

Draft Report - South Carolina Taxation Realignment Commission (TRAC)

“Timely Conformity” - Issues, Concerns and TRAC’s recommendations

As previously discussed, South Carolina’s income tax laws are modeled after federal income tax laws. According to S.C. Code § 12-6-40(B), “All elections made for federal income tax purposes in connection with Internal Revenue Code sections adopted by this State automatically apply for South Carolina income tax purposes unless otherwise provided.” South Carolina follows the majority of the provisions of the Internal Revenue Code (IRC), with certain exceptions. Where states conform to the IRC, the state tax calculation begins with federal taxable income as the starting point, or states may conform to certain definitions contained in the IRC (e.g. “income”, “deduction”, etc.).¹

South Carolina, primarily for simplicity, administrative, and taxpayer friendly reasons, adopts “federal taxable income” as its starting point for determining state taxable income. Related advantages to federal “conformity” include uniformity, the simplicity of a single starting point and reduction of compliance costs.² Taxpayers, tax preparers and state administrative personnel may also be able to rely on federal interpretations (IRC rulings, procedures, and pronouncements) when analyzing state tax treatment of issues that arise related to federal conformity.³

Disadvantages to federal conformity may include a delegation of policy making power from the state to the federal level and, related, a lessening of control by the state over federal tax policy that could have an adverse impact on state revenue.⁴

The overwhelming majority of states “conform” in some aspect(s) to the IRC. Most of these states utilize one of two methods to conform to the IRC; either “rolling conformity” or “fixed date conformity”. When a state’s tax code is written to automatically adopt federal tax law, and any changes to it, on a continual basis, it is referred to as “rolling conformity”. 21 states currently utilize the “rolling conformity” method.⁵

The primary advantage to rolling conformity is a level of “certainty” it provides both taxpayers and tax preparers. The “rules of the game” (and how they will be applied), are often known well in advance of tax filing deadlines. As a result, rolling conformity, and the certainty that it offers, is generally considered to be less burdensome for taxpayers/preparers from a compliance standpoint.⁶ As noted above, disadvantages relate to a greater loss of state policy making power to the federal government and issues related to state revenue concerns resulting from federal tax law changes.

In contrast to rolling conformity, a state’s tax code might be written so that it reflects the federal tax code (and changes to it) as of a certain “date”. This method of conformity is commonly referred to as “fixed date” conformity. South Carolina and 20 other states follow “fixed date” conformity.⁷ It is common practice among most “fixed date” states to routinely “move” their dates forward each year.⁸ As such, fixed date conformity requires deliberate legislative action to be taken each year by a state’s legislature to update the state income tax laws to changes in the IRC.⁹ Currently, South Carolina’s “date” through which it has conformed to the IRC is December 31, 2009.¹⁰

The primary advantage of “fixed date” conformity is the ability it gives states to examine changes made to federal tax law during the prior year to determine whether or not the state should conform to those changes (e.g. “adopt” them) or if it should “opt out” (e.g. “decouple” from) of specific changes due to potential revenue or other tax policy concerns.

A primary disadvantage of fixed date conformity is actually a derivative of its primary advantage, namely, the requirement for deliberate legislative action to be taken each year to conform. Problems arise

when delays, sometimes lengthy, in legislative action create uncertainty for taxpayers and tax preparers as to what federal provisions will or will not be adopted by the state, if at all.¹¹ And while conformity legislation almost always ultimately passes, it is not uncommon that legislative delays force passage well after tax filing deadlines, creating compliance burdens for taxpayers and preparers alike.

South Carolina's General Assembly has not been immune to these concerns, but has in recent years attempted to effectuate a more "timely" passage of the State's annual federal tax conformity bill. TRAC commends the General Assembly for "detangling" conformity provisions from what is commonly referred to as the state's annual "BAT" (Big Annual Tax) bill which historically has been one of the last bills to pass (if it passes) each legislative session. Passage of conformity so late in a session means there is no certainty as to what federal changes the State will (or will not) conform to, often as late as May or June, months past both the individual and corporate tax filing deadlines.

In an effort to further prioritize the importance of timely conformity, conformity provisions, usually introduced in the House, were instead introduced in the Senate last session (S. 1174) so that the bill could be debated by that body prior to it receiving the budget from the House, a fact that helped to expedite the process (and the bill's ultimate passage).¹²

And while TRAC applauds both these recent approaches by the General Assembly to take action on conformity legislation in a more timely manner, it recommends that they (the General Assembly) consider implementation of one (or more) of the following actions to better ensure timely passage of conformity.

