



STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE

300A Outlet Pointe Blvd., Columbia, South Carolina 29210
P.O. Box 125, Columbia, South Carolina 29214-0575

SC REVENUE RULING #21-11

SUBJECT: Catastrophe Savings Accounts – Taxability of Contributions and Withdrawals
(Individual Income Tax)

EFFECTIVE DATE: All periods open under statute.

SUPERSEDES: All previous advisory opinions and any oral directives in conflict herewith.

REFERENCES: S.C. Code Ann. Section 12-6-1610 (2014)
S.C. Code Ann. Section 12-6-1620 (2014)
S.C. Code Ann. Section 12-6-1630 (2014)
S.C. Code Ann. Section 12-43-220(c) (2014 and Supp. 2020)

AUTHORITY: S.C. Code Ann. Section 12-4-320 (2014)
S.C. Code Ann. Section 1-23-10(4) (2005)
SC Revenue Procedure #09-3

SCOPE: The purpose of a Revenue Ruling is to provide guidance to the public. It is an advisory opinion issued to apply principles of tax law to a set of facts or general category of taxpayers. It is the Department's position until superseded or modified by a change in statute, regulation, court decision, or another Department advisory opinion.

OVERVIEW

Article 11, Chapter 6 of Title 12, was added in 2007 to allow individuals an income tax deduction for certain contributions to a Catastrophe Savings Account to cover an insurance deductible or self-insured losses for the taxpayer's legal residence from certain hurricanes, rising floodwaters, or other catastrophic windstorm event damage.

With hurricane season approaching and as a result of the increase in catastrophic weather events in South Carolina and the extensive damage these events have caused in the past, the purpose of

this advisory opinion is to remind individual taxpayers of the tax deduction available for establishing a catastrophe savings account and the tax consequences of withdrawals.

This question and answer document will address some common issues surrounding the Catastrophe Savings Account provisions in Code Sections 12-6-1610 through 12-6-1630.

The following terms are defined in Code Section 12-6-1610:

- “Qualified catastrophe expenses” means expenses paid or incurred by reason of a major disaster that has been declared by the Governor to be an emergency by executive order.
- “Qualified deductible” means the deductible for the individual’s homeowner’s policy for a taxpayer’s legal residence.
- “Legal residence” means the taxpayer’s legal residence pursuant to Code Section 12-43-220(c).

For purposes of this advisory opinion, the use of the terms “taxpayer,” “covered catastrophe,” and “insurance” have the following meaning:

- “Taxpayer” means the individual who:
 1. Owns the home that meets the legal residence requirements under Code Section 12-43-220(c),
 2. Is named as an insured on the homeowner’s insurance policy that covers the legal residence, if the person is not self-insured, and
 3. Established the Catastrophe Savings Account.
- “Covered catastrophe” means a hurricane, rising floodwater, or other catastrophic windstorm event that has been declared by the Governor to be an emergency by executive order.
- “Insurance” means the individual’s homeowner’s policy, unless otherwise noted.

QUESTIONS AND ANSWERS

1. Q. What is a Catastrophe Savings Account (“CSA”)?

A. A CSA is a savings or money market account established by a taxpayer for the specific purpose of covering the amount of an insurance deductible and other uninsured portions of risks of loss from a covered catastrophe to the taxpayer’s legal residence. A CSA is limited to an interest-bearing account. The account must be labeled as a “Catastrophe Savings Account.” Code Section 12-6-1620(B)(1).

2. Q. Who can establish a Catastrophe Savings Account?

- A. A CSA can only be established by the South Carolina resident individual who owns the property that qualifies as a legal residence under Code Section 12-43-220(c).

A taxpayer can only establish one CSA at a time. Since the CSA is connected to a legal residence, joint owners of a legal residence may only establish one CSA. For example, two sisters owning the legal residence may only establish one CSA for that residence – each sister may not establish a separate CSA. However, if the residence is sold, the CSA may be used for the new legal residence.

The qualifying requirements for legal residence are set forth in Code Section 12-43-220(c) and can include:

1. The residence must be the taxpayer's legal residence and where the taxpayer is domiciled at the time of application for the legal residence status to the county assessor;
2. Neither the taxpayer nor any other member of the taxpayer's household may claim to be a legal resident of another jurisdiction other than South Carolina for any purpose; and
3. Neither the taxpayer nor any member of the taxpayer's household may claim the 4% assessment ratio on another residence.

