

# FEDERAL TAX CONFORMITY

## TAX YEAR 2017 AND 2018

PRESENTED TO

SENATE FINANCE SUBCOMMITTEE  
ON CONFORMITY

August 8, 2018



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# CONFORMITY

## Tax Year 2017 and 2018

- Conformity is more complicated due to major federal tax reform
- Winners and losers
  - Detailed RFA report on federal tax changes:
  - Estimated South Carolina Impact of Federal “Tax Cuts And Jobs Act” of 2017 and “Bipartisan Budget Act” of 2018  
(<http://rfa.sc.gov/econ/reports/econanalysis>)
- Taxpayers, tax professionals, and DOR need time for implementation of tax changes

# CONFORMITY - RETROACTIVE Tax Year 2017 (April 2018 filings)

- Conforming to federal tax changes for tax year 2017 will allow taxpayers under 65 to claim higher medical deductions: \$3.5 million revenue reduction
- Twelve tax provisions extended in the Bipartisan Budget Act affect taxpayers for 2017
  - Total of \$11.8 million including:
    - Medical deductions for taxpayers over 65 (\$4.8 M)
    - Qualified tuition and related expenses (\$2.8 M)
- Current filers will have to file amended returns if these provisions are adopted

# CONFORMITY

## Tax Year 2018 (April 2019 Filings)

### Adopt Federal Income Tax Changes

- Simplest for taxpayers and least likely to result in non-compliance
- No changes to tax processing or revenue flow

### BUDGET/REVENUE ISSUES

**\$204 Million Revenue Increase\***  
**(\$172 Individual; \$32 Corporate)**

#### For Individual Tax Filers:

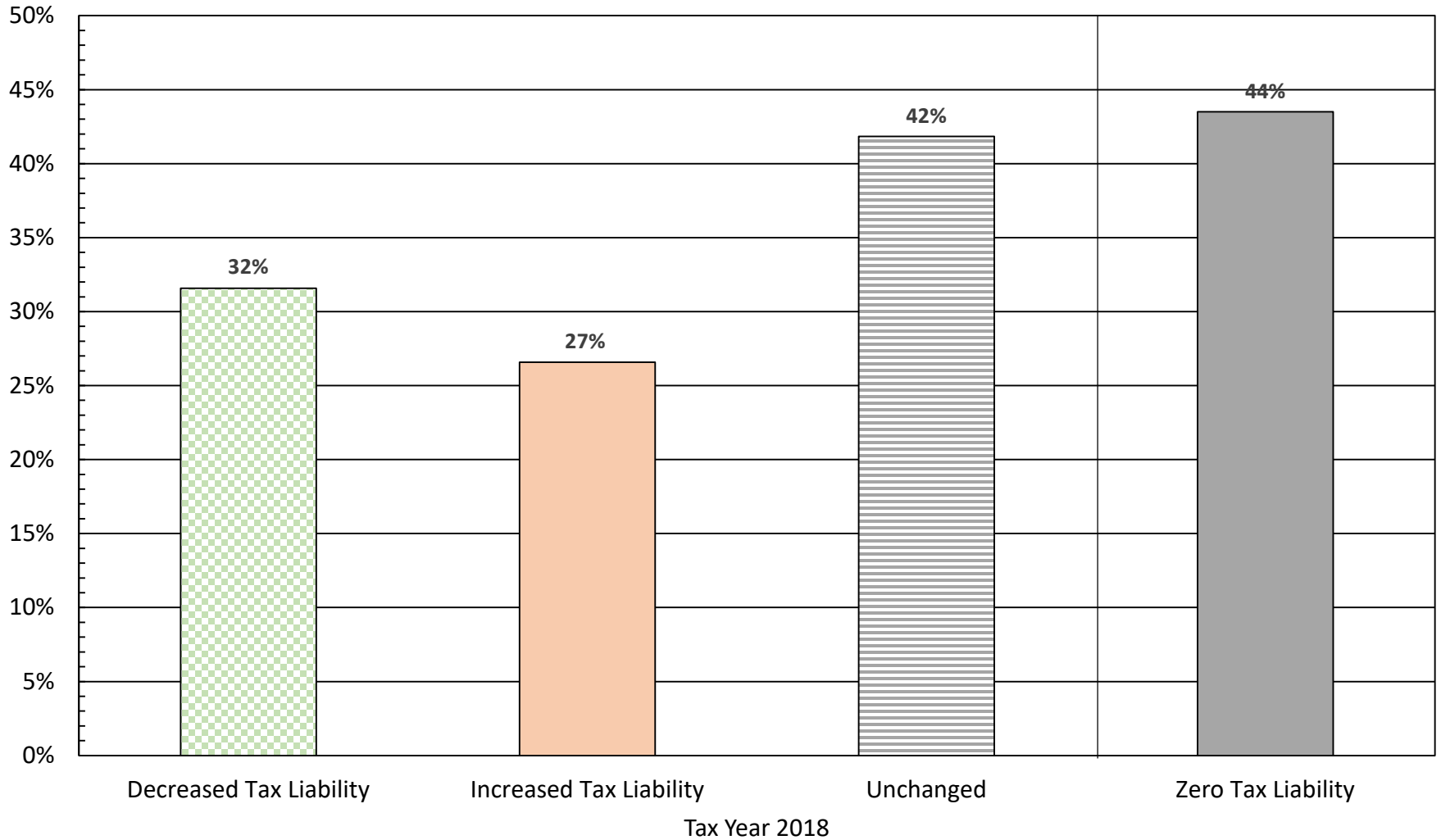
- **Decreased Tax Liability:**  
**32%**
- **Increased Tax Liability:**  
**27%**
- **Unchanged Tax Liability:**  
**42%**