1) Thoroughly study the "pros and cons" (as briefly discussed herein) of "rolling conformity" for adoption here in South Carolina. As noted above, "rolling conformity" is the method of conformity used by 21 states. In its analysis of possible implementation, the General Assembly should give consideration to development of a system under which, by a date certain, the General Assembly would be provided a complete list of federal law changes by the Department of Revenue, along with a revenue analysis by the Board of Economic Advisors as to what impact those changes would have on state revenue, if any. If such information is determined to warrant "decoupling" from one or more federal law changes, legislation could then be introduced for expedited passage by the General Assembly (see 2)c) below).

2) Fixed-date conformity. If the General Assembly determines that rolling conformity is not a viable option for the State, TRAC recommends the following amendments to the current process to ensure timely passage:

a) Continue recent practice of introducing conformity as free-standing legislation and prohibit amendments unrelated to conformity (bobtailing). Such non-germane amendments inevitably slow down conformity's passage.

b) Add a statutory requirement that the Department of Revenue, in conjunction with the Board of Economic Advisors, provide a detailed analysis (include revenue impacts, if any) to the General Assembly of federal law changes to the IRC by a date certain.

c) Pass a "rule". Both bodies of the General Assembly should add to their respective "rules" a requirement that conformity legislation must pass each body by a date certain. There is precedent in current House and Senate rules regarding actions being taken by certain dates.¹³ TRAC recommends that, whatever the respective dates are, ultimate passage allow for an effective date of no later than March 1 of any given year. Annual passage of conformity no later than March 1 will provide both taxpayers and tax

preparers' ample time to "know the rules of the game". Such certainty will reduce taxpayer/preparer burden while increasing compliance.

Notes:

1. www.scstatehouse.gov/citizensinterestpage/TRAC/021910Meeting/Conformity.pdf. Page 2 of link, bullet under "Federal Conformity".
2. www.scstatehouse.gov/citizensinterestpage/TRAC/021910Meeting/Conformity.pdf. Page 1 of link, footnote "1".
3. www.scstatehouse.gov/citizensinterestpage/TRAC/021910Meeting/Conformity.pdf. Page 1 of link, "A. State Conformity to Federal Provisions in General".
4. www.scstatehouse.gov/citizensinterestpage/TRAC/021910Meeting/Conformity.pdf. Page 1 of link, footnote "1".
5. www.scstatehouse.gov/citizensinterestpage/TRAC/021910Meeting/Conformity.pdf. Page 2 of link, bullet under "Federal Conformity".
6. www.scstatehouse.gov/citizensinterestpage/TRAC/021910Meeting/Conformity.pdf. Page 2 of link, bullet under "Federal Conformity".
7. www.scstatehouse.gov/citizensinterestpage/TRAC/021910Meeting/Conformity.pdf. Page 2 of link, bullet under "Federal Conformity".
8. <http://www.cbpp.org/cms/index.cfm?fa=view&id=1051>. Page 3 of link.
9. www.scstatehouse.gov/citizensinterestpage/TRAC/021910Meeting/Conformity.pdf. Page 2 of link, bullet under "Federal Conformity".
10. Section 12-6-40(A)(1)(a) of the 1976 Code, as last amended by Act 16 of 2009.
11. www.scstatehouse.gov/citizensinterestpage/TRAC/021910Meeting/Conformity.pdf. Page 1 of link, footnote "1".
12. Act 142 of 2010.
13. Examples of current "rules" include:
 - Senate Rule 10
Not later than the first Tuesday in March, the Senate Finance Committee should report to the full Senate the annual Proviso Codification Bill. Notwithstanding the provisions of Rule 24, the Proviso Codification Bill must be composed only of those items that permanently codify a temporary proviso that has been included in the final version of a previous General Appropriations Bill.
 - Senate Rule 47
Bills received after May 1 shall be received, read and referred to the appropriate committee but are not eligible to be taken up until the next regular session unless upon the report of such a bill by a committee it receives a two thirds (2/3) vote of the Senators present and voting to be placed on the calendar. Any bill failing to receive the required vote shall be returned to the committee. The committee report on any such bill received after the May 1 deadline shall clearly indicate that the bill had been received after May 1 and is subject to this rule.
 - House Rule 5.12
No statewide bill or joint resolution, except an appropriations bill, general, supplemental, deficiency, or a joint resolution approving or disapproving regulations of a state agency shall be considered unless (1) such legislation is introduced in the House prior to April fifteenth of the second year of a two-year legislative session or (2) such legislation shall have been introduced in the Senate and received by May first in the House, unless in either event it was introduced in the previous year and was carried over to the year in which it is to be considered; *provided*, however, that nothing herein shall prevent a statewide bill or joint resolution from being received, given first reading, and referred to the appropriate committee.