~~Indicates Matter Stricken~~

Indicates New Matter

COMMITTEE REPORT

February 23, 2011

**S. 522**

Introduced by Senators Leatherman, O’Dell and Setzler

S. Printed 2/23/11--S.

Read the first time February 9, 2011.

**THE COMMITTEE ON FINANCE**

To whom was referred a Bill (S. 522) to amend Section 12‑6‑40, as amended, Code of Laws of South Carolina, 1976, relating to the application of the Internal Revenue Code to State Income, etc., respectfully

**REPORT:**

That they have duly and carefully considered the same and recommend that the same do pass:

HUGH K. LEATHERMAN, SR. for Committee.

**STATEMENT OF ESTIMATED FISCAL IMPACT**

**REVENUE IMPACT 1/**

This bill would decrease general fund income tax revenue by $5,288,658 in FY 2010-11 and increase revenue by $6,312,069 in FY 2011-12.

**Explanation**

This bill updates the conformity of the South Carolina income tax statutes to the Internal Revenue Code as amended through December 31, 2010. Federal law changes were implemented in five separate tax bills enacted at the federal level in 2010. Specific federal tax modifications with significant South Carolina revenue impact include an increase in the maximum amount a taxpayer may expense under Section 179 to $500,000 and increases the phase-out threshold amount to $2,000,000 for tax years 2010 and 2011. The maximum deduction for Section 179 properties was $250,000 with a phase-out threshold of $800,000 in tax years 2008 and 2009. We expect this added incentive to expense properties in the year of purchase rather than depreciate them over many years will reduce general fund income tax revenue by $6,109,541 in FY 2010-11 and $1,897,818 in FY 2011-12. An increase in the amount small businesses may deduct in start-up expenses to $10,000 from the prior $5,000 in tax year 2010 is expected to reduce South Carolina income tax revenue by $828,278 in FY 2010-11 and increase revenue by $9,548 in FY 2011-12 due to fewer deductions in that tax year. Another federal change will allow retirees to rollover qualified distributions from 401(k), 403(b) and 457(b) plans to Roth designated accounts. These rollovers will be taxable at conversion, but tax free when the retirement savings are used in future years. We anticipate that this change will increase income tax revenue by $614,210 in FY 2010-11 and $1,437,687 in FY 2011-12. Health care reform legislation mandates that expenditures for over-the-counter medicines are no longer reimbursable from health savings accounts, Archer medical spending accounts, and health flexible spending arrangements. We anticipate that this change will increase income tax revenue by $1,087,098 in FY 2010-11 and $1,630,647 in FY 2011-12. The final significant revenue impact from the federal changes in 2010 is the reduction in Section 179 expensing maximum amounts to $125,000 from $500,000 and decreasing the phase-out threshold amount to $500,000 from $2,000,000 for tax year 2012. We expect that this additional modification to Section 179 expensing will increase general fund income tax revenue by $5,049,969 in FY 2011-12. Based on our analysis of these changes, we estimate that the net revenue impact of updating IRS conformity would decrease general fund income tax revenue by $5,288,658 in FY 2010-11 and increase revenue by $6,312,069 in FY 2011-12. The Board of Economic Advisors has not accounted for these projected revenue declines or increases in its forecasts of FY 2010-11 or FY 2011-12 general fund revenues. A table summarizing the South Carolina revenue impact from all the recent federal tax changes is below.

**2010 Federal Acts Affecting South Carolina Tax Revenue**

**Line #**

**Effective FY 2010-11 FY 2011-12**

**1 Small Business Jobs Act of 2010**

**2 A. ProvidingAccess to Capital**

**3** 1. Increase in exclusion for gain

from certain small business stock

acquired at original issue and held

for at least 5 years to 100%. The

revenue gain in FY 2011 is from

estimated taxes paid on gains that

exceed the greater of 10 times the

taxpayers' basis or $10 million.

(sunset 12/31/10) DOE 5,435 0

**4** 4. Reduction in recognition period

from 7 years to 5 for built-in gains

tax on the sale of appreciated

assets sold after conversion from

a C corporation to S corporation.

(sunset 12/31/11) tyba -62,759 -12,968

12/31/10

**5 B. Encouraging Investment**

**6** 1. Expand definition of eligible

section 179 property to include

certain real property and increase

maximum amount and phase-out

thresholds to $500,000 and

$2,000,000 respectively from

$250,000 maximum deduction

and $800,000 phase-out threshold

that existed in tax years 2008

and 2009. tyba -6,109,541 -1,897,818

12/31/09 &

before

1/1/12

**7 C. Promoting Entrepreneurship**

**8** 1. Increase in amount allowed

as a deduction for start-up

expenditures from $5,000 to

$10,000 and increase the deduction

phase-out threshold from $50,000

to $60,000. tyba -828,278 9,548

2/31/09

**9 D. Promoting Small Business**

**Fairness**

**10** 3. Remove cellular telephones

and similar telecommunications

equipment from listed property

which excludes the fair market

value of personal use of a cell

phone provided to an employee

from gross income. tyba -40,444 -34,866

12/31/09

**11 Total of Small Business Relief   -7,035,586 -1,936,104**

**13 II. Revenue Provisions**

**14 B. Promoting Retirement**

**Preparation**

**15** 1.Allow participants in

governmental 457 plans to

contribute deferred amounts

beginning in 2011 to designated

Roth accounts. tyba 32,613 46,202

12/31/10

**16** 2.Allow rollovers of qualified

distributions from 401(k), 403(b)

and 457(b) plans to Roth designated

accounts . DOE 614,210 1,437,687

**17** 3.Permit partial annuitization

of a nonqualified annuity contract.