**\*Before any state tax reform**

# SOUTH CAROLINA STATE INDIVIDUAL INCOME TAX LIABILITY IMPACT

## Tax Year 2018 - Projected Impact of Federal Tax Changes

### Percentage of Returns



Percentages may not add to totals due to rounding.

# NONCONFORMITY

## No Action (Maintain 2016 Tax Code)

### Decouple from Federal Tax Code

- Significant change for taxpayers, tax professionals, and DOR
- Potential for unintended tax liability impacts
- Taxpayers must follow two sets of tax laws

### BUDGET/REVENUE ISSUES

#### Unknown Impacts on Compliance

- Voluntary Compliance
  - Taxpayer confusion may have unintended revenue effects
- Involuntary Compliance
  - Tens of millions in audit revenue affected
- Short Time for Implementation
  - Processing Delays - revenue timing and budget cash flow would be affected, especially if electronic filings are affected

# NONCONFORMITY - SPECIFIC CONCERNS

## Tax Year 2018 Issues for Taxpayers

- Federal and state tax law differences
  - Significant differences between federal and state standard deductions and personal exemptions may affect compliance
  - Different thresholds for medical deductions
- Taxpayers will need to follow two sets of tax rules and complete another set of forms to duplicate federal returns under old law
  - Individuals and business may have much higher tax preparation expenses. For example, Indiana estimates their businesses' expenses will increase by \$100 million.<sup>1</sup>
- Delays in processing would mean taxpayers would have to wait to receive refunds

<sup>1</sup> *Indianapolis Business Journal*, March 23, 2018 <https://www.ibj.com/articles/68093-without-state-fix-federal-tax-change-could-cost-indiana-firms-100m>

# House Bill 5341

Conform to federal law, with exceptions, and enact a state personal exemption

- Adopts changes to federal standard deduction amounts, itemized deductions, and some business tax rules
- Creates a state personal exemption of \$1,525 per person adjusted annually for inflation
- Does not conform to:
  - Pass through deduction for qualified business income
  - Federal limits on interest expense deductions
  - Treatment of deferred foreign income
  - FDIC deduction limit
  - Rule changes for contributions to capital



# House Bill 5341

## May 8, 2018 Impact Statement Summary

### Individual Income Tax:

- Potential revenue increase of \$253M offset by new personal exemption for FY 2018-19
- No revenue change for FY 2018-19

### Corporate Income Tax:

- No revenue change for FY 2018-19 based upon the provisions that are adopted

Net impact: \$0\*

*\*Possible additional impact for Tax Year 2017 amended returns/refunds*

# H. 5341

## PROJECTED IMPACT ON STATE INDIVIDUAL INCOME TAX FOR TAX YEAR 2018 Conform to Federal Tax Changes with Exceptions and Provide a State Personal Exemption of \$1,525