Note: The specific rules for an individual qualifying a residence as a legal residence eligible for the special 4% assessment ratio in Code Section 12-43-220(c) are complex and beyond the scope of this advisory opinion.¹

3. Q. How much can be contributed to a Catastrophe Savings Account?

- A. Code Section 12-6-1620(B)(3) establishes the total amount that an individual may contribute to a CSA. The total amount that may be contributed depends on the taxpayer's deductible amount, if any, for the homeowner's policy. The total amounts are listed below.

¹ For complete information about the requirements to qualify a residence as a legal residence, contact the county assessor in which the property is located.

Individuals Qualified Deductible for the Homeowner's Policy on the Legal Residence*	Total CSA Contribution² on the Legal Residence
The qualified deductible is \$1,000 or less	\$2,000
The qualified deductible is over \$1,000	The lesser of \$15,000 or twice the qualified deductible
No insurance deductible - the taxpayer is "self-insured"	The lesser of \$250,000 or the value of the legal residence

*Note: The CSA contribution amount is determined based upon the individual's homeowner's policy deductible only. If a taxpayer has multiple insurance policies with different deductible amounts based on the catastrophic event (e.g., a general homeowner's policy and a separate flood policy), the deductibles for each separate policy cannot be aggregated to calculate the total CSA contribution amount. See definition of "qualified deductible" in Code Section 12-6-1610.

Caution: Code Section 12-6-1620(B)(4) provides that a taxpayer who contributes in excess of the above amounts shall withdraw the amount of the excess contributions and include that amount in South Carolina income in the year of withdrawal. This amount is not subject to the 2.5% additional tax. (See Question 12.)

4. Q. Is the total contribution to a Catastrophe Savings Account fixed on the date the account is established?
 - A. The total CSA contribution is based on the qualified deductible for the individual's homeowner's policy or the value of the legal residence of a self-insured individual as explained above in Question 3. If the owner increases the policy deductible or the value of the residence increases in the case of a self-insured individual, the total CSA contribution amount is adjusted upward. The total CSA contribution amount, however, is not lowered if the policy deductible is decreased or the value of the residence decreases.

For example, a taxpayer established a CSA when the homeowner's insurance policy deductible was \$5,000. The total CSA contribution is \$10,000 (the lesser of \$15,000 or twice the deductible). No further contributions are made to, and no distributions are made from, the CSA. Any interest accrued is not considered in determining the total contribution amount. The taxpayer later increases his insurance deductible from \$5,000 to \$10,000. The total CSA contribution for a deductible of \$10,000 is \$15,000 (the lesser of \$15,000 or twice the deductible). The taxpayer may make additional contributions up to \$5,000 to the CSA (\$15,000 total CSA contribution allowed based on the new deductible amount less \$10,000 of prior contributions).

² Any interest accrued is not considered in determining the total contribution amount.

5. Q. Must distributions from a Catastrophe Savings Account be used to only pay for “qualified catastrophe expenses”?
- A. While the purpose of a CSA is to cover the amount of insurance deductibles and other uninsured portions of risks of loss from a hurricane, rising floodwater, or other catastrophic windstorm event, distributions from a CSA are not limited to qualified catastrophe expenses. However, a distribution from a CSA must be included in the taxpayer’s income if the distribution is used to cover nonqualified catastrophe expenses. Code Section 12-6-1630(A). See Question 10 and the exception in Code Section 12-6-1630(E) for use of distributions for any reason by certain taxpayers age 70 and older.
6. Q. Are distributions from a Catastrophe Savings Account used to pay expenses from damage caused by any tornado, severe rain and wind storm, or hail storm considered “qualified catastrophe expenses”?
- A. No. Code Section 12-6-1610(1) defines “qualified catastrophe expenses” as expenses paid or incurred by reason of a major disaster that has been declared by the Governor to be an emergency by executive order. A distribution from a CSA to pay for expenses for damage from a major disaster that is not declared an emergency by the Governor must be included in the taxpayer’s income since the distribution is used to cover “nonqualified” catastrophe expenses. Code Section 12-6-1630(A).
7. Q. Are expenses paid from a Catastrophe Savings Account that was established after the catastrophic event was declared by the Governor “qualified catastrophe expenses”?
- A. No. The CSA must be established before the catastrophic event occurs.
8. Q. Can the taxpayer continue to contribute to the Catastrophe Savings Account after a distribution?
- A. Generally, a taxpayer taking distributions from the CSA may make additional contributions to the CSA, up to the total contribution limit allowed. See Question 10 for an exception.
9. Q. What are the tax consequences of a Catastrophe Savings Account?
- A. Code Sections 12-6-1620(B) and 12-6-1630 provide the tax rules for contributions to a CSA, interest earned on the CSA, and distributions from the CSA. The tax consequences vary and include:
- Contributions. An individual taxpayer is allowed an income deduction from the income tax imposed under Code Section 12-6-510 for amounts contributed to a CSA, up to the contribution limits allowed in Code Section 12-6-1620(B)(3). See Questions 3 and 4 for the total contribution amounts allowed.

