paying tax on gains if those gains are invested in Qualified Opportunity Funds that in turn invest in economically distressed communities designated by the governor.

One additional state modification proposed by the bill is the implementation of a $1,525 personal exemption for taxpayers and dependents in tax year 2018. This deduction must be adjusted for inflation annually pursuant to IRC Section 1(f).

In summary, we anticipate that this bill, including all proposed federal and state specific changes, will have no expenditure or revenue impact on the General Fund, Other Funds, or Federal Funds.

Fiscal Impact of Non-Conformity. Unlike with most bills, there is a fiscal impact associated with not maintaining or significantly changing income tax conformity. As detailed above, adopting the definition changes by Congress without any change to the state tax system would increase total individual and corporate income tax collections. If no action were taken, the state income tax code essentially would be frozen to match the federal tax code through December 31, 2016. This represents a major change in tax administration and policy, and the short timeframe for implementing this change successfully may lead to unintended and possibly significant impacts on state revenues and our forecast.

South Carolina changed its income tax law in 1985 by conforming to the federal income tax provisions. Some of the reasons for this change were to make tax compliance easier for taxpayers and to reduce administrative costs by relying on the Internal Revenue Service (IRS) to perform certain functions instead of duplicating these at the state level. We are concerned a decision to non-conform will affect this process and compliance, and therefore, affect state revenues by any one of several ways.

One, South Carolina is one of the six states most reliant on the IRS in that we conform to federal taxable income, whereas many states only conform to federal adjusted gross income. Nonconformity will severely limit the ability of South Carolina to rely on legal interpretations and guidance from the IRS, the U.S. Treasury Department, and federal courts and increase the demand on the available resources within DOR to address and respond to these issues. DOR believes it has the authority to continue the 2016 federal tax code and make the traditional inflationary adjustments for 2017 and 2018. DOR is committed to making such a transition as effectively as possible. However, this is a major undertaking, and we believe the likelihood of successfully and completely accomplishing this challenge within a few months without disrupting the income tax processing cycle, and therefore revenue collections, is low. Our hope is any disruption would be minor, but the potential range is broad.

A second consequence is the challenge this will present to taxpayers and tax preparers in trying to understand and prepare the new returns. Some specific examples of these challenges are:

- Taxpayers will no longer be able to use their federal tax return or will have to make significant adjustments before determining their state tax liability for tax year 2018. DOR will now have to prepare and issue forms and instructions for taxpayers to reference the federal tax code prior to the updates in TCJA or BBA. Normally, DOR begins distributing information for tax filing in September. Given these changes in tax law and this new scope of duties, we believe this traditional timeframe for preparing, distributing, and receiving tax forms could be delayed. If this process is delayed significantly, the availability of tax preparation software to taxpayers and tax professionals may be reduced. Approximately 87 percent of tax returns were filed electronically in recent tax years. If electronic filings are reduced significantly and taxpayers must file paper returns, the tax-processing schedule would be affected by not only the delay, but also slower processing and could affect revenues in FY 2018-19 and FY 2019-20.
- Educating taxpayers will be a challenge. Once DOR distributes the new forms and instructions, these changes will have to be communicated to taxpayers to avoid a reduction in compliance. Decoupling from the federal tax code and requiring different calculations on the state return will add a new source of confusion for the taxpayer and probably will result in delayed preparation and processing of tax returns. Additionally, the prevalence of returns with errors may increase. Over the past three years, approximately ten percent of returns were flagged as errors and required additional review.
- Taxpayers who itemized deductions under current state law may experience a tax increase due to the change in the standard deduction. TCJA significantly increased the amount of the standard deduction for federal income tax. The basic standard deduction for tax year 2017 was $6,350 for singles, $12,700 for married joint filers, and $9,525 for head-of-household. Under TCJA, the federal basic standard deduction for tax year 2018 is increased to $12,000 for singles, $24,000 for married joint filers, and $18,000 for head of household filers. Section 12-6-40(B) requires that all elections made for federal income tax purposes in connection with Internal Revenue Code sections adopted by the state automatically apply for South Carolina income tax purposes unless otherwise provided. Absent further legislative changes, DOR expects that if taxpayers elect the federal standard deduction for federal income tax purposes, they would be required to elect the lower state standard deduction for state income taxes. Since South Carolina will no longer conform to the federal standard deduction, any taxpayers with total itemized deductions falling between the state standard deduction and the new higher federal standard deduction would lose the benefit of their itemized deductions.
- Additionally, taxpayers who continue to itemize on their federal return may not itemize their deductions properly under the rules prior to TCJA. TCJA changed the itemized deduction rules. The deduction for state and local taxes paid is limited to $10,000 starting with tax year 2018, which would not apply under this legislation. Deductions for expenses subject to the 2 percent AGI floor are eliminated at the federal level and include unreimbursed employee expenses, investment expenses, and tax preparation expenses,

