

**ESTIMATED SOUTH CAROLINA IMPACT
OF FEDERAL “TAX CUTS AND JOBS ACT” OF 2017
AND “BIPARTISAN BUDGET ACT” OF 2018**

PENDING ANY STATE TAX LAW CHANGES

South Carolina Revenue and Fiscal Affairs Office

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Frank A. Rainwater, Executive Director

Lisa H. Jolliff

Gordon O. Shuford



The following report updates the report issued on January 29, 2018 to include the changes to the Internal Revenue Code through February 9, 2018. Our analysis of the distribution for items 9 and 10 has been revised to reflect additional information from subject matter experts regarding the impact on pass-through businesses and corporations. Revisions to Figure 1 were previously published on April 27, 2018. Corrections include a typographical error on page 5 regarding the year the eleven extended provisions expired and on page 6 regarding the standard deduction amount for head-of-household filers for 2017.

**ESTIMATED SOUTH CAROLINA IMPACT
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“BIPARTISAN BUDGET ACT” OF 2018**

PENDING ANY STATE TAX LAW CHANGES

Federal tax reform in the Tax Cuts and Jobs Act of 2017 (TCJA) affected both the definition and calculation of taxable income and lowered federal tax rates. At the national level, South Carolinians are expected to see their federal tax liability decrease by \$1.621 billion.

At the state level, the South Carolina General Assembly will decide how to maintain conformity and any adjustment of state tax rates, deductions, or exemptions. This analysis estimates the impact of federal tax reform on state income tax liability before any adjustments are made by the General Assembly.

The report is revised to include the provisions in the Bipartisan Budget Act of 2018 and to reflect revisions to the distribution of the impact for items affecting business income taxes.

Limitations of Analysis

- This analysis assumes adoption of all federal tax law changes in the Tax Cuts and Jobs Act of 2017, the Bipartisan Budget Act of 2018 (BBA), and no changes to current state law.
- The estimates provided are determined with the interactions from all provisions based upon estimates by the Joint Committee on Taxation. Each provision individually may have a different fiscal impact.
- Federal tax forms have not been produced to determine how the deduction for qualified business income for pass-through businesses will be implemented or if this deduction will impact the calculation of state active trade or business income. The estimate for pass-through business assumes the federal deduction will impact the determination of state active trade or business income. If active trade or business income is not impacted, the estimate would change.
- Our analysis is revised to include the provisions of Act 40 of 2017 for earned income credits, two-wage earner credits, and tuition tax credits as phased-in for tax year 2018. The original analysis was based upon the credit amounts when fully implemented for simplicity.

Summary of Impact

- State individual income tax will increase by a net of \$172 million. (See Figure 1)
 - \$246 million in increases for all S.C. individual income taxpayers from changes to deductions and exemptions
 - \$74 million in reductions for S.C. pass-through businesses (-\$77 million from pass-through business changes and +\$3 million from other business changes)
 - The majority of the reduction for pass-through businesses is attributable to the new 20 percent deduction for qualified business income.
- Total corporate income tax will increase by \$32 million. (See Figure 1)
- The impact on individuals varies. (See Figure 2)
 - 32 percent of returns decrease in tax liability
 - 27 percent of returns increase in tax liability
 - 42 percent of returns remain unchanged
(Percentages may not add to totals due to rounding)
 - 44 percent of returns will have zero tax liability
 - The distribution of these tax liability changes is reported by federal adjusted gross income range (AGI). (See Figure 3)
- Projected income before and after the TCJA is included in Figures 4-6. These charts show federal adjusted gross income and state taxable income before and after the federal tax law changes. The group reporting the largest amount of federal AGI and state taxable income is taxpayers with federal AGI of \$50,000-\$75,000.
- The change in state taxable income varies by income group. (See Figure 7)
 - The majority of income groups increase.
 - Taxpayers with federal AGI of over \$1,000,000 will see a decrease.
- The change in total state taxable liability also varies by income group. The majority of income groups increase in total state tax liability. (See Figure 8)
- The net impact on state taxable liability is highest for taxpayers with federal AGI of \$50,000-\$75,000, the largest income group. (See Figure 9) However, within each income group, a group of taxpayers has an increase in tax, and a group has a decrease in tax. The components of the net tax change are shown in Figure 10.

- Overall, the net tax liability impact is an average increase of \$72. (See Figure 11)
 - This average includes returns with \$0 tax liability.
 - The largest average increase is for taxpayers with federal AGI between \$200,000 and \$250,000. The largest average decrease is for taxpayers with federal AGI over \$1,000,000.

- The average tax liability impact also is calculated separately for tax returns with a decrease versus an increase, removing \$0 tax liability returns. (See Figure 12)
 - For taxpayers with a decrease in tax liability, the average decrease is \$166 and ranges from \$43 to \$3,203.
 - For taxpayers with an increase in tax liability, the average increase is \$469 and ranges from \$69 to \$1,803.

- Other Information: Federal individual income taxes for S.C. taxpayers will decrease by an estimated \$1.621 billion based upon U.S. estimates. (See Figure 13)

- The Bipartisan Budget Act extended eleven provisions affecting South Carolina that expired on December 31, 2016. 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 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 but do not affect revenue significantly.

Select Provisions

The following summary is limited to new provisions expected to have an impact on South Carolina of at least ± 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 number in Figure 1. Provisions extended in the Bipartisan Budget Act are addressed in the fiscal impact statement for Senate Bill 250 of 2017.

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. (The current basic standard deduction for tax year 2017 is \$6,350 for singles, \$12,700 for married joint filers, and \$9,350 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).
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 including 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 exemptions: The personal exemption is eliminated. (Estimated to be \$4,150 for tax year 2018)
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. Since the federal personal exemption is eliminated, or effectively \$0, the state additional deduction would be eliminated without a change to state law.
5. 529 Plan: The Act changes the restrictions on usage for funds in a 529 plan. Funds contributed to a 529 plan currently are not subject to federal or state taxes

if the withdrawals are used for higher education. 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 change 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.
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.
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. 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.
10. Simplified small business accounting: The Act simplifies the accounting requirements for small business 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: 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.
12. Net operating loss deduction: A net operating loss 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 years under federal law. The Act limits the deduction to 80 percent of taxable income and requires 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.
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: 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.

