SC REVENUE RULING #87-3

SUBJECT: Interest on Bonds Issued By Puerto Rico

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

REFERENCE: S.C. Code Sections 12-7-410, 12-7-430

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

SCOPE: A Revenue Ruling is the Commission's official interpretation of how tax law is to be applied to a specific set of facts. A Revenue Ruling is public information and remains a permanent document until superseded by a Regulation or is rescinded by a subsequent Revenue Ruling.

Question:

Is interest earned on bonds issued by Puerto Rico taxable to South Carolina residents (1) if the bonds are purchased and held directly by South Carolina residents, (2) if the bonds are purchased and held by a regulated investment company and the interest is paid to the resident-shareholder as exempt-interest dividends under IRC Section 852(b)(5)?

Law:

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."

Section 12-7-430(b) provides:

(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.
(2) In any and all Internal Revenue Code sections that make reference to Internal Revenue Code Section 103, the modification provided in subitem (b) of this section similarly applies.

Internal Revenue 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 any credit or deduction, and
(iv) the determination of the basis in the hands of any shareholder of any share of stock of the company.

The United States Code, Title 48, Section 745 provides:

All bonds issued by the government of Puerto Rico or by its authority, shall be exempt from taxation by the government of the United States, or by the government of Puerto Rico or of any political or municipal subdivision thereof, or by any state, territory, or possession, or by any county, municipality, or other municipal subdivision of any state, territory, or possession of the United States or by the District of Columbia.
Discussion:

South Carolina would treat as exempt-interest dividends to the extent provided under IRC Section 852(b)(5), dividends of regulated investment companies whose assets consists of obligations of this state or any of its political subdivisions, obligations of the United States and obligations specifically exempt from taxation by any state by the United States Code. The United States Code exempts bonds issued by Puerto Rico from taxation by any state.

Conclusion:

Interest earned on bonds issued by Puerto Rico, when the bonds are purchased and held directly by South Carolina residents, is exempt from taxation by South Carolina as provided by the United States Code, Title 48, Section 745.

Exempt-interest dividends paid to a South Carolina resident-shareholder by a regulated investment company whose fund assets are comprised of Puerto Rico bonds are exempt from taxation by South Carolina to the extent excluded from taxation by Section 852(b)(5) of the Internal Revenue Code. (April 22, 1987)

SOUTH CAROLINA TAX COMMISSION

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Columbia, South Carolina
April 22, 1987