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Comments Due by: **September 29, 2021**

SC REVENUE RULING #21-x [DRAFT - 9/1/21]

SUBJECT: Retirement Income Deduction – Applicability to COVID-Related Distributions from Retirement Plans under the Federal CARES Act of 2020
(Individual Income Tax)

EFFECTIVE DATE: Tax Years 2020

REFERENCES: S.C. Code Ann. Section 12-6-1170 (2014) (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 and Department personnel. 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 It is the Department’s position until superseded or modified by a change in statute, regulation, court decision, or another Department advisory opinion.

PURPOSE

The purpose of this Revenue Ruling is to address whether individuals are entitled to the South Carolina retirement income deduction of \$3,000 or \$10,000 provided in Code Section 12-6-1170 for COVID-related distributions from eligible retirement plans under Section 2202 of the Federal Coronavirus Aid, Relief, and Economic Security Act of 2020 (CARES Act)¹ and the impact on any South Carolina retirement income deduction claimed if the COVID-related distribution is repaid in a direct nontaxable transfer.

OVERVIEW OF FEDERAL CARES ACT SECTION 2202

On March 27, 2020, Congress enacted the CARES Act in response to the COVID pandemic. It provided significant financial relief and assistance to individuals and businesses, including tax relief. Section 2202 of the Act, “Special Rules for Use of Retirement Funds,” provides “qualified

¹ Public Law 116-136.

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individuals” favorable tax treatment with respect to “coronavirus-related distributions” made in 2020, from an eligible retirement plan, as well as special rollover rules.²

For federal income tax purposes, the COVID-related distribution is taxable income. Section 2202 allows a COVID-related distribution (not to exceed \$100,000) to be included in income ratably over a 3-year period (2020, 2021, and 2022), or a taxpayer may elect to include all the COVID-related distribution in income in 2020, the year of the distribution. Section 2202 also provides that a COVID-related distribution is not subject to the 10% additional federal tax generally imposed on early distributions under Internal Revenue Code Section 72(t).

Further, a taxpayer may repay all or part of the amount of a COVID-related distribution to an eligible retirement plan within a 3-year period beginning on the day after the date on which the distribution was received. Such repayment is treated as though it were paid in a direct rollover to an eligible retirement plan and the distribution (all or part) would then not be includable in federal taxable income.

See Internal Revenue Service Notice 2020-50, issued on June 19, 2020, for detailed guidance on the federal tax treatment of COVID-related distributions under Section 2202 of the CARES Act.

SOUTH CAROLINA TAX RELIEF TREATMENT OF COVID-RELATED DISTRIBUTIONS FROM RETIREMENT PLANS UNDER THE CARES ACT

South Carolina has adopted Section 2202 of the CARES Act.³ South Carolina has not adopted Internal Revenue Code Section 72(t), and does not impose a penalty for premature distribution. Accordingly, for South Carolina income tax purposes, the same tax treatment is provided for COVID-related distributions from eligible retirement plans under the CARES Act as the federal tax treatment.

SOUTH CAROLINA RETIREMENT INCOME DEDUCTION IN CODE SECTION 12-6-1170

Code Section 12-6-1170(A) provides an annual income tax deduction from South Carolina taxable income for retirement income to the original owner of a qualified retirement account. The qualifying taxpayer receiving retirement income may deduct up to \$3,000 of such retirement income annually through age 64, and deduct up to \$10,000 of such retirement income annually at age 65 and thereafter.

Code Section 12-6-1170(A)(2) defines the term “retirement income,” as used in this subsection, to mean the total of all otherwise taxable income not subject to a penalty for premature

² See CARES Act Section 2202(a)(4)(A) for the definition of “coronavirus-related distribution” and Section 2202(a)(4)(A)(ii) for the definition of “qualified individual.” Note: Section 2202 does not apply to all distributions by individuals during 2020 or to every type of distribution.

³ South Carolina retroactively adopted Section 2202 in Act No. 87 of 2021, enacted May 18, 2021. See Information Letter #21-15, “COVID-Related Distribution from Retirement Plans Under the Federal CARES Act of 2020.”