Projected <i>Federal Adjusted Gross Income</i> 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%	196,000	\$8	158	0.6%	(\$189)	370	1.5%	\$610	24,429	97.9%
\$1-\$10,000	301,760	12.6%	(12,000)	(\$0)	195	0.1%	(\$105)	100	0.0%	\$83	301,464	99.9%
\$10,001-\$20,000	378,838	15.9%	(6,167,000)	(\$16)	85,267	22.5%	(\$73)	1,050	0.3%	\$42	292,521	77.2%
\$20,001-\$30,000	324,595	13.6%	(19,261,000)	(\$59)	139,246	42.9%	(\$144)	7,634	2.4%	\$107	177,714	54.7%
\$30,001-\$40,000	253,886	10.6%	(20,805,000)	(\$82)	142,191	56.0%	(\$173)	22,742	9.0%	\$170	88,954	35.0%
\$40,001-\$50,000	186,457	7.8%	(11,584,000)	(\$62)	114,828	61.6%	(\$178)	36,680	19.7%	\$240	34,949	18.7%
\$50,001-\$75,000	311,678	13.1%	(7,204,000)	(\$23)	183,752	59.0%	(\$196)	86,627	27.8%	\$332	41,299	13.3%
\$75,001-\$100,000	199,641	8.4%	(637,000)	(\$3)	111,890	56.0%	(\$223)	65,874	33.0%	\$369	21,878	11.0%
\$100,001-\$125,000	130,161	5.5%	2,181,000	\$17	73,140	56.2%	(\$239)	48,915	37.6%	\$402	8,106	6.2%
\$125,001-\$150,000	77,608	3.3%	5,420,000	\$70	39,589	51.0%	(\$239)	33,279	42.9%	\$448	4,740	6.1%
\$150,001-\$175,000	47,077	2.0%	6,175,000	\$131	20,730	44.0%	(\$238)	22,971	48.8%	\$483	3,377	7.2%
\$175,001-\$200,000	30,587	1.3%	5,542,000	\$181	11,812	38.6%	(\$231)	16,029	52.4%	\$516	2,746	9.0%
\$200,001-\$250,000	35,115	1.5%	8,806,000	\$251	11,310	32.2%	(\$227)	20,226	57.6%	\$562	3,579	10.2%
\$250,001-\$300,000	19,239	0.8%	6,046,000	\$314	4,871	25.3%	(\$219)	11,762	61.1%	\$605	2,606	13.5%
\$300,001-\$500,000	30,243	1.3%	12,175,000	\$403	4,941	16.3%	(\$215)	19,728	65.2%	\$671	5,573	18.4%
\$500,001-\$750,000	12,238	0.5%	6,091,000	\$498	977	8.0%	(\$217)	8,092	66.1%	\$779	3,169	25.9%
\$750,001-\$1,000,000	5,678	0.2%	3,014,000	\$531	297	5.2%	(\$222)	3,630	63.9%	\$848	1,751	30.8%
\$1,000,000+	15,736	0.7%	9,719,000	\$618	402	2.6%	(\$196)	9,441	60.0%	\$1,038	5,893	37.5%
Total	2,385,493		0	\$0	945,595	39.6%	(\$182)	415,151	17.4%	\$413	1,024,748	43.0%

Columns may not add to totals due to rounding.

- 39.6% of returns will have a decreased tax liability
- 17.4% of returns will have an increased tax liability

- 43.0% of returns will have an unchanged tax liability
- 46.5% of returns will have zero tax liability

Exceptions: Conform to federal tax changes except for passthrough deduction (\$199), interest expense limitation (\$163), foreign income changes (\$250, 267, etc.), contributions to capital (\$118) and FDIC premium deduction (\$162).

# Senate Bill 1258

Conform to federal law with exceptions and adjustments

- Adopts some business tax rule changes
- Creates a state standard deduction of \$7,570 for single filers, \$15,140 for married filers, and \$11,355 for head of household filers
- Creates a state personal exemption and additional state exemption for dependents under 6 of \$4,050 each
- Does not conform to:
  - Pass through deduction for qualified business income
- Additional adjustments:
  - Increases state tax bracket inflation from half of inflation to full amount
  - Fully implements the earned income tax credit and two-wage earner credit increases in 2018 instead of the six-year phase-in

# Senate Bill 1258

## Preliminary Revenue Impact

### Individual Income Tax:

- Potential increase of \$265M offset by changes to deductions, exemptions, etc.
- \$32M decrease in individual income tax revenue for FY 2018-19
- Additional \$4M decrease for FY 2019-20 (bracket inflation change)

