



SC PRIVATE LETTER RULING #87-6

TO: ABC Fund, Inc.

SUBJECT: Exempt Interest-Dividends

REFERENCE: S.C. Code Section 12-7-410; 12-7-430

AUTHORITY: S.C. Code Section 12-3-170

SCOPE: A Private Letter Ruling is a temporary document issued to a taxpayer, upon request, and it applies only to the specific facts or circumstances related in the request. Private Letter Ruling have no precedential value and are not intended for distribution.

Question:

- 1) Is the interest earned on investments in obligations of the State of South Carolina or its political subdivisions and obligations of territory or possessions of the United States exempt from South Carolina income tax if held directly by a South Carolina taxpayer?
- 2) If all dividends paid by the National Series are exempt-interest dividends as that term is defined in IRC Section 852(b), is the prorata share of such dividends paid to South Carolina shareholders which corresponds to the share of interest earned by the fund from South Carolina "exempt securities" exempt from South Carolina income tax?
- 3) If all dividends paid by the South Carolina series are "exempt-interest dividends" as that term is defined in IRC Section 852(b) of the Internal Revenue Code of 1986 and if the South Carolina series invests solely in South Carolina exempt securities, are all dividends paid to South Carolina shareholders exempt from South Carolina income tax?

Facts:

The ABC Fund, Inc. is a regulated investment company under Subchapter M of the Internal Revenue Code. The Fund has taken and intends to continue to take all action required to insure that it meets the requirements to retain its status as a regulated investment company. The Fund offers a National Series and several State series.

The investment objective of the National Series is to maximize income exempt from federal income tax. The National Series will invest 100%, under normal market conditions, but never less than 80% of the value of its assets in securities of states, territories and possessions of the United States, the interest of which is exempt from federal income tax. Approximately 10% of the assets of the National Series are South Carolina exempt securities.

The Fund also offers a State Series. A subscriber must indicate that he wishes to purchase a specific State Series. The objective of each individual State Series is to maximize income exempt from federal income taxes and from personal income taxes in that state. The South Carolina Series will invest 100% of its assets under normal market conditions but never less than 80% of the value of its assets in South Carolina exempt securities i.e. securities that bear interest which is exempt from South Carolina income taxes.

Law/Discussion

South Carolina Code Section 12-7-410 provides:

The South Carolina gross income, adjusted gross income, and taxable income of an individual is the individual's gross income, adjusted gross income, and taxable income as determined under the Internal Revenue Code with the modifications specified in Sections 12-7-430 and 12-7-435.

South Carolina Code Section 12-7-430(b) provides:

The determination of gross income as provided in the following Internal Revenue Code Sections is made with the following modifications:

- (1) The exclusion from gross income authorized by Internal Revenue Code Section 103 is modified to exempt only interest upon obligations of this State, any of its political subdivision, and to exempt interest upon obligations of the United States.
- (2) In any and all Internal Revenue Code Sections that make reference to Internal Revenue Code Section 103, the modification provided in sub-item (1) of item (b) of this section similarly applies.

Internal Revenue Code Section 851(q)(h)

(q)(h) Special Rule for Series Funds

- (1) In General - In the case of a regulated investment company (within the meaning of subsection (a)) having more than one fund, each fund of such regulated investment company shall be treated as a separate corporation for purposes of this title (except with respect to the definitional requirement of subsection (a)).

- (2) Fund Defined - For purposes of paragraph (1) the term "fund" means a segregated portfolio of assets, the beneficial interests in which are owned by the holders of a class or series of stock of the regulated investment company that is preferred over all other classes or series in respect of such portfolio assets.

Internal Code Section 852(b) (5) provides:

Exempt-interest dividends. - If, at the close of each quarter of its taxable year, at least 50 percent of the value (as defined in Section 851(c) (4) of the total assets of the regulated investment company consists of obligations described in section 103(a), such company shall be qualified to pay exempt-interest dividends, as defined herein, to its shareholders.

(A) Definition. - An exempt-interest dividend means any dividend or part thereof (other than a capital gain dividend) paid by a regulated investment company and designated by it as an exempt-interest dividend in a written notice mailed to its shareholders not later than 45 days after the close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the company (including exempt-interest dividends paid after the close of the taxable year as described in Section 855) is greater than the excess of-

- (i) the amount of interest excludable from gross income under section 103(a), over
- (ii) the amounts disallowed as deductions under sections 265 and 171(a)(2), the portion of such distribution which shall be only that proportion of the amount so designated as the amount of such excess for such taxable year bears to the amount so designated.

(B) Treatment of exempt-interest dividends by shareholders. – An exempt-interest dividend shall be treated by the shareholders for all purposes of this subtitle as an item of interest excludable from gross income under Section 103(a). Such purposes include but are not limited to-

- (i) the determination of gross income and taxable income.
- (ii) the determination of distributable net income under subchapter J,
- (iii) the allowance of, or calculation of the amount of, and credit or deduction, and
- (iv) the determination of the basis in the hands of any shareholder of any share of stock of the company.

South Carolina law exempts all interest upon obligations of this State and its political subdivisions and obligations of the United States. Interest upon obligations of territories or possessions of the United States is not exempted by South Carolina Statute, however, the interest of certain obligations of territories or possessions of the United States is exempted by the United States Code.

South Carolina adopted IRC Sections 851 and 852 providing for taxation of a Regulated Investment Company and its shareholders as part of the 1985 Conforming Amendments. The 1986 amendments to Sections 851 and 852 have also been adopted by South Carolina. In determining South Carolina taxable income, references to IRC Section 103 that appear in these

sections are modified as provided by S.C. Section 12-7-430(b)(2). Therefore, to qualify as exempt-interest dividends under IRC Section 852(b)(5), at least 50 percent of the value of the total assets of the regulated investment trust company (or each separately considered fund as provided by Section 851(q) [(h)] must consist of South Carolina tax exempt securities.

Conclusion:

- 1) Interest earned on investments in obligations of the State of South Carolina or its political subdivisions is exempt from South Carolina income tax if held directly by a South Carolina taxpayer. Interest earned on investments in obligations of territories or possessions of the United States is held exempt from South Carolina income tax to the extent provided by the United States Code.
- 2) Dividends paid by the National Series would not qualify as exempt-interest dividends as at least 50% of the fund is not South Carolina exempt securities.
- 3) All dividends paid by the South Carolina Series are exempt-interest dividends if the fund invests solely in South Carolina exempt securities and thus exempt from income tax when paid to South Carolina Shareholders.

SOUTH CAROLINA TAX COMMISSION

s/S. Hunter Howard Jr.
S. Hunter Howard, Jr., Chairman

s/John M. Rucker
John M. Rucker, Commissioner

s/Howard E. Duvall Jr.
Howard E. Duvall, Jr., Chairman

Columbia, South Carolina
June 4, 1987