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| **Bill Number:** | H. 4017 Amended by the House of Representatives on April 7, 2021 |
| Author: | Simrill |
| Subject: | Income Tax Conformity |
| Requestor: | Senate Finance |
| RFA Analyst(s): | Jolliff |
| Impact Date: | April 13, 2021 |

## Fiscal Impact Summary

This bill updates South Carolina's conformity to the Internal Revenue Code (IRC) through December 31, 2020. The Department of Revenue (DOR) will administer the changes to income tax provisions with existing staff and resources. Therefore, the bill is not expected to impact expenditures for the agency.

The bill as amended conforms to the IRC with the exception of specific provisions. Further, the bill as amended allows taxpayers to exclude up to $10,200 of unemployment compensation from income taxes for tax year 2020. This unemployment compensation exemption is the only adopted provision that will impact revenue, and it will reduce General Fund individual income tax revenue by $61,300,000. As the exemption only applies to tax year 2020, the impact is a one-time, non-recurring reduction. This impact may occur in FY 2020-21 or be extended to FY 2021-22 if taxpayers file for an extension or have already filed their state income taxes and do not file an amended return until after June 30, 2021. At this time, we estimate that approximately 50 percent of the impact will occur in FY 2020-21, and the remaining 50 percent will occur in FY 2021-22 due to extended or amended returns. Therefore, we estimate that the bill will reduce FY 2020-21 General Fund individual income tax revenue by $30,650,000 and FY 2021-22 revenue by $30,650,000. This split may be affected by the timing of enactment of this legislation.

For reference, Table 1 lists the provisions affecting revenue that are either adopted or not adopted. Tables 2 and 3 list the changes that have either been incorporated in or are already affecting revenue currently and would not have further impact on revenue.

## Explanation of Fiscal Impact

**Amended by the House of Representatives on April 7, 2021**
**State Expenditure**
This bill updates South Carolina's conformity to the IRC through December 31, 2020. DOR will administer the changes to income tax provisions with existing staff and resources. Therefore, the bill is not expected to impact expenditures for the agency.

**State Revenue**
This bill updates South Carolina's conformity to the IRC through December 31, 2020. In addition, this bill proactively adopts any expired provisions of the federal code that are extended, but not otherwise amended, by congressional enactment during 2021.

Research by DOR identified four federal tax laws enacted by Congress that impact South Carolina's conformity through December 31, 2020.

- Families First Coronavirus Response Act (Families First Act) (PL 116-127) enacted on March 18, 2020
- Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (PL 116-136) enacted on March 27, 2020
- Paycheck Protection Program Flexibility Act of 2020 (PPPF Act) (PL 116-142) enacted on June 5, 2020
- Consolidated Appropriations Act of 2021 (CAA of 2021) (PL 116-260) enacted on December 27, 2020

Further, the bill adds additional language in Section 1 (B) to specify that South Carolina adopts the federal tax treatment for any exclusion from federal taxable income or allowance of expenses as provided in the CAA of 2021. As these provisions are not codified in the IRC, these additional sections of the bill allow for administration of the provisions. S.C. Act 147 of 2020, which adopted IRC conformity through December 31, 2019, specifically provides that for tax year 2020 paycheck protection program (PPP) loans that were forgiven and excluded from gross income under the CARES Act are excluded for South Carolina income tax purposes and to the extent the federal government allows the deduction for expenses associated with the forgiven PPP loans, these expenses will be allowed as a deduction for South Carolina income tax purposes. The bill adopts this federal tax treatment for 2021 as allowed by the CAA. As the provisions were adopted in Act 147 for 2020 and these special provisions are a unique event not typically in the revenue stream, extending this treatment to 2021 will not affect the current revenue forecast. These provisions are noted in Section B of Table 1 and have no effect on revenue.

Section 2 of the amended bill lists specific provisions that are not adopted. Section 3 adopts the amendment in the American Rescue Plan of 2021 that exempts up to $10,200 of unemployment compensation from income taxes. Under state law, unemployment compensation is taxable for state individual income taxes, and the bill would exempt the first $10,200 for tax year 2020 only.