Summary of Federal Tax Law Changes Impacting South Carolina Income Tax Revenue

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] | \$ (93) | |
| 8. Pass-Through Loss Limitation | \$ 16 | |
| Pass-Through Business Only | \$ (77) | |
| Individual Income Only Total | \$ 169 | |
| 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 | \$ 12 |
| 12. Modified Net Operating Loss Deduction | \$ 6 | \$ 6 |
| Other (net) [c] | \$ 5 | \$ 5 |
| Business (Individual and Corporate Income Tax) Total | \$ 3 | \$ 17 |
| Corporate Income Tax Only | | |
| 13. Deduction for Foreign-source Dividends | | \$ (6) |
| 14. Treatment of Deferred Foreign Income | | \$ 17 |
| Other (net) [c] | | \$ 4 |
| Corporate Income Tax Only Total | | \$ 15 |
| TOTAL | \$ 172 | \$ 32 |

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 $\pm 0.1\%$ of revenue in year 2

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

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

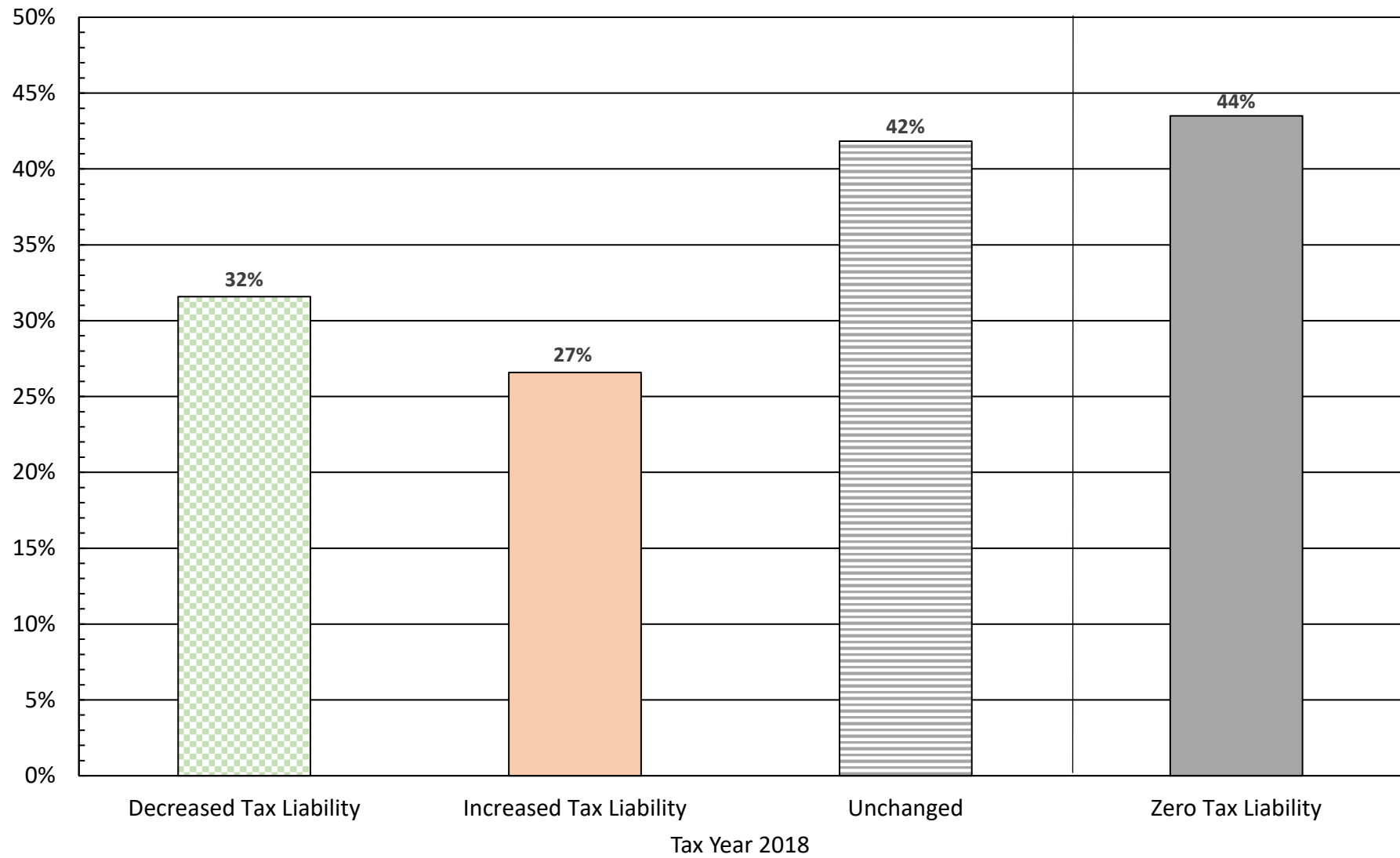
IMPACT ON STATE INDIVIDUAL INCOME TAX LIABILITY
PERCENTAGE OF RETURNS

SOUTH CAROLINA STATE INDIVIDUAL INCOME TAX LIABILITY IMPACT

