



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

SC PRIVATE LETTER RULING 92-1

TO: Mr. & Mrs. X

TAX ANALYST: Jean P. Croft

SUBJECT: Treatment of Capital Gain and Capital Loss Carryover
(Income Tax)

REFERENCE: S.C. Code Ann. 12-7-437 (Supp. 1990)
S.C. Code Ann. 12-7-445 (Supp. 1990)
S.C. Code Ann. 12-7-430 (Supp. 1990)

AUTHORITY: S.C. Code Ann. 12-4-320(2) (July 1991)
S.C. Revenue Procedure 87-3

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 Rulings have no precedential value and are not intended for
general distribution.

Questions:

1. What type of income tax return should Mr. and Mrs. X file if they are residents of another state at the beginning of the taxable year but are legal residents of South Carolina at the end of the year?
2. How should Mr. and Mrs. X treat a capital loss carryover for South Carolina income tax purposes if they were residents of another state at the time the loss was incurred?
3. How should Mr. and Mrs. X treat, for South Carolina income tax purposes, a capital gain which is reported on the installment basis for federal income tax purposes if the sale occurred prior to the time they became residents of South Carolina?

Facts:

On February 7, 1991, Mr. and Mrs. X ("taxpayers"), legal residents of Wisconsin, sold short 28,600 shares of stock for \$928,280. On March 12, 1991, the transaction was closed out when the taxpayers purchased the 28,600 shares at a cost of \$1,173,789. The loss of \$242,509 on the transaction will be reported as a short-term capital loss. This loss is not connected with any business of the taxpayers. Since the taxpayers have no capital gains in 1991, the loss for federal income tax purposes will be limited to \$3,000 and the remainder will be carried over to subsequent years. For Wisconsin income tax purposes, the loss will be limited to \$500.

Also in 1991, while residents of Wisconsin, the taxpayers sold stock in a Wisconsin corporation on the installment method. Although the sale took place during 1991, the contract provides that payments be made for 5 years beginning in 1992. They will not elect out of the installment method; therefore, pursuant to Internal Revenue Code 453, the gain of \$435,000 on the sale will be recognized in the following manner: \$195,000 in the first year; \$69,112 in years 2 through 4; and \$69,113 in the last year. Since the stock has been held for several years, the gain will be a long-term capital gain. Although the taxpayers are reporting the gain on the sale on the installment basis for federal income tax purposes, for Wisconsin income tax purposes they may either elect to report the total gain in 1991 or report the gain on the installment method.

During 1991 the taxpayers will move to South Carolina and become residents.

Discussion:

1. The first issue concerns the type of income tax return the taxpayers may file with South Carolina for 1991 - a resident or part-year resident return.

S.C. Code 12-7-445 answers this question by providing that a taxpayer who is a part-year resident of South Carolina may elect to:

- (a) Report and compute his South Carolina tax as if he were a resident for the entire year and take the applicable credit as provided in [12-7-1240]; or
- (b) Report and compute his South Carolina tax as if he were a nonresident for the entire year, except that for purposes of this computation the South Carolina taxable income for that period during which the individual was a resident includes all items of income, gain, loss, or deductions whether or not derived from sources within South Carolina with the modifications specified in 12-7-430 and 12-7-435.

2. & 3. The next two issues concern whether gains/losses on sales of intangible assets are taxable to South Carolina when the transactions which gave rise to such gains/losses take place in another state.

In the present case, the taxpayers have 1) a capital loss carryover and, 2) a capital gain which is to be recognized for federal income tax purposes over the next 5 years. S.C. Code 12-7-1120(5) provides:

Gains and losses from sales of intangible personal property not connected with the business of the taxpayer other than any intangible personal property held for sale to customers in the regular course of business, less all related expenses, shall be allocated to the state of a corporation taxpayer's principal place of business or of an individual taxpayer's domicile.

S.C. Code 12-7-410 provides that South Carolina gross income, adjusted gross income, and taxable income of an individual is the same as determined under the Internal Revenue Code, with the modifications provided in 12-7-430 and 12-7-435. Neither of these sections provides for any adjustment to be made to the computation of a capital loss carryover or of a capital gain because the taxpayer changed domicile or otherwise.