To estimate the impact of conforming to IRC changes, Revenue and Fiscal Affairs (RFA) utilizes U.S. estimates by the Joint Committee on Taxation and adjusts those estimates to project the impact of adopting these federal provisions on South Carolina. Further, based upon research by RFA and discussions with the Department of Revenue (DOR) and the South Carolina Association of CPAs (SCACPA), RFA made additional adjustments to refine these estimates with respect to South Carolina. Additionally, the S.C. Department of Employment and Workforce (DEW) provided data on unemployment compensation paid in 2020.

The provisions affecting South Carolina in these federal law changes are listed separately in Tables 1, 2, and 3 based upon their effect on revenues. Provisions that would affect revenue if adopted are listed in Table 1. The amended bill specifically does not adopt most of these provisions. However, adopting the unemployment compensation exemption for tax year 2020 would reduce income tax revenue. Based upon data provided by DEW and estimates by the Joint Committee on Taxation, the estimated reduction in General Fund income tax revenue is approximately $61,300,000. Because this provision only applies to tax year 2020, the impact is a one-time, non-recurring reduction. In order to claim the exemption, taxpayers who have already filed their tax return will need to file an amended return. Therefore, this impact may occur in FY 2020-21 or be extended to FY 2021-22 if taxpayers file for an extension or have already filed their state income taxes and do not file an amended return until after June 30, 2021. The Internal Revenue Service and DOR have extended filing for tax year 2020 until May 17, 2021. If this bill is enacted prior to May 17, more of the impact may occur in FY 2020-21. At this time, we would estimate that approximately 50 percent of the impact will occur in FY 2020-21, and the remaining 50 percent will occur in FY 2021-22 due to extended or amended returns. Therefore, we estimate that the bill will reduce General Fund individual income tax revenue by $30,650,000 in FY 2020-21 and $30,650,000 in FY 2021-22. This split may be affected by the timing of enactment.

The CAA also extended certain provisions that have been regularly extended by Congress. The extended provisions are listed in Table 2. These provisions are included in the current forecast by the Board of Economic Advisors, as the forecast expectation was that these provisions would be extended. Therefore, there is no revenue impact as a result of adopting these extended provisions. If South Carolina does not adopt the provisions, however, revenue would increase as the reductions are already in the forecast.

Table 3 provides information on those provisions that DOR advises us they believe are already affecting South Carolina regardless of conformity to the IRC because federal law determines how these provisions are implemented, and they cannot be avoided. Essentially, the change in revenue resulting from these provisions will occur regardless of whether South Carolina adopts this bill to extend conformity to 2020. Many of these provisions are already affecting revenues and will be accounted for by the Board of Economic Advisors in the revenue forecast.

Notably, Congress passed the American Rescue Plan Act of 2021 (PL 117-2) on March 11, 2021, which includes additional federal stimulus programs and other provisions. Because the Act passed after December 2020, this bill does not address these provisions with the exception of the unemployment exemption specifically adopted in Section 3. Of particular interest, the Act included a provision that prohibits using any of the State and Local Fiscal Recovery Funds to reduce taxes. The Act specifically states:

> *(A) In general.—A State or territory shall not use the funds provided under this section or transferred pursuant to section 603(c)(4) to either directly or indirectly offset a reduction in the net tax revenue of such State or territory resulting from a change in law, regulation, or administrative interpretation during the covered period that reduces any tax (by providing for a reduction in a rate, a rebate, a*

*deduction, a credit, or otherwise) or delays the imposition of any tax or tax increase.*

Since our previous impact statement, the U.S. Treasury has issued guidance that conforming to federal tax law changes does not constitute a tax reduction that would impact the use of federal recovery funds.