Tax Year 2018 - Projected Impact of Federal Tax Changes

Percentage of Returns

Figure 2

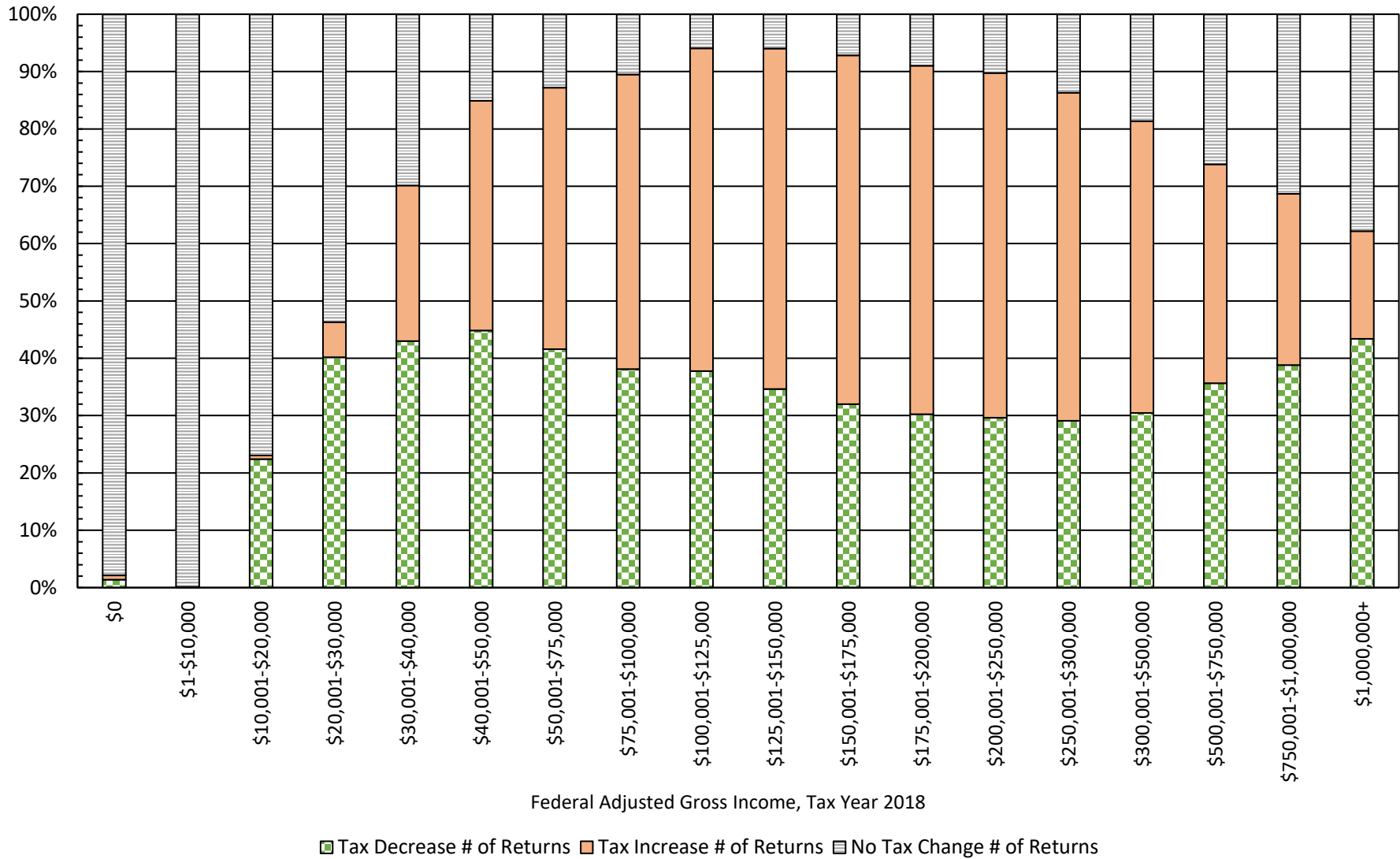


SOUTH CAROLINA STATE INDIVIDUAL INCOME TAX LIABILITY IMPACT

Tax Year 2018 - Projected Impact of Federal Tax Changes

Percent of Returns with Decrease, Increase, or No Change

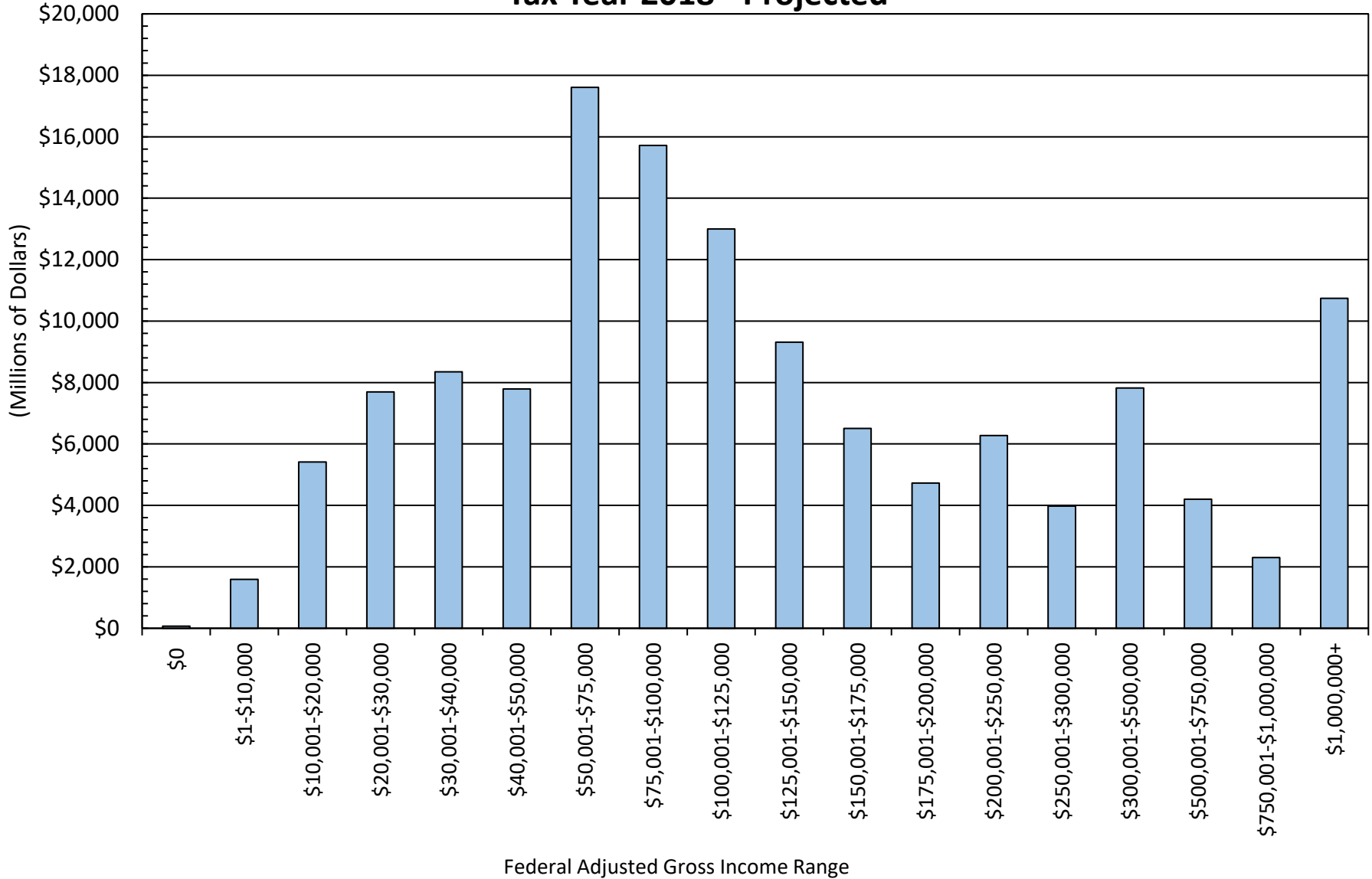
Figure 3



CHANGES IN SOUTH CAROLINA TAXABLE INCOME
FEDERAL ADJUSTED GROSS INCOME AND STATE TAXABLE INCOME
BEFORE AND AFTER

Figure 4

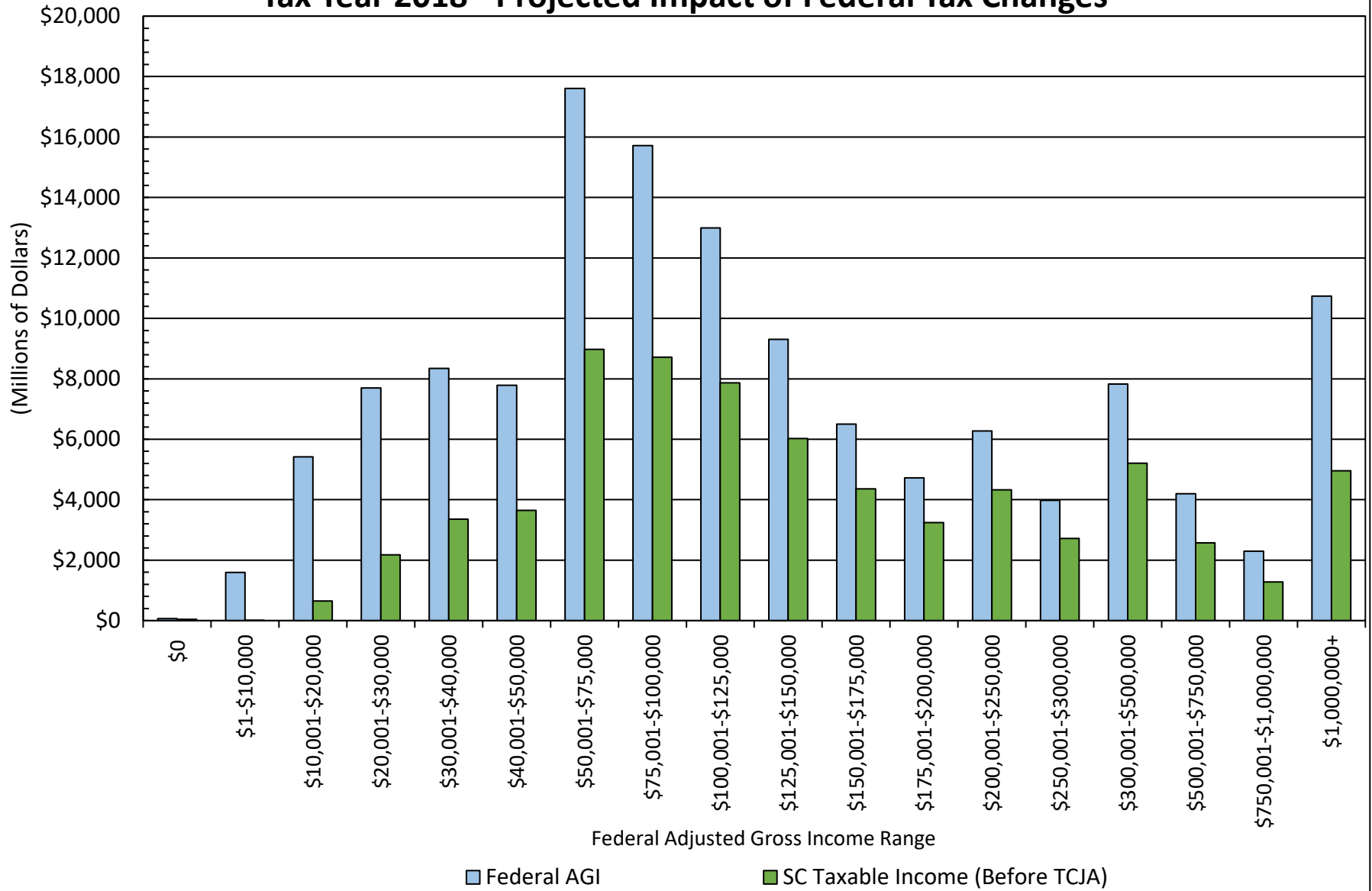
FEDERAL ADJUSTED GROSS INCOME Tax Year 2018 - Projected