### Corporate Income Tax:

- Potential increase of \$32M\* for FY 2018-19

Net Impact: \$0\*

*\*Pending any technical issues*

# S. 1258

## PROJECTED IMPACT ON STATE INDIVIDUAL INCOME TAX FOR TAX YEAR 2018 Conform to Federal Tax Changes with Exceptions and Changes to Standard Deduction and Personal Exemption

Projected <i>Federal Adjusted Gross Income</i> 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 Tax 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%	\$172,000	\$7	169	0.7%	(\$106)	346	1.4%	\$551	24,442	97.9%
\$1-\$10,000	301,760	12.6%	(\$18,000)	(\$0)	235	0.1%	(\$100)	63	0.0%	\$83	301,462	99.9%
\$10,001-\$20,000	378,838	15.9%	(\$2,574,000)	(\$7)	84,965	22.4%	(\$31)	1,289	0.3%	\$41	292,584	77.2%
\$20,001-\$30,000	324,595	13.6%	(\$6,957,000)	(\$21)	139,636	43.0%	(\$54)	5,740	1.8%	\$97	179,218	55.2%
\$30,001-\$40,000	253,886	10.6%	(\$14,405,000)	(\$57)	149,659	58.9%	(\$108)	10,352	4.1%	\$163	93,875	37.0%
\$40,001-\$50,000	186,457	7.8%	(\$10,436,000)	(\$56)	129,606	69.5%	(\$102)	15,715	8.4%	\$181	41,137	22.1%
\$50,001-\$75,000	311,678	13.1%	(\$9,631,000)	(\$31)	219,103	70.3%	(\$85)	47,663	15.3%	\$191	44,912	14.4%
\$75,001-\$100,000	199,641	8.4%	(\$6,541,000)	(\$33)	137,258	68.8%	(\$107)	39,341	19.7%	\$206	23,043	11.5%
\$100,001-\$125,000	130,161	5.5%	(\$5,709,000)	(\$44)	91,464	70.3%	(\$134)	29,832	22.9%	\$220	8,865	6.8%
\$125,001-\$150,000	77,608	3.3%	(\$1,690,000)	(\$22)	50,971	65.7%	(\$138)	21,578	27.8%	\$248	5,059	6.5%
\$150,001-\$175,000	47,077	2.0%	\$271,000	\$6	27,688	58.8%	(\$135)	15,866	33.7%	\$253	3,523	7.5%
\$175,001-\$200,000	30,587	1.3%	\$989,000	\$32	16,220	53.0%	(\$130)	11,512	37.6%	\$269	2,856	9.3%
\$200,001-\$250,000	35,115	1.5%	\$2,405,000	\$68	16,162	46.0%	(\$124)	15,235	43.4%	\$289	3,718	10.6%
\$250,001-\$300,000	19,239	0.8%	\$2,131,000	\$111	7,035	36.6%	(\$114)	9,527	49.5%	\$308	2,677	13.9%
\$300,001-\$500,000	30,243	1.3%	\$5,309,000	\$176	7,321	24.2%	(\$108)	17,212	56.9%	\$354	5,710	18.9%
\$500,001-\$750,000	12,238	0.5%	\$3,471,000	\$284	1,409	11.5%	(\$106)	7,588	62.0%	\$477	3,241	26.5%
\$750,001-\$1,000,000	5,678	0.2%	\$2,081,000	\$366	397	7.0%	(\$117)	3,497	61.6%	\$608	1,784	31.4%
\$1,000,000+	15,736	0.7%	\$9,072,000	\$577	435	2.8%	(\$103)	9,340	59.4%	\$976	5,961	37.9%
Total	2,385,493		(\$32,000,000)	(\$13)	1,079,734	45.3%	(\$94)	261,695	11.0%	\$267	1,044,065	43.8%

Columns may not add to totals due to rounding.

- 45.3% of returns will have a decreased tax liability
- 11.0% of returns will have an increased tax liability
- 43.8% of returns will have an unchanged tax liability
- 46.7% of returns will have zero tax liability

### Std. Deduction

\$ 7,570 single  
\$ 11,355 head of household  
\$ 15,140 married joint

### Personal Exemption

\$ 4,050

Earned income tax credit and two-wage earner credit increases are fully

Exceptions: Conform to federal tax changes except for passthrough deduction (\$19A)