Interest Income. Interest earned on a CSA is exempt from South Carolina income tax.

Withdrawals (Distributions). Code Section 12-6-1630(A) provides that a distribution from a CSA is included in income unless the amount of the distribution is used to cover qualified catastrophe expenses. If the aggregate distributions exceed the qualified catastrophe expenses during the tax year, then the excess amount (total distributions less qualified catastrophe expenses) must be included in South Carolina income. Code Section 12-6-1630(C). Further, Code Section 12-6-1630(D) provides that the tax paid attributable to a taxable distribution must be increased by 2.5% of the amount includable in income. Exceptions exist to each of these provisions and are discussed in Questions 10, 12, and 13. Additionally, other specific types of distributions may not be subject to South Carolina income tax.

Account Legally Protected. A CSA is not subject to attachment, levy, garnishment, or legal process. Code Section 12-6-1620(B)(2).

10. Q. What distributions from a Catastrophe Savings Account are not taxable?

A. The following distributions from a CSA are not included in South Carolina taxable income:

Distributions Used for Qualified Catastrophe Expenses. No distribution used to cover qualified catastrophe expenses is included in income. Code Section 12-6-1630(A).

Qualified Expenses are Equal to or Greater than the Total Distributions. No amount is included in income if the qualified catastrophe expenses of the taxpayer during the tax year equal or exceed the total distributions during the tax year. Code Section 12-6-1630(B).

Distribution by a Taxpayer Age 70 or Older who has a Homeowner's Policy. No amount is included in income if the distribution is from a CSA established based upon an individual's homeowner's policy deductible (rather than a CSA established by a self-insured individual) and, if at the time of distribution the taxpayer is at least age 70.

Note: This provision in Code Section 12-6-1630(E) allows the individual to withdraw the CSA funds for any purpose or expense (disaster related or unrelated to a disaster). If this provision applies, the 70 or older taxpayer cannot make further contributions to any CSA.

11. Q. What is the tax on taxable distributions?

A. Taxable distributions are taxed at the tax rate established in Code Section 12-6-510 (the general tax rates for individuals). In certain instances, a taxable distribution is also subject to an additional 2.5% tax, as discussed in Question 12. Code Section 12-6-1630(D) and (F).

12. Q. Does the 2.5% additional tax apply to all taxable distributions (e.g., an excess distribution or a distribution used to cover a nonqualified expense)?

A. The additional 2.5% tax does not apply to a taxable distribution if:

1. The taxpayer no longer owns a legal residence that qualifies under Code Section 12-43-220(C); or
2. The distribution is from a self-insured individual who chose not to obtain insurance on his legal residence and the distribution is made on or after the date the taxpayer attains age 70; or
3. The distribution is on death of the taxpayer or the surviving spouse. Code Section 12-6-1630(D)(2) and (F).

Further, the 2.5% additional tax does not apply to a taxpayer who contributes over the CSA amount set forth in Code Section 12-6-1620(B)(4) who is required to withdraw the excess contributions and include the excess in South Carolina income in the year of withdrawal. See Questions 3 and 4.

13. Q. What are the tax consequences of a Catastrophe Savings Account when the account owner dies?

A. When a person who owns a CSA dies, the tax consequences depend upon who is the recipient of the account.

If the person receiving the account is the surviving spouse, the income is not included in the income of the surviving spouse. Upon the death of the surviving spouse, the account is included in the income of the person receiving it. The 2.5% additional tax does not apply.

If the person receiving the account is not the surviving spouse, the account is included in the income of the person receiving it. Code Section 12-6-1630(F).

14. Q. What records should be kept to substantiate policy deductibles and uninsured losses paid from a Catastrophe Savings Account?

A. A taxpayer must maintain documentary evidence to substantiate expenses incurred, such as receipts, invoices, pictures of damages, or insurance policy information. Receipts

should not be included with the taxpayer's income tax return, but must be readily available in the event of a Department audit. Documentation should show the expense amount, date, and item description.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/W. Hartley Powell

W. Hartley Powell, Director

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Columbia, South Carolina