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SC revenue ruling #21-5

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STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE

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SC REVENUE RULING #21-5

- SUBJECT:** South Carolina Housing Tax Credit
(Income Tax, Corporate License Fee, and Bank Franchise Tax)
- EFFECTIVE DATE:** Applies to qualified projects placed in service January 2, 2020 to December 30, 2030.
- SUPERSEDES:** SC Revenue Ruling #21-1, and all previous advisory opinions and any oral directives in conflict herewith.
- REFERENCES:** S.C. Code Section 12-6-3795 (Act No. 137 of 2020) (enacted May 14, 2020)
Internal Revenue Code Section 42
- 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 It is the Department's position until superseded or modified by a change in statute, regulation, court decision, or another Department advisory opinion.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

Enacted May 14, 2020, South Carolina's "Workforce and Senior Affordable Housing Act" created a tax credit in Code Section 12-6-3795 for qualified low-income housing projects. The SC housing tax credit is based upon the federal low-income housing credit provided in Internal Revenue Code (IRC) Section 42, and is available for a qualified project placed in service in South Carolina after January 1, 2020.

The purpose of this advisory opinion is to provide an overview of the federal low-income housing tax credit (federal credit) and the new South Carolina housing tax credit (credit), and to address general questions about the state credit.

OVERVIEW OF FEDERAL LOW-INCOME HOUSING TAX CREDIT¹

The federal credit in IRC Section 42 was enacted by Congress as part of the Tax Reform Act of 1986² to encourage new construction and rehabilitation of existing buildings as low-income rental housing for households with income at or below specified income levels. Congress recognized that a private sector developer may not receive enough rental income from low-income housing to cover the costs of development and still provide a return to investors sufficient to attract the needed equity investment. The IRC Section 42 program provides tax incentives for investors to make equity investments. In exchange for equity, investors receive federal credits and other tax benefits associated with ownership of the building to offset federal income taxes for a 10-year period.

The major rules of the federal credit program are:

- The taxpayer agrees to provide low-income housing for at least 30 years.
- In exchange for the investment in low-income housing, the taxpayer will receive federal credits each year for 10 years. This is known as the “credit period.”
- To keep the federal credit, the taxpayer must provide low-income housing for 15 years. This is known as the “compliance period.” Failure to maintain the housing in compliance with IRC Section 42 requirements for the entire compliance period can result in the recapture of a portion of the federal credit allowable in prior years.³
- After the compliance period ends, the state agency has jurisdiction and the taxpayer must continue to provide low-income housing for at least another 15 years. This is known as the “extended use period.”

Two types of federal credits are available. For each year of the credit period, a federal credit approximately equal to 9% or 4% of a building’s qualified basis may be claimed depending on the type of project (e.g., new construction, acquisition, or rehabilitation). In effect, the federal credit yields a subsidy equal to 30% (for the 4% credit) and equal to 70% (for the 9% credit) of the present value of a building’s qualified basis.

The process of allocating, awarding, and claiming the federal credit is complex and lengthy. The process begins at the federal level with each state receiving an annual federal credit allocation. Developers (e.g., non-profit organizations, for-profit organizations, partnerships, trusts, corporations) apply for the federal credits by providing plans to state agencies. State agencies then set aside federal credits for developers of low-income housing according to required

¹ Congressional Research Service Report RS22389, “An Introduction to the Low-Income Housing Tax Credit,” updated February 27, 2019. This is a brief overview of the federal credit. Questions regarding the federal credit should be directed to the Internal Revenue Service or your tax professional.

² P.L. 99-514.

³ In effect, the federal credit is claimed in advance of providing housing during the last five years after the credit period has ended. As a result, one-third of the federal credit (referred to as the “accelerated portion”) claimed each year during the credit period is associated with providing housing during years 11 through 15 of the compliance period.

allocation plans. The South Carolina State Housing Finance and Development Authority (SC Housing Authority) provides support to the Internal Revenue Service in administering