South Carolina Tax Commission
301 Gervais Street, P.O. Box 125, Columbia, South Carolina 29214

# TECHNICAL ADVICE MEMORANDUM #89-23

TO: Mr. Marvin Davant, Director
Field Services Division

FROM: John Swearingen, Manager
Policy and Special Procedures Division

DATE: August 23, 1989

SUBJECT: Distributions from Individual Retirement Account (IRA)

REFERENCE: S.C. Code Ann. Section 12-7-410 (Law Co-op. Supp. 1988)
S.C. Code Ann. Section 12-7-430(b)(1)

AUTHORITY: S.C. Code Section 12-3-170
S.C. Revenue Procedure #87-3

SCOPE: A Technical Advice Memorandum is a temporary document issued to an individual within the commission, upon request, and it applies only to the specific facts or circumstances related in the request. Technical Advice Memoranda have no precedential value and are not intended for general distribution.

Question:

Does S.C. Code Section 12-7-430 (b)(1) exclude from taxation a taxpayer's IRA distribution which includes interest earned by the Trust from its investment in U.S. Government obligations?

Facts:

A taxpayer is currently receiving distributions from an IRA account that is invested in U.S. Treasury obligations. The distributions are of current earnings of the investment of the IRA account in U.S. Treasury obligations. Taxpayer claims this interest is excluded the same as regular interest income from U.S. Government obligations per S.C. Code Section 12-7-430(b)(1).

Discussion:

S.C. 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.

S.C. Code Section 12-7-430 provides in part:

> (b) 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 subdivisions, and to exempt interest upon obligations of the United States.

IRC Section 103 provides in part:

> (a) Exclusion- Except as provided in subsection (b), gross income does not include interest on any State or local bond.

Since IRC Section 103(a) excludes interest on any State or local bond, and since S.C. Code Section 12-7-410 adopted the IRC for computation of gross income (unless specifically excluded under S.C. Code Section 12-7-10), it was necessary to modify IRC Section 103(a) so as to limit application of the exemption only to interest earned from this state's obligations. S.C. Code Section 12-7-430(b)(1) provides this modification. S.C. Code Section 12-7-430(b)(1) also provides an exemption for interest earned from obligations of the United States. However, IRC Section 103(a) applies to governmental (U.S. or State) obligations actually owned by the taxpayer.

The Code Section which governs distributions from an Individual Retirement Account (IRA) is IRC Section 408(d):

> (1) In general- Except as otherwise provided in this subsection, any amount paid or distributed out of an individual retirement plan shall be included in gross income by the payee or distributee, as the case may be, in the manner provided under section 72.

Thus, IRC Section 408(d)(1) specifically states any amount paid or distributed from an IRA is included in the computation of gross income unless otherwise provided in that subsection. Since IRC Section 408 does not provide an exclusion for interest earned from governmental (U.S. or State) obligations nor does it refer to IRC Section 103(a), taxpayer's IRA distribution is subject to this state's income tax and, therefore, should be included in gross income.

The Internal Revenue Service has ruled similarly in two separate rulings on distributions from employees' trusts. In a 1955 ruling on exempt interest:

> Although a distribution from an employees' trust meeting the requirements of section 401 of the Internal Revenue Code of 1954 is made whole or in part from funds received by the trust as interest on tax-free securities, such distribution, when received or made available, is taxable income to the distributee in the manner and to the extent provided by Section 402(a) of the Code Rev. Rul. 55-61, 1955-1 CB 40.

In a 1972 ruling on dividends:

> Section 72 and 402(a) of the Code specify the federal income tax treatment to be accorded to a distribution from an employees' trust. The fact that part of the distribution is derived from dividends, or any other specific type of income has no bearing on the treatment of the distribution for purposes of those sections. The cash dividends in this case became part of the trust assets when they were paid to the trustee and as such lost their identity as dividends. Rev. rul. 71-99, 1972-1 CB 115.

<u>Conclusion</u>:

Taxpayer's IRA distribution is governed by IRC Section 408(d) which specifically states "all amounts paid or distributed out of an IRA shall be included in gross income..." There is no reference to IRC Section 103(a) and as a result, S.C. Code Section 12-7-430(b)(1) is <u>not</u> applicable. Thus, the source of the distribution is irrelevant. There-fore, in accordance with IRC Section 408(d), taxpayer's IRA distribution shall be included in the computation of gross income.