FEDERAL ADJUSTED GROSS INCOME AND STATE TAXABLE INCOME

Tax Year 2018 - Projected Impact of Federal Tax Changes

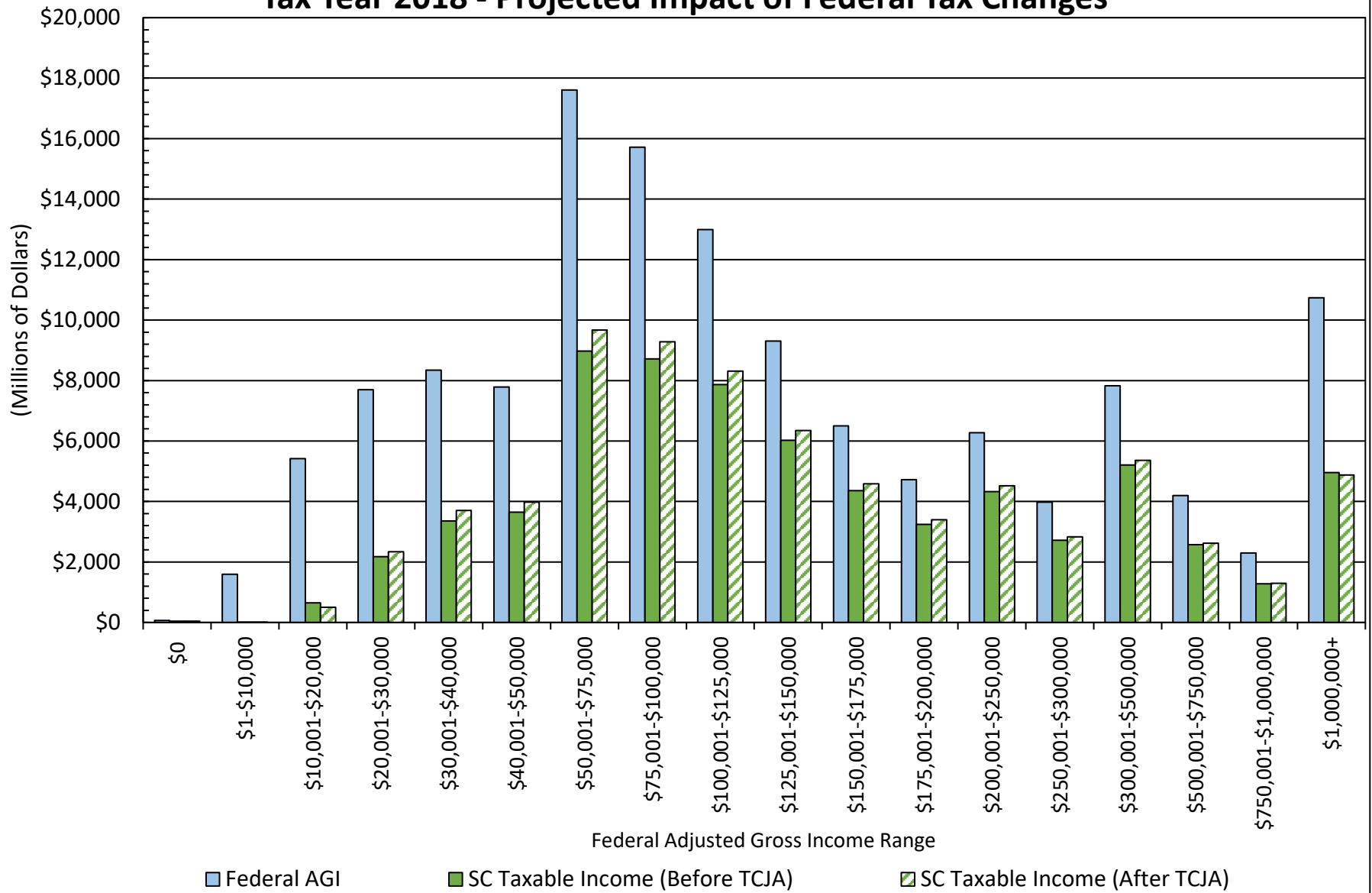
Figure 5



FEDERAL ADJUSTED GROSS INCOME AND STATE TAXABLE INCOME

Tax Year 2018 - Projected Impact of Federal Tax Changes

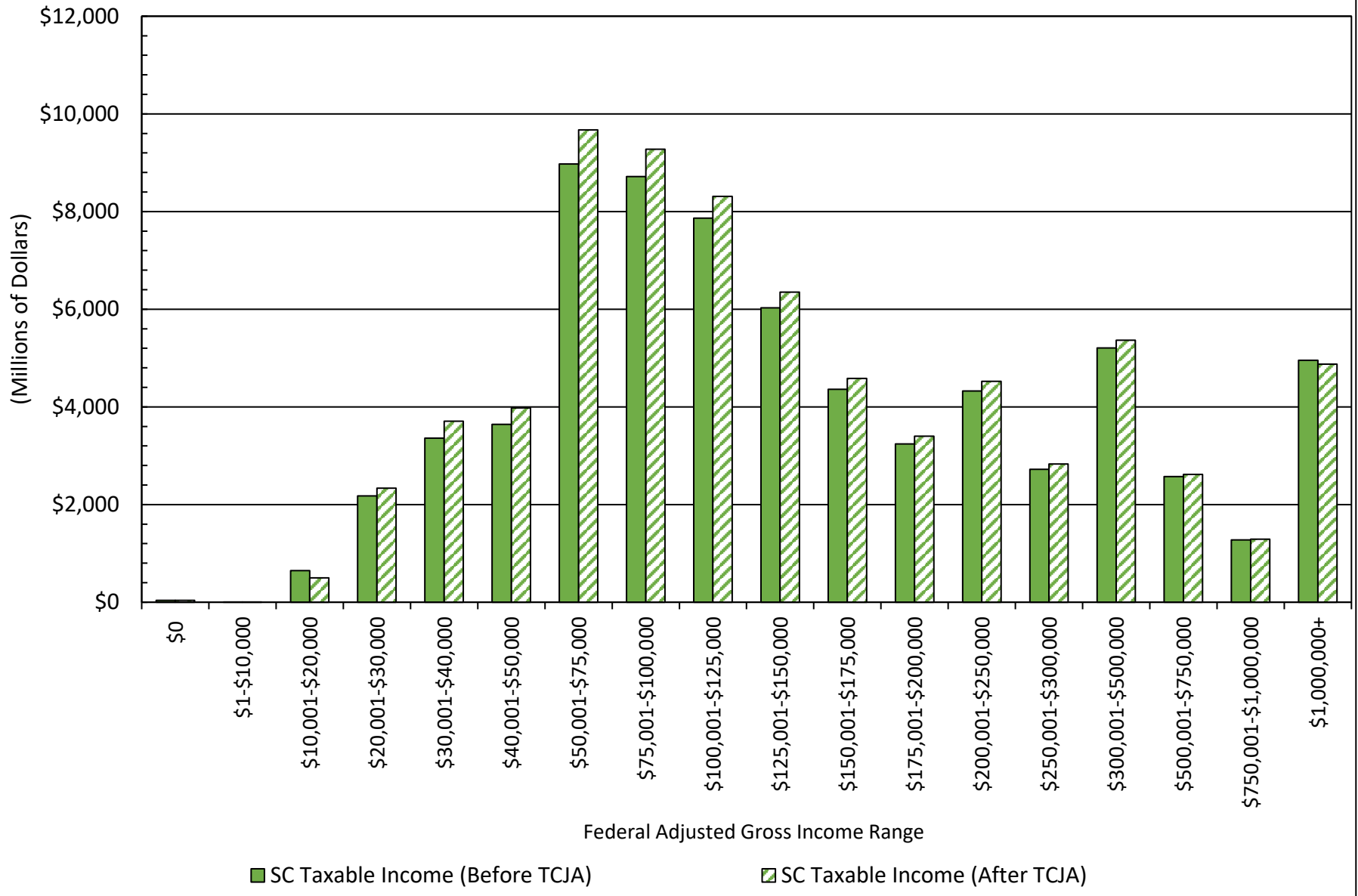
Figure 6



STATE TAXABLE INCOME

Tax Year 2018 - Projected Impact of Federal Tax Changes

Figure 7