**Local Expenditure**
N/A

**Local Revenue**
N/A

*Impact statements for prior versions of the bill are available here:*
*[http://rfa.sc.gov/impacts](http://rfa.sc.gov/impacts)*

### Table 1. Provisions Affecting Revenue – Bill as Amended

| Line | Provision | IRC § | Individual or Corporate | | FY 2021-22 | FY 2022-23 | |
|---|---|---|---|---|---|---|---|
| ~~1~~ | ~~$300 charitable deduction allowed without itemizing deductions in 2020 (See also Line 2)~~ | ~~62~~ | ~~I~~ | - | ~~($3,808,000)~~ | ~~$0~~ | Not Adopted |
| ~~2~~ | ~~Certain charitable contributions deductible by non-itemizers in 2021 ($300/$600 married joint) (See also Line 1)~~ | ~~170~~ | ~~I~~ | - | ~~($7,035,000)~~ | ~~$0~~ | Not Adopted |
| ~~3~~ | ~~Modification of limits on charitable contributions for 2020 (See also Line 4)~~ | ~~170~~ | ~~I/C~~ | - | ~~($10,498,000)~~ | ~~$5,225,000~~ | Not Adopted |
| ~~4~~ | ~~Temporary modification of limitations on charitable contributions for 2021 (See also Line 3)~~ | ~~170~~ | ~~I/C~~ | - | ~~($7,000,000)~~ | ~~$3,481,000~~ | Not Adopted |
| ~~5~~ | ~~Modifications to income limitations for net operating losses for 2018, 2019, and 2020 (Carrybacks not allowed by SC)~~ | ~~172~~ | ~~I~~ | ~~*~~ | ~~($38,577,000)~~ | ~~$1,363,000~~ | Not Adopted |
| ~~6~~ | ~~Modification of limitation on losses for non-corporate taxpayers in 2018, 2019, and 2020~~ | ~~461(1)~~ | ~~I~~ | ~~*~~ | ~~($172,070,000)~~ | ~~$729,000~~ | Not Adopted |
| ~~7~~ | ~~Personal protective equipment expenses included in educator expense deduction (DOR recommends adopting)~~ | ~~62(a)(2)(D)~~ | ~~I~~ | - | ~~($5,000)~~ | ~~($5,000)~~ | Not Adopted |
| ~~8~~ | ~~Temporary allowance of full deduction for business meals through 2022~~ | ~~274(n)~~ | ~~I~~ | - | ~~($5,483,000)~~ | ~~($6,176,000)~~ | Not Adopted |
| ~~9~~ | ~~Special rules for qualified disaster relief charitable contributions~~ | ~~170~~ | ~~I~~ | - | ~~($195,000)~~ | ~~$68,000~~ | Not Adopted |
| ~~10~~ | ~~Special rules for qualified disaster-related personal casualty loses~~ | ~~165~~ | ~~I~~ | - | ~~($3,312,000)~~ | ~~($1,019,000)~~ | Not Adopted |
| **Section 1(B) of H. 4017- Additional Changes to Section 12-6-40(A)(1)** | | | | | | | |
| **11** | **Small Business Association loan forgiveness** | | | | $0 | $0 | |
| **12** | **Emergency financial aid grants to students not included in gross income** | | I | | $0 | $0 | |
| **13** | **Clarification of loan forgiveness and other business financial assistance** | | | | $0 | $0 | |
| **Section 3 of H. 4017- Adopt American Rescue Plan of 2020 Amendment** | | | | | | | |
| **14** | **Exempt $10,200 of unemployment compensation for tax year 2020** | | I | | ($61,300,000)<br>*See impact for timing* | | |

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| **Individual Income Tax** | ($61,300,000) | $0 |
| **Corporate Income Tax** | ($0) | $0 |
| **Total Provisions Affecting Revenue** | **($61,300,000)** | **$0** |