among others. The deduction for home interest expense is limited to $750,000 of acquisition debt (as opposed to $1,000,000) for mortgages acquired after December 31, 2017. If taxpayers do not properly account for these itemized deductions, this may increase or decrease their tax liability, depending upon the taxpayers' circumstances.

- Not conforming to the tax year 2018 changes will complicate tax filings for companies as well. Corporate income taxes also start with federal taxable income for state tax purposes. Not adopting these changes will require companies to recalculate their taxable income under the 2017 federal tax laws. For multistate corporations filing consolidated returns, not adopting the federal tax changes may cause particular complications.

Finally, in addition to the cost savings by relying on the administrative services by the IRS, the state also benefits from conformity through audit revenues by being able to "piggyback" off IRS audits. Under conformity, if the IRS has an audit finding and issues a tax adjustment, the state is able accept this finding and issue a state tax adjustment. DOR has informed us that the state receives tens of millions of dollars stemming from these IRS audits. Without conformity, DOR will not be able to rely on IRS audits and instead would have to identify these problems itself. Its ability to replicate this function, especially in a short time frame and without impacting the current level of revenues, is a concern.

Local Expenditure
N/A

Local Revenue
N/A

Frank A. Rainwater, Executive Director

Summary of Impact on South Carolina Income Tax Revenue of Conformity * Table 1

For Internal Revenue Code Changes Through February 9, 2018 - FY 2018-19 (Millions of Dollars)

	Individual Income Tax		Corporate Income Tax	
Individual Income Tax Only				
1. Standard Deduction	$	(241)		
2. Itemized Deductions	$	77		
3. Personal Exemption	$	364		
4. SC Dependents Under 6 Exemption [a]	$	49		
5. 529 Plan Changes [a]	$	(5)		
6. Inflation Change [b]	$	2		
Other (net) [c]	$	0		
Individual Excluding Pass-Through Only	**$**	**246**		
~~7. Pass-Through Deduction [d]~~	$	-		
8. Pass-Through Loss Limitation	$	16		
Pass-Through Business Only	**$**	**16**		
Individual Income Only Total	**$**	**262**		
Business (Individual and Corporate Income Tax)				
9. Section 179 Expensing	$	(8)	$	(3)
10. Simplified Small Business Accounting	$	(12)	$	(2)
~~11. Limit on Interest Expense Deduction~~	$	-	$	-
12. Modified Net Operating Loss Deduction	$	6	$	6
Other (net) [c]	$	5	$	5
Business (Individual and Corporate Income Tax) Total	**$**	**(9)**	**$**	**5**
Corporate Income Tax Only				
13. Deduction for Foreign-source Dividends			$	(6)
~~14. Treatment of Deferred Foreign Income~~			$	-
Other (net) [c]			$	(0)
Corporate Income Tax Only Total			**$**	**(6)**
TOTAL	**$**	**253**	**$**	**(0)**

Notes:

Details may not add to totals due to rounding.

Estimates are based upon a combination of estimates by the Joint Committee on Taxation and estimates by RFA staff based upon additional information from the S.C. Department of Revenue, analysis of S.C. individual income tax returns, and input from subject matter experts. Items 9 and 10 revised based upon additional information.

Each estimate includes interactions from other changes.

[a]- Impact specific to SC; Estimate by RFA

[b]- Increases above revenue threshold of ± 0.1% of revenue in year 2

[c] - Net impact of items impacting less than ± 0.1% of state income tax revenue

[d] - Estimate assumes the deduction will impact S.C. active trade or business income

*Nonconform to passthrough deduction (§199A), interest expense limitation (§§163(j),381(c)(20), 382(d)(3)), foreign income deduction changes (§§250, 267A), contributions to capital (§118(b)(2)), and FDIC premium deduction (§162(r)).

