

THE TAX CUTS AND JOBS ACT (TCJA)

FEDERAL TAX REFORM AND THE
EFFECTS ON SOUTH CAROLINA





New Federal Law Highlights

- Congress passed the Tax Cuts and Jobs Act in December 2017
- Serves as the largest major tax reform in over 30 years
- Effective beginning with Tax Year 2018 (tax returns due Spring 2019)
- Dramatically changes taxation of individual taxpayers and businesses

Highlights of Specific Changes

- Increased Standard Deduction
 - Combined personal exemption and standard deduction into a “new” increased deduction - \$24,000 for joint return
- Expanded use of 529 Account Funds
 - Allows withdrawal of tuition payments for elementary or secondary schools
- Section 179 Expensing
 - Depreciable tangible personal property expensed up to \$1M from \$500k
- Net Operating Loss Reduction Carryforward
 - Carryforward indefinitely (previously 20 years)
- IRC Section 199A (pass-through entities)
 - 20% deduction of qualified business income for partnerships, s-corporations and sole proprietorships



Individual Income Tax Highlights

- New income brackets and tax rates – 37% highest tax rate
- Repealed personal exemptions - \$4,050
- Increased the standard deduction – up to \$24,000
- Decreased the limit on annual mortgage interest deduction - \$750k and eliminated interest deduction on home equity loans
- Limited State and Local Tax deduction to \$10,000
- 20% deduction for pass-through entities
- Expanded use of 529 Account Funds
- Repeal of moving expenses and alimony deductions
- More generous child tax credits (\$1,000 to \$2,000/child)



Corporate Income Tax Highlights

- Permanently reduced the Corporate tax rate to 21%
- Repeals Corporate alternative minimum tax
- Imposes new limits on business interest deductions (30%)
- Changes to Section 179 expensing and bonus depreciation
- Net operating loss deduction carryforward

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Overview of SC Tax Principles

- Federal taxable income is the starting point for SC taxpayers
- Elections made for federal income tax purposes automatically apply for SC income tax purposes
- Federal principles of accounting, filing requirements, and a taxpayer's tax year are used for SC income tax purposes



Overview of Conformity

- Historically, SC has conformed to the federal tax code with limited modifications since 1985
- Conformity simplifies the filing of returns since the starting point is federal taxable income
- Keeps filing simple and maximizes compliance

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Benefits of Nonconformity

Allows Additional Time

- Allows SC additional time to consider the effects of the new federal tax laws
- The IRS is in the process of providing guidance
- The full impact on SC is unknown at this time

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Consequences of Nonconformity

Results in a Complex Tax System

- By not conforming, SC's tax system will go from one of the simplest to one of the most complex in the US
- SC taxpayers will be “stuck” in time relying on 2016 federal tax laws
- Other states will continue to partner with the federal government, utilizing federal tax changes to their benefit

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Consequences of Nonconformity

SC taxpayers will be required to have a working knowledge of 2 sets of federal laws

- A federal return using 2017 federal tax laws
- A SC return using 2016 federal tax laws
- No longer can SC taxpayers use their federal taxable income as a starting point for their SC return
- Recalculate current federal taxable income to comply with 2016 federal tax laws
- This will require the taxpayers to make up to 30 adjustments - just to begin their SC return!