Although not directly on point, this reasoning is further supported by the principle that the character of income is determined at the time it is reported rather than at the time the transaction giving rise to the income occurred. In *Picchione et al. v. Commissioner of Internal Revenue*, 440 F.2d 170, (1st Cir. 1971), the United States Court of Appeals held that payments received on the installment basis for a copyright constituted ordinary income in the current year even though such payments were correctly reported as capital gain in preceding years. A change in the definition of capital assets which excluded copyrights from this category applied to the payments currently being received even though the copyright constituted a capital asset at the time the sale took place. In *Snell v. Commissioner of Internal Revenue*, 97 F.2d 891 (5th Cir. 1938), the court held that in the case of installment sales, the law in effect at the time the payment is received, not at the time of the sale, determines the character of the income. South Carolina's adoption of the Internal Revenue Code warrants compliance with these cases at the state level.

Although South Carolina taxable income is defined as federal taxable income, certain deductions with respect to capital gains are allowed to be subtracted from South Carolina taxable income. S.C. Code §12-7-437 provides:

- A There is allowed a deduction from the South Carolina taxable income of individuals, partnerships (including S corporations), estates, and trusts equal to the following amounts of net long term capital gain recognized during the below-referenced taxable years:
 - (1) fourteen percent for taxable years beginning in 1990;
 - (2) twenty-nine percent for taxable years beginning in 1991;
 - (3) forty-four percent for taxable years beginning after 1991.
- B. For purposes of this section, net long term capital gain is as defined in the Internal Revenue Code of 1986, as amended through December 31, 1988, except that the required holding period is two or more years.
- C. The commission may promulgate regulations necessary to implement the provisions of this section.

Therefore, the capital loss carryover and the net long term capital gain are computed in the same manner as for federal income tax purposes but the net long term capital gain is decreased by the applicable percentage for the given taxable year.

S.C. Code 12-7-1240 grants a credit for income taxes paid by a resident of South Carolina to another state subject to certain conditions. S.C. Code 12-7-1240(1) provides that the credit is limited to taxes paid to another state on income derived from sources within the state which is taxed under the laws of that state irrespective of the residence of the recipient. Wisconsin Code of Laws 71.04 states:

All other income or loss of nonresident individuals . . . including income or loss derived from land contracts, mortgages, stocks, bonds and securities or from the sale of similar intangible personal property, shall follow the residence of such persons . . .

Hence, the taxpayers do not qualify for a credit even if they elect to pay taxes in Wisconsin due to the fact that the gain from the sale of the stock is not taxed by Wisconsin irrespective of the residence of the taxpayers.

Conclusions:

1. The South Carolina income tax laws will allow Mr. and Mrs. X to file a 1991 South Carolina income tax return in one of the following manners:
 - a. They may file a resident South Carolina income tax return for 1991, reporting all income earned.
 - b. They may file a nonresident South Carolina income tax return for 1991. They must report and compute their South Carolina tax as if they were nonresidents for the entire year, except that for purposes of this computation the South Carolina taxable income for the period during which they were residents must include all items of income, gain, loss, or deductions whether or not derived from sources within South Carolina.
2. The amount of Mr. and Mrs. X's capital loss carryover resulting from the sale of shares of stock is the same for South Carolina income tax purposes as for federal income tax purposes. The limitation on the amount of the loss which Wisconsin will allow them to deduct will not affect the amount of the loss carryover available for South Carolina income tax purposes.
3. A capital gain from the sale of shares of stock reported on the installment method for federal income tax purposes must be reported in the same manner for South Carolina income tax purposes. Accelerating the recognition of the gain into the current taxable year for Wisconsin income tax purposes will have no bearing on this treatment; hence, Mr. and Mrs. X will recognize the same amount of gain on their South Carolina income tax return as they report on their federal return, notwithstanding the manner in which they reported the gain on their Wisconsin income tax return. Any net long term capital gain should be reduced by the applicable percentage as provided in 12-7-437.