Table 2

PROJECTED IMPACT ON STATE INDIVIDUAL INCOME TAX FOR TAX YEAR 2018
SCENARIO - H.5341 Amended by Senate Finance Subcommittee on Conformity on Sep. 18, 2018

Projected *Federal Adjusted Gross Income* Range	Projected # of Returns	Projected % of Returns	Change in Net Tax Liability in Range	Avg. Change in Net Tax Liability in Range	Tax Decrease # of Returns	Tax Decrease % of Returns	Average Decrease Amount	Tax Increase # of Returns	Tax Increase % of Returns	Average Increase Amount	No Tax Change # of Returns	No Change % of Returns
Column 1	**Column 2**	**Column 3**	**Column 4**	**Column 5**	**Column 6**	**Column 7**	**Column 8**	**Column 9**	**Column 10**	**Column 11**	**Column 12**	**Column 13**
$0	24,957	1.0%	$204,000	$8	165	0.7%	($117)	361	1.4%	$618	24,431	97.9%
$1-$10,000	301,760	12.6%	($2,000)	($0)	189	0.1%	($59)	125	0.0%	$73	301,445	99.9%
$10,001-$20,000	378,838	15.9%	($3,398,000)	($9)	84,805	22.4%	($41)	1,651	0.4%	$51	292,382	77.2%
$20,001-$30,000	324,595	13.6%	($9,685,000)	($30)	138,849	42.8%	($76)	6,918	2.1%	$130	178,828	55.1%
$30,001-$40,000	253,886	10.6%	($14,282,000)	($56)	148,207	58.4%	($114)	12,385	4.9%	$216	93,295	36.7%
$40,001-$50,000	186,457	7.8%	($12,752,000)	($68)	128,461	68.9%	($133)	17,569	9.4%	$247	40,427	21.7%
$50,001-$75,000	311,678	13.1%	($15,658,000)	($50)	217,062	69.6%	($140)	50,714	16.3%	$291	43,902	14.1%
$75,001-$100,000	199,641	8.4%	($5,046,000)	($25)	133,967	67.1%	($148)	43,057	21.6%	$342	22,617	11.3%
$100,001-$125,000	130,161	5.5%	$576,000	$4	85,507	65.7%	($151)	36,239	27.8%	$372	8,415	6.5%
$125,001-$150,000	77,608	3.3%	$4,967,000	$64	45,150	58.2%	($149)	27,523	35.5%	$424	4,935	6.4%
$150,001-$175,000	47,077	2.0%	$5,836,000	$124	23,334	49.6%	($145)	20,255	43.0%	$455	3,488	7.4%
$175,001-$200,000	30,587	1.3%	$5,275,000	$172	13,157	43.0%	($140)	14,600	47.7%	$487	2,830	9.3%
$200,001-$250,000	35,115	1.5%	$8,401,000	$239	12,168	34.7%	($137)	19,255	54.8%	$523	3,692	10.5%
$250,001-$300,000	19,239	0.8%	$5,799,000	$301	5,032	26.2%	($132)	11,546	60.0%	$560	2,660	13.8%
$300,001-$500,000	30,243	1.3%	$11,512,000	$381	5,147	17.0%	($130)	19,400	64.1%	$628	5,696	18.8%
$500,001-$750,000	12,238	0.5%	$5,743,000	$469	1,067	8.7%	($134)	7,944	64.9%	$741	3,227	26.4%
$750,001-$1,000,000	5,678	0.2%	$2,919,000	$514	348	6.1%	($144)	3,547	62.5%	$837	1,783	31.4%
$1,000,000+	15,736	0.7%	$9,594,000	$610	601	3.8%	($156)	9,171	58.3%	$1,056	5,965	37.9%
Total	2,385,493		$0	$0	1,043,216	43.7%	($121)	302,260	12.7%	$418	1,040,018	43.6%

Columns may not add to totals due to rounding.

- **43.7% of returns will have a decreased tax liability**
- **12.7% of returns will have an increased tax liability**
- **43.6% of returns will have an unchanged tax liability**
- **46.2% of returns will have zero tax liability**

Dependent Exemption (no personal exemption)
$ 4,110 Age 6 and over $ 8,220 Under 6

Exceptions: Conform to federal tax changes except for passthrough deduction (§199A), interest expense limitation (§§163(j),381(c)(20), 382(d)(3)), foreign income deduction changes (§§250, 267A), contributions to capital (§118(b)(2)), and FDIC premium deduction (§162(r)).