The annual benefits received as

an annuity payment will become

taxable as income. tyba 13,589 54,355

12/31/10

**18 Total Revenue Provisions   660,412 1,538,244**

**19**

**20 Total of Small Business Act   -6,375,174 -397,860**

**21**  

**22**   **Effective FY 2010-11 FY 2011-12**

**23 Education/Jobs/Medicaid**

**Assistance Act of 2010**

**24** 1. Special rule with respect to

certain redemptions by foreign

subsidiaries. The new law requires

the subsidiary's earnings to remain

subject to U.S. tax when repatriated

to the foreign parent as a dividend. **DOE 26,596 26,596**

**25**  

**26 Total of Education/Jobs**

**/Medicaid Assistance Act   26,596 26,596**

**27**  

**28**  

**29**   **Effective FY 2010-11 FY 2011-12**

**30 Patient Protection and**

**Affordable Care Act and**

**Health Care and Education**

**Reconciliation Acts of 2010**

**31 Revenue Provisions**

**32** 1. Conform the definition of

medical expenses for health

savings accounts, Archer MSAs,

health flexible spending

arrangements, and health

reimbursement arrangements to

the definition of the itemized

deduction for medical expenses

Therefore, over-the-counter

medicines are not reimbursable

from these accounts unless

prescribed by a physician. tyba 1,087,098 1,630,647

12/31/10

**33** 2. Limit health flexible

spending arrangements in

cafeteria plans to $2,500;

indexed to CPI-U

after 2013 [1] [5] tyba 12/31/1 - -

**34** 4. Raise 7.5% AGI floor on

medical expenses deduction to

10%; AGI floor for individuals

age 65 and older (and their

spouses) remains at 7.5%

through 2016 tyba 12/31/12 - -

**35** 5. $500,000 deduction

limitation on taxable year

remuneration to officers,

employees, directors,

and service providers of

covered health insurance

provide. tyba 12/31/12 - -

**36**

**37 Total Patient Protection Act   1,087,098 1,630,647**

**38**  

**39**  

**40**   **Effective FY 2010-11 FY 2011-12**

**41 The Tax Relief,**

**Unemployment Insurance**

**Reauthorization, and Job**

**Creation Act of 2010**

**42** Section 179 expensing

amounts and threshold limits

reduced to $125,000/$500,000

for tax year 2012 from the

$500,000 maximum deduction

and $2,000,000 phase-out

threshold that is law for tax

years 2010 and 2011. (sunset

12/31/12) This reduction in

Section 179 expensing amounts

reverses the increases in tax

years 2008 through 2011 as enacted

in earlier legislation including

the Small Business Jobs Act of

2010. The proposed $125,000

/$500,000 levels are identical to

the amounts that existed for tax

year 2007 as established by the

Small Business and Work

Opportunity Tax Act of 2007. tyba 0 5,049,969

12/31/11

**43**

**44 Total Tax Relief, Unemployment**

**Insurance Reauthorization, and**

**Job Creation Act** 0 5,049,969

**45**  

**46**  

**47**   **Effective FY 2010-11 FY 2011-12**

**48 The Regulated Investment**

**Company Modernization**

**Act of 2010**

**49** I. Capital loss carryovers of

Regulated Investment Companies

(RIC) derived from long-term

capital losses will now be required

to use those losses to offset

long-term capital gains. This

will result in a greater distribution

of short-term capital gains to

shareholders that will be taxed as

ordinary income. As a partial

offset, the RIC will be permitted

to carryforward its net capital losses

without limit, rather than the 8 years

in previous law. DOE 8,153 59,790

**50** III.3. A RIC may pass-thru exempt

interest dividends in fund of

fund structure without regard to

the requirement that at least 50%

of the value of its total assets

consist of tax-exempt State and

local bonds. Previous law allowed

exempt-interest dividends to be

passed through by a RIC only if at

least 50% of the value of the total

assets consist of tax-exempt

obligations. tyba DOE -5,435 -10,871

**51** III.6. Allow distributions in

redemption of stock of a RIC to

be treated as an exchange if the

redemption is upon the demand

of the shareholder and the company

issues only stock which is

redeemable upon the demand of

the shareholder. Otherwise, the

redemption is treated as a

distribution of property. DOE -13,589 -24,460

**52** Modification of sales load basis

deferred rule for RIC to allow

shareholders to take capital losses

for the amount of the load charges

paid on the acquisition of fund

shares after subsequent repurchase

of shares with reinvestment rights. tyba DOE -16,306 -21,742

**53**  

**54 Total Regulated Investment**

**Company Modernization Act** -27,177 2,718

**55**  

**56**  

**57 Total IRS Conformity Impact   -5,288,658 6,312,069**

*Approved By:*

William C. Gillespie

Board of Economic Advisors

1/ This statement meets the requirement of Section 2-7-71 for a state revenue impact by the BEA, or Section 2-7-76 for a local revenue impact or Section 6-1-85(B) for an estimate of the shift in local property tax incidence by the Office of Economic Research.

**A** **BILL**

TO AMEND SECTION 12‑6‑40, AS AMENDED, CODE OF LAWS OF SOUTH CAROLINA, 1976, RELATING TO THE APPLICATION OF THE INTERNAL REVENUE CODE TO STATE INCOME TAX LAWS, SO AS TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE TO THE YEAR 2010.

Be it enacted by the General Assembly of the State of South Carolina:

SECTION 1. Section 12‑6‑40(A)(1)(a) of the 1976 Code, as last amended by Act 142 of 2010, is further amended to read:

“(a) Except as otherwise provided, ‘Internal Revenue Code’ means the Internal Revenue Code of 1986, as amended through December 31, ~~2009~~ 2010, and includes the effective date provisions contained in it.”

SECTION 2. This act takes effect upon approval by the Governor.

‑‑‑‑XX‑‑‑‑