* Applies to tax years 2018, 2019, and 2020

**Table 2. Provisions Extended - Currently in Revenue Forecast**

| Line | Provision | IRC § | Individual or Corporate | | FY 2021-22 | FY 2022-23 |
|---|---|---|---|---|---|---|
| 14 | Energy efficient commercial buildings deduction modified and made permanent | 179D | I | | ($174,000) | ($174,000) |
| 15 | Benefits provided to volunteer firefighters and emergency medical responders made permanent | 139B | I | | ($174,000) | ($177,000) |
| 16 | Permanent extension of medical expense deduction for expenses in excess of 7.5% of AGI | 213(f) | I | | ($2,425,000) | ($2,422,000) |
| 17 | Modification and Extension of exclusion from gross income for discharge of qualified principal residence indebtedness | 108 | I | | ($1,316,000) | ($1,355,000) |
| 18 | Extension of 7-year recovery period for Motorsports Entertainment Complexes through 2025 | 168(i)(15)(D) | I | | ($86,000) | ($98,000) |
| 19 | Extension of expensing rules for certain film, television, and live theatrical productions | 181 | I | | ($2,018,000) | ($1,002,000) |
| 20 | Extension of certain empowerment zone tax incentives | 1391, 1397A, 1397B | I | | ($638,000) | ($660,000) |
| 21 | Extension of exclusion from income certain employer payments of student loans | 127 | I | | ($1,571,000) | ($1,660,000) |
| 22 | Extension of mortgage insurance premiums treated as qualified residence interest through 2021 | 163(h)(3) | I | | ($432,000) | $0 |
| 23 | Extension of classification of certain racehorses as 3-year property for depreciation purposes | 168(e)(3)(A) | I | | $0 | $0 |
| 24 | Extension of accelerated depreciation for business property on Indian Reservations | 168(j) | I | | ($34,000) | ($22,000) |
| **Total of Extended Provisions Currently in Revenue Forecast** | | | | | **($8,868,000)** | **($7,570,000)** |

## Table 3. Other Provisions for Information Only - Largely Already Affecting Revenue

| Line | Provision | IRC § | Individual or Corporate | | FY 2021-22 | FY 2022-23 |
|---|---|---|---|---|---|---|
| 25 | **Employee income exclusion for certain employer payments of student loans** | 127 | I | | ($1,129,000) | $0 |
| 26 | **Special Rules for Retirement Plans** | 72(t), 401, 402, 403, 408, 457 | I | | ($239,644) | ($40,882) |
| 27 | **Temporary waiver of required minimum distribution rules for certain retirement plans and accounts for 2020** | 401, 402, 403, 408, 457 | I | | ($28,786,702) | $2,266,302 |
| 28 | **Technical amendments to TCJA regarding qualified improvements to property** | 168 | I | | $0 | $0 |
| 29 | **Single-employer delay in minimum contribution funding for defined benefit plans** | 430(j), 436 | I | | $13,047,811 | ($1,018,977) |
| 30 | **New pension plan rules applied to certain charitable employers** | 414(y) | I | | ($2,455) | ($2,455) |
| 31 | **Health Saving Account (HAS) exemption for telehealth services** | 223 | I | | $0 | ($159,599) |
| 32 | **Inclusion of certain over-the-counter medical products as qualified medical expenses** | 106, 220, 223 | I | | ($137,500) | ($1,227,683) |
| 33 | **Application of special rules to money purchase pension plans** | no section | I | | ($174,331) | ($36,830) |
| 34 | **2020 election to terminate transfer period for qualified transfers from pension plans** | 420(f) | I/C | | $130,470 | $102,201 |
| 35 | **Beer, wine and distilled spirits - exempt aging process from certain inventory capitalization rules.** | 239A(f)(4) | I | | ($37,000) | ($32,000) |
| 36 | **Repeal of deduction for higher education qualified tuition and related expenses for tax years beginning after 2020** | 222 | I | | ($3,167,421) | ($3,075,345) |
| 37 | **Minimum age for distribution during working retirement** | 401(a)(36) | I | | $0 | $0 |
| 38 | **Temporary rule preventing partial plan termination** | 411(d)(3) | I | | $0 | $0 |
| 39 | **Temporary rules for health and dependent care flexible suspending arrangements** | 125 | I | | $93,000 | $39,000 |
| 40 | **Disaster related rules for use of retirement funds** | 72(t), 401, 402, 403, 408, 457 | I | | ($67,523) | ($15,960) |
| **Total Provisions for Information Only** | | | | | **($20,470,296)** | **($3,202,227)** |

Frank A. Rainwater, Executive Director