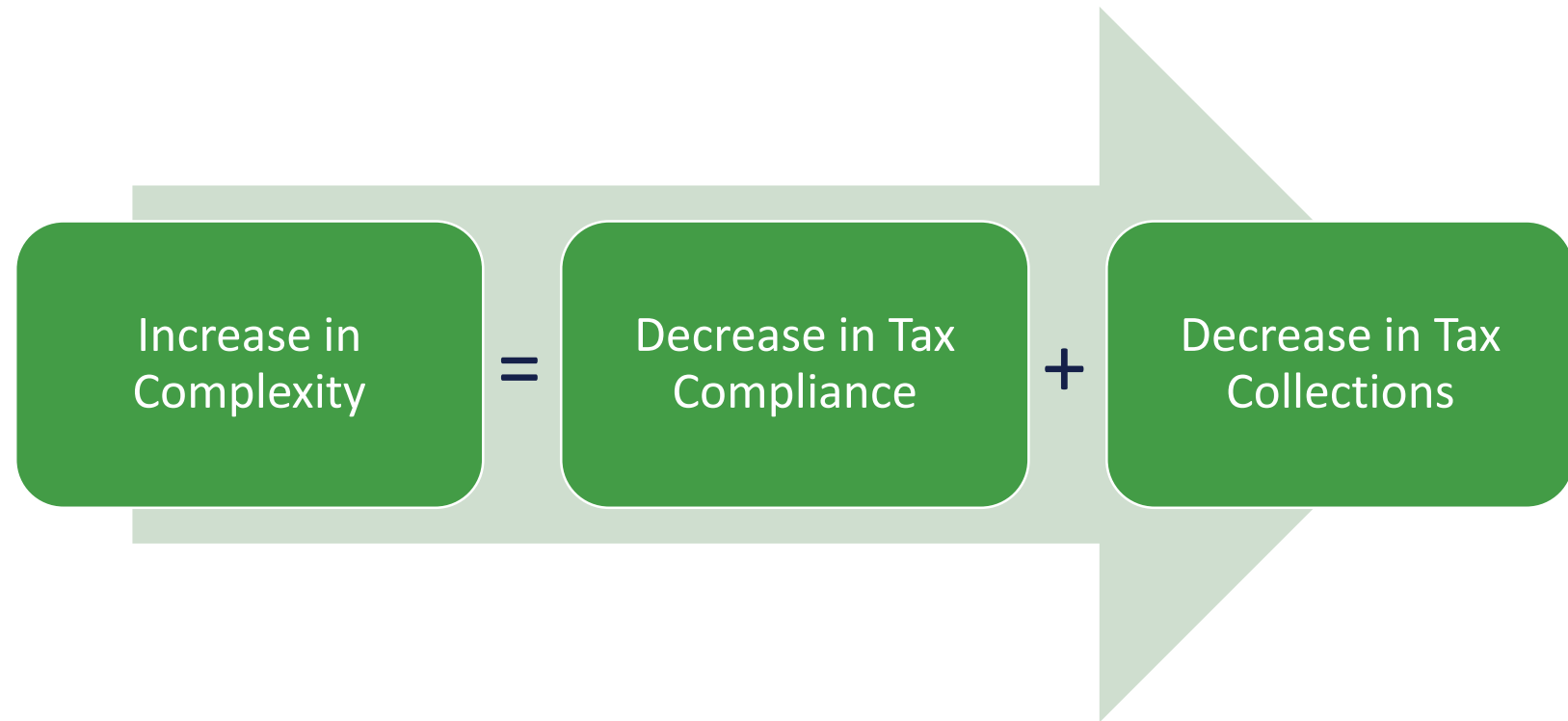


Consequences of Nonconformity

- SC taxpayers can no longer utilize IRS guidance to complete their SC tax return
- Preparation costs may increase due to complexity of SC tax system
- Software providers may not support all SC forms and schedules – possible filing delays, reduction in electronic filing
- SCDOR no longer able to utilize federal audit data to ensure compliance and collections
- Possible chilling effect on economic development

Conclusion

Results of Nonconformity





Recommendations

SCDOR recommends conforming (with modifications) to offset any tax increase resulting from federal tax reform



List of Potential Modifications

- Restore personal exemptions
- Restore under age 6 exemption
- Reduce income tax rates
- Restore itemized deductions
 - Miscellaneous – tax prep fees, employee business expenses, investment management fees
 - Property taxes over \$10,000
 - Interest on home equity line of credit
- Increase SC's two wage earner credit
- Increase SC's retirement income deduction for persons 65+



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