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distribution received by the taxpayer or the taxpayer's surviving spouse in a taxable year from qualified retirement plans. These plans include:

- All public employee retirement plans of the federal, state, and local governments, including military retirement.
- Plans defined in Internal Revenue Code Sections:
401, "Qualified Pension, Profit-Sharing, and Stock Bonus Plan"
403, "Taxation of Employee Annuities"
408, "Individual Retirement Accounts" and
457, "Deferred Compensation Plans of State and Local Governments and Tax-Exempt Organizations."

Based on Code Section 12-6-1170, since COVID-related distributions from eligible retirement plans under the CARES Act are not subject to an early withdrawal penalty under Internal Revenue Code Section 72(t), a COVID-related distribution from a "qualified retirement plan" meeting the requirements in Code Section 12-6-1170 is allowed the South Carolina retirement income deduction.⁴ The deduction is up to \$3,000 for a qualifying individual under age 65 and increases to up to \$10,000 for a qualifying individual age 65 or older. The age of a qualifying individual is determined as of each December 31st for which the COVID-related distribution is included in income.

For example, assume a qualifying individual receives a \$30,000 COVID-related distribution in 2020 at age 64, and includes the distribution in income over a 3-year period (\$10,000 in 2020, \$10,000 in 2021, and \$10,000 in 2022) and assume the individual also meets the requirements in Code Section 12-6-1170. The taxpayer's South Carolina retirement income deduction in 2020, at age 64, is \$3,000, and partially offsets the taxable distribution amount. In 2021, at age 65 and in 2022, at age 66, the individual's retirement income deduction increases to \$10,000, and completely offsets the \$10,000 taxable distribution.

REPAYMENT OF DISTRIBUTION – IMPACT ON TAXABLE INCOME AND RETIREMENT INCOME DEDUCTION

To the extent an individual reports income attributable to a COVID-related distribution (e.g., 2020 and 2021) and later repays a portion, or all, of it, (e.g., 2022) federal taxable income and South Carolina taxable income⁵ is lowered for the tax years that previously included the distribution in income (e.g., tax years 2020 and 2021). The previously included income is, in effect, treated as never distributed.⁶ For South Carolina income tax purposes, since the amount is treated as "never distributed," the taxpayer would also lower his or her South Carolina

⁴ Caution: The rules for "qualifying retirement income" and "qualifying individual" may differ between Section 2202 of the CARES Act and Code Section 12-6-1170. For example, Code Section 12-6-1170 requires an individual to be the original owner of the retirement plan to qualify for the retirement income deduction.

⁵ Federal taxable income is the starting point to determine an individual's South Carolina taxable income.

⁶ CARES Act Section 2202(a)(3).

PUBLIC DRAFT

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retirement income deduction originally claimed to the extent the repaid distribution was included in that deduction. The deduction correction, if any, will depend on the facts and circumstances of each taxpayer, including whether other retirement income eligible for the retirement income deduction was received in the tax year being adjusted.

Examples best illustrate the South Carolina tax treatment of COVID-related distributions, the South Carolina retirement income deduction, and the tax implications of repayment of part, or all, of the COVID-related distribution.

EXAMPLE 1 – COVID-Related Distribution is Taxpayer’s Only Retirement Income – Individual is under Age 65

Facts and Federal Tax Treatment. Assume Individual X, age 40, received a \$9,000 COVID-related distribution from a qualifying retirement plan in 2020 in which he was the original owner. Under the CARES Act provision, X includes the distribution amount in income over a 3-year period (\$3,000 in 2020, \$3,000 in 2021, and \$3,000 in 2022). During this entire 3-year period, X is under the age of 65, and is eligible for the \$3,000 South Carolina retirement income deduction amount.

South Carolina Tax Treatment of a 2020 COVID-Related Distribution – Ratable Recognition of Income on Retirement Distribution and Retirement Income Deduction Allowed. Since federal taxable income is the starting point of computing South Carolina taxable income and since South Carolina has adopted the special federal tax relief provision, X’s South Carolina taxable income includes the \$3,000 distribution made in 2020 in income in 2020, 2021, and 2022.