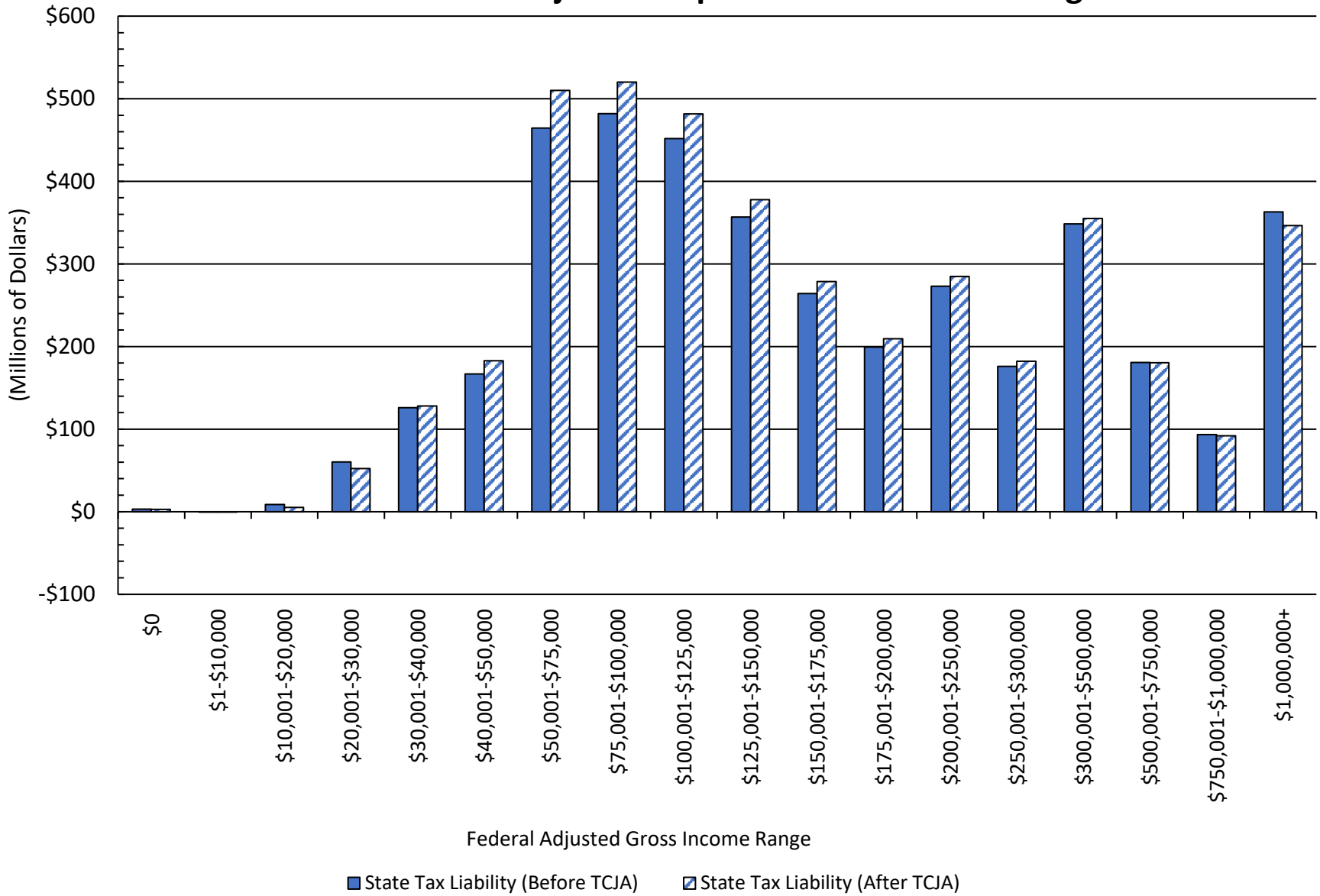


**CHANGE IN TOTAL STATE INDIVIDUAL INCOME TAX LIABILITY
BEFORE AND AFTER**

TOTAL STATE INDIVIDUAL INCOME TAX LIABILITY

Tax Year 2018 - Projected Impact of Federal Tax Changes

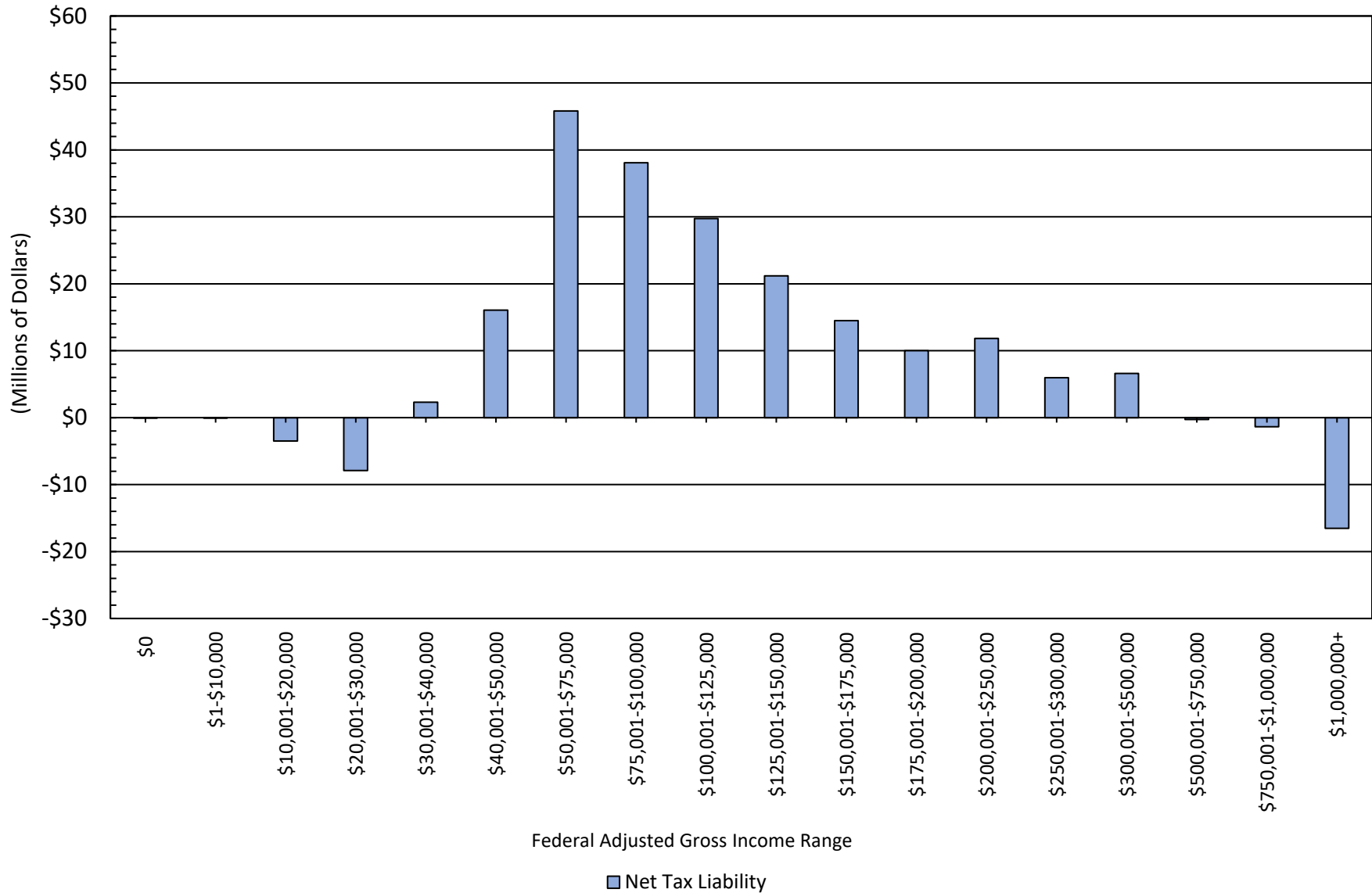
Figure 8



NET SOUTH CAROLINA INCOME TAX LIABILITY
CHANGE IN TAX AND COMPONENTS OF CHANGE

STATE INDIVIDUAL INCOME TAX LIABILITY CHANGE Tax Year 2018 - Projected Impact of Federal Tax Changes

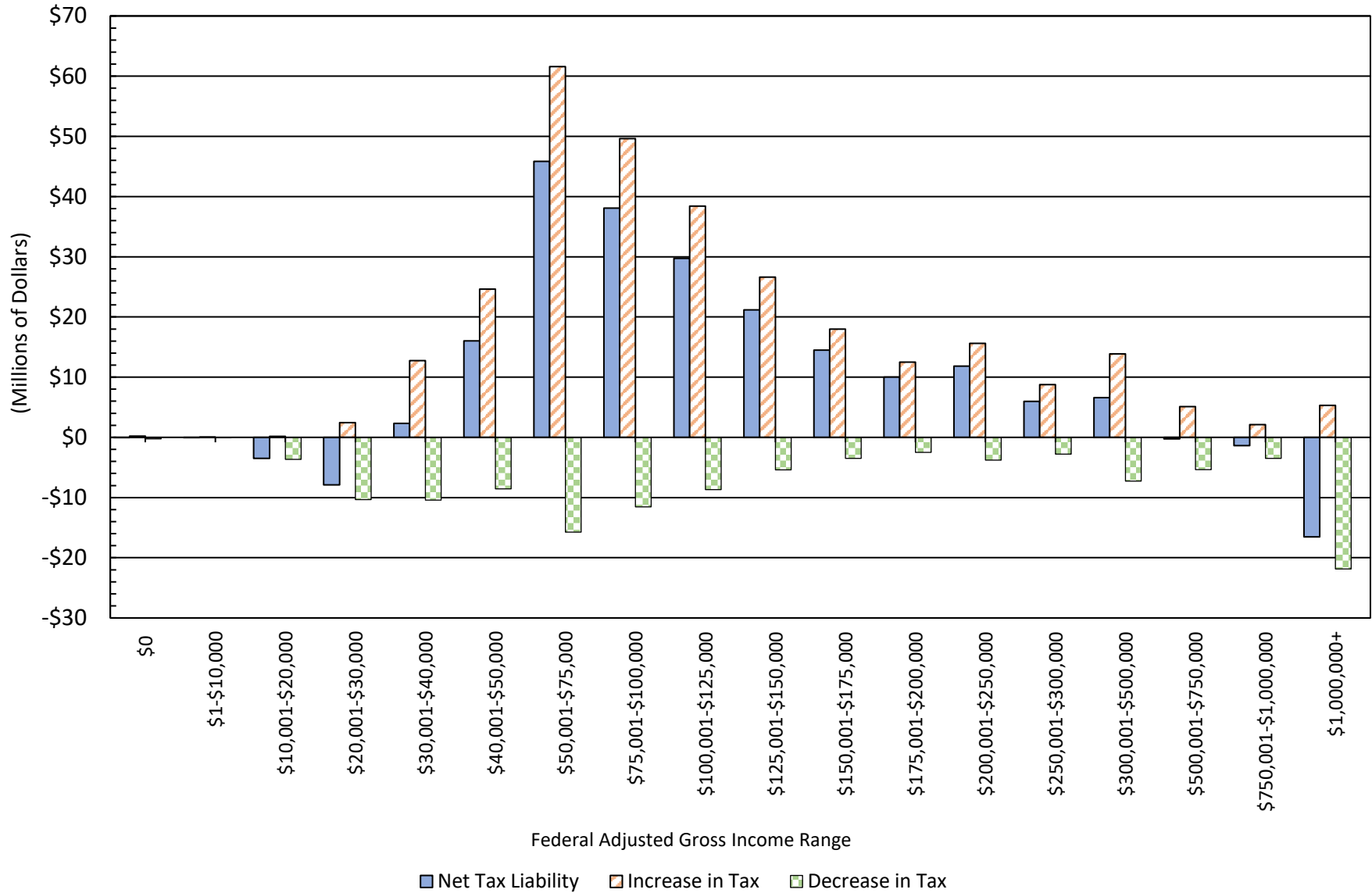
Figure 9



COMPONENTS OF STATE INDIVIDUAL INCOME TAX LIABILITY CHANGE

Tax Year 2018 - Projected Impact of Federal Tax Changes

Figure 10



NET SOUTH CAROLINA INCOME TAX LIABILITY DATA TABLES
DISTRIBUTION OF IMPACT BY FEDERAL ADJUSTED GROSS INCOME
DISTRIBUTION OF INCREASE OR DECREASE BY FEDERAL ADJUSTED
GROSS INCOME

**PROJECTED IMPACT OF FEDERAL TAX CHANGES ON STATE INDIVIDUAL INCOME TAX
Tax Year 2018**

| Projected <i>Federal Adjusted Gross Income</i> Range 2018 | Projected # of Returns 2018 | Projected % of Returns 2018 | Net Tax Liability in Range | Average Net Tax Liability in Range |
|--|------------------------------------|------------------------------------|-----------------------------------|---|
| Column 1 | Column 2 | Column 3 | Column 4 | Column 5 |
| \$0 | 24,957 | 1.0% | (\$59,000) | (\$2) |
| \$1-\$10,000 | 301,760 | 12.6% | (\$3,000) | (\$0) |
| \$10,001-\$20,000 | 378,838 | 15.9% | (\$3,497,000) | (\$9) |
| \$20,001-\$30,000 | 324,595 | 13.6% | (\$7,891,000) | (\$24) |
| \$30,001-\$40,000 | 253,886 | 10.6% | \$2,308,000 | \$9 |
| \$40,001-\$50,000 | 186,457 | 7.8% | \$16,048,000 | \$86 |
| \$50,001-\$75,000 | 311,678 | 13.1% | \$45,827,000 | \$147 |
| \$75,001-\$100,000 | 199,641 | 8.4% | \$38,069,000 | \$191 |
| \$100,001-\$125,000 | 130,161 | 5.5% | \$29,739,000 | \$228 |
| \$125,001-\$150,000 | 77,608 | 3.3% | \$21,184,000 | \$273 |
| \$150,001-\$175,000 | 47,077 | 2.0% | \$14,476,000 | \$308 |
| \$175,001-\$200,000 | 30,587 | 1.3% | \$10,007,000 | \$327 |
| \$200,001-\$250,000 | 35,115 | 1.5% | \$11,830,000 | \$337 |
| \$250,001-\$300,000 | 19,239 | 0.8% | \$5,957,000 | \$310 |
| \$300,001-\$500,000 | 30,243 | 1.3% | \$6,597,000 | \$218 |
| \$500,001-\$750,000 | 12,238 | 0.5% | (\$258,000) | (\$21) |
| \$750,001-\$1,000,000 | 5,678 | 0.2% | (\$1,361,000) | (\$240) |
| \$1,000,000+ | 15,736 | 0.7% | (\$16,534,000) | (\$1,051) |
| Total | 2,385,493 | 100.0% | \$172,000,000 | \$72 |

PROJECTED IMPACT OF FEDERAL TAX CHANGES ON STATE INDIVIDUAL INCOME TAX
Average Decrease, Increase, or No Change
Tax Year 2018