Further, in tax year 2020, X (age 40) is allowed a \$3,000 retirement income deduction under Code Section 12-6-1170. In tax year 2021, X (age 41) is allowed a \$3,000 retirement income deduction. In tax year 2022, X (age 42) is allowed a \$3,000 retirement income deduction.

Additional Facts – Distribution Repayment in 2021. In 2021, X repays the \$9,000 distribution. Under the federal rules, X may file an amended 2020 federal return to claim a refund for the tax attributable to the \$3,000 distribution that was included in income in 2020.

South Carolina Tax Treatment in Year of Repayment in 2021– Reduction of Taxable Income and “Adjustment” to the Retirement Income Deduction. Since X’s federal taxable income is reduced by \$3,000, X’s South Carolina taxable income is also reduced by this \$3,000. However, since X claimed a South Carolina retirement income deduction solely attributable to the COVID-related distribution, and X repaid the retirement distribution, X no longer had “retirement income” in the 2020 tax year, and is, therefore, not allowed the \$3,000 retirement income deduction in 2020. However, the net change to South Carolina taxable income for tax year 2020 after the distribution repayment is \$0 (\$3,000 lower taxable income plus \$3,000 lost retirement income deduction); an amended SC 1040 is not required. No amount of the COVID-related distribution is included in income in 2021 or 2022 since X repaid the entire \$9,000 distribution in 2021.

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EXAMPLE 2 – COVID-Related Distribution along with “Other Retirement Income” – Individual is Age 65 and Older during the 3-Year Income Recognition Period

Facts and Federal Tax Treatment. Assume Individual Z, age 65, received a \$30,000 COVID-related distribution from a qualifying retirement plan in 2020 in which he was the original owner. Under the CARES Act provision, Z includes the distribution amount in income over a 3-year period (\$10,000 in 2020, \$10,000 in 2021, and \$10,000 in 2022). During this 3-year period, the taxpayer is age 65 or older and is eligible for the increased \$10,000 South Carolina retirement income deduction. Z has other retirement income of \$25,000 each year from a pension.

South Carolina Tax Treatment of a 2020 COVID-Related Distribution – Ratable Recognition of Income on Retirement Distribution and Retirement Income Deduction Allowed. Since federal taxable income is the starting point of computing South Carolina taxable income and since South Carolina has adopted this special federal tax relief provision, Z’s South Carolina taxable income includes the \$10,000 distribution in income in 2020, 2021, and 2022.

Further, in tax year 2020, Z (age 65) is allowed a \$10,000 retirement income deduction under Code Section 12-6-1170. In tax year 2021, Z (age 66) is allowed a \$10,000 retirement income deduction. In tax year 2022, Z (age 67) is allowed a \$10,000 retirement income deduction amount.

Additional Facts – Distribution Repayment in 2021. In 2021, Z repays the entire \$30,000 distribution. Under the federal rules, Z may file an amended federal return for 2020 to claim a refund for the tax attributable to the \$10,000 ratable portion of the distribution that was included in income in 2020.

South Carolina Tax Treatment in Year of Repayment in 2021– Reduction of Taxable Income and “No Adjustment” to the Retirement Income Deduction. Since Z’s federal taxable income is reduced by \$10,000, Z’s South Carolina taxable income is also reduced by \$10,000. Although Z claimed a South Carolina retirement income deduction of \$10,000, it is not adjusted by the repayment of the COVID-related distribution. Since Z had \$25,000 of retirement income in 2020 from a pension that is eligible for the \$10,000 retirement income deduction, Z’s retirement income deduction was not attributable to the COVID-related distribution and is not reduced. Accordingly, the net reduction to South Carolina taxable income is \$10,000, the amount of the COVID-related distribution repaid; Z may file an amended SC 1040 to claim a refund of the tax attributable to the amount of the \$10,000 ratable portion of the distribution included in income in 2020 on the originally filed return. No amount of the COVID-related distribution is included in income in 2021 or 2022 since Z repaid the entire \$30,000 distribution in 2021. Z remains eligible for the \$10,000 retirement income deduction in 2021 and 2022 since he has \$25,000 of pension income each year.