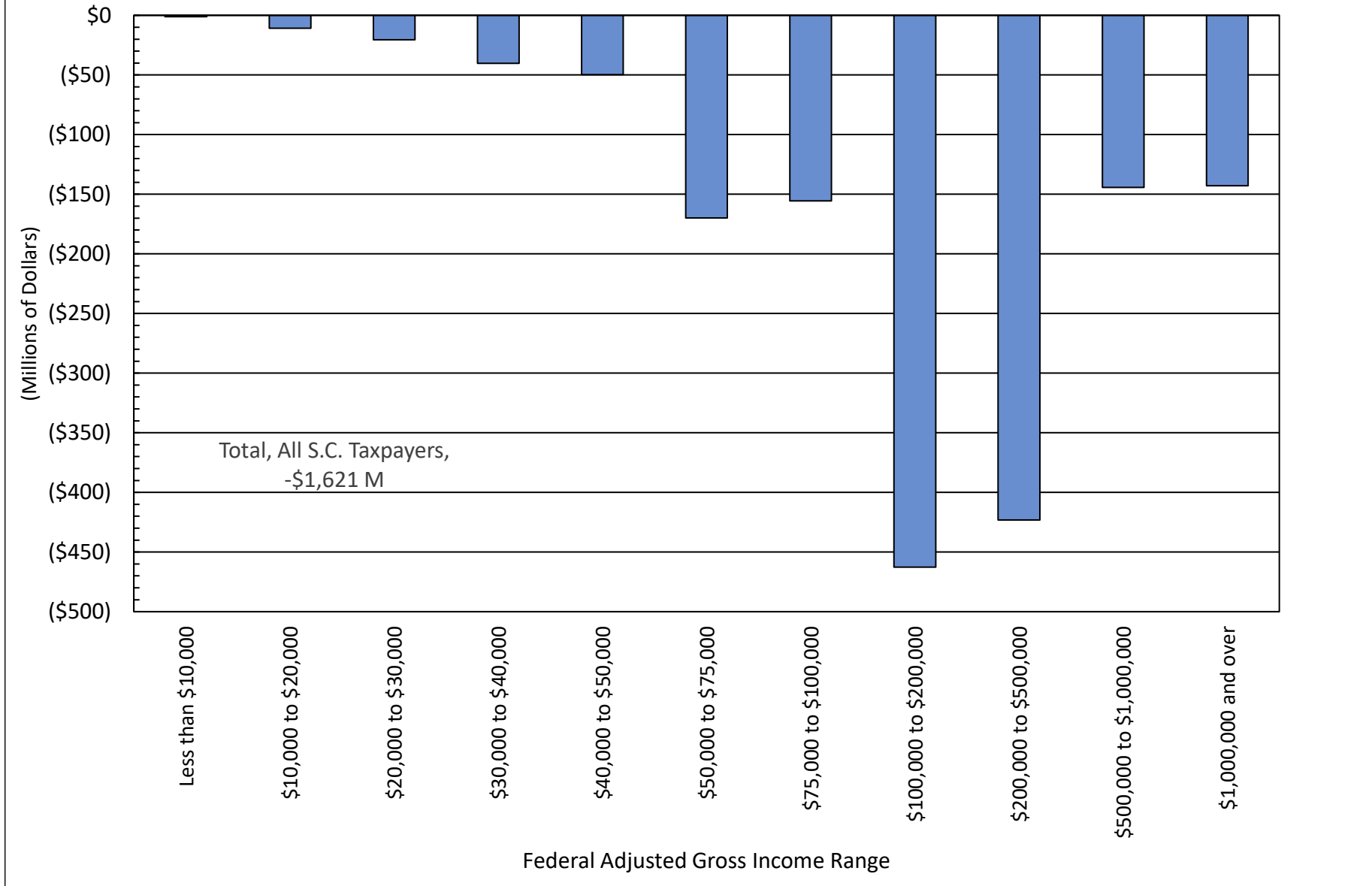
| <i>Projected Federal Adjusted Gross Income Range</i> | <i>Projected # of Returns</i> | <i>Projected % of Returns</i> | <i>Tax Decrease # of Returns</i> | <i>Tax Decrease % of Returns</i> | <i>Average Decrease Amount</i> | <i>Tax Increase # of Returns</i> | <i>Tax Increase % of Returns</i> | <i>Average Increase Amount</i> | <i>No Tax Change # of Returns</i> | <i>No Change % of Returns</i> |
|--|-------------------------------|-------------------------------|----------------------------------|----------------------------------|--------------------------------|----------------------------------|----------------------------------|--------------------------------|-----------------------------------|-------------------------------|
| Column 1 | Column 2 | Column 3 | Column 4 | Column 5 | Column 6 | Column 7 | Column 8 | Column 9 | Column 10 | Column 11 |
| \$0 | 24,957 | 1.0% | 348 | 1.4% | (\$743) | 180 | 0.7% | \$1,109 | 24,429 | 97.9% |
| \$1-\$10,000 | 301,760 | 12.6% | 266 | 0.1% | (\$59) | 35 | 0.0% | \$355 | 301,458 | 99.9% |
| \$10,001-\$20,000 | 378,838 | 15.9% | 84,940 | 22.4% | (\$43) | 2,441 | 0.6% | \$69 | 291,458 | 76.9% |
| \$20,001-\$30,000 | 324,595 | 13.6% | 130,384 | 40.2% | (\$79) | 19,837 | 6.1% | \$124 | 174,374 | 53.7% |
| \$30,001-\$40,000 | 253,886 | 10.6% | 109,203 | 43.0% | (\$96) | 68,846 | 27.1% | \$185 | 75,837 | 29.9% |
| \$40,001-\$50,000 | 186,457 | 7.8% | 83,630 | 44.9% | (\$102) | 74,706 | 40.1% | \$329 | 28,122 | 15.1% |
| \$50,001-\$75,000 | 311,678 | 13.1% | 129,614 | 41.6% | (\$122) | 142,191 | 45.6% | \$433 | 39,874 | 12.8% |
| \$75,001-\$100,000 | 199,641 | 8.4% | 76,067 | 38.1% | (\$152) | 102,538 | 51.4% | \$484 | 21,037 | 10.5% |
| \$100,001-\$125,000 | 130,161 | 5.5% | 49,159 | 37.8% | (\$177) | 73,271 | 56.3% | \$524 | 7,731 | 5.9% |
| \$125,001-\$150,000 | 77,608 | 3.3% | 26,866 | 34.6% | (\$202) | 46,082 | 59.4% | \$577 | 4,660 | 6.0% |
| \$150,001-\$175,000 | 47,077 | 2.0% | 15,071 | 32.0% | (\$231) | 28,630 | 60.8% | \$627 | 3,375 | 7.2% |
| \$175,001-\$200,000 | 30,587 | 1.3% | 9,249 | 30.2% | (\$271) | 18,590 | 60.8% | \$673 | 2,748 | 9.0% |
| \$200,001-\$250,000 | 35,115 | 1.5% | 10,395 | 29.6% | (\$365) | 21,119 | 60.1% | \$740 | 3,601 | 10.3% |
| \$250,001-\$300,000 | 19,239 | 0.8% | 5,600 | 29.1% | (\$499) | 11,010 | 57.2% | \$795 | 2,629 | 13.7% |
| \$300,001-\$500,000 | 30,243 | 1.3% | 9,214 | 30.5% | (\$787) | 15,383 | 50.9% | \$900 | 5,646 | 18.7% |
| \$500,001-\$750,000 | 12,238 | 0.5% | 4,363 | 35.7% | (\$1,229) | 4,671 | 38.2% | \$1,093 | 3,204 | 26.2% |
| \$750,001-\$1,000,000 | 5,678 | 0.2% | 2,205 | 38.8% | (\$1,585) | 1,694 | 29.8% | \$1,259 | 1,779 | 31.3% |
| \$1,000,000+ | 15,736 | 0.7% | 6,826 | 43.4% | (\$3,203) | 2,955 | 18.8% | \$1,803 | 5,955 | 37.8% |
| Total | 2,385,493 | | 753,399 | 31.6% | (\$166) | 634,178 | 26.6% | \$469 | 997,916 | 41.8% |

OTHER INFORMATION:

ESTIMATE OF REDUCTION IN FEDERAL INDIVIDUAL INCOME TAXES FOR
SOUTH CAROLINA TAXPAYERS
BY FEDERAL ADJUSTED GROSS INCOME RANGE

ESTIMATED REDUCTION IN FEDERAL INDIVIDUAL INCOME TAXES South Carolina Taxpayers, Tax Year 2019

Figure 13



Data Source: Joint Committee on Taxation, December 18, 2017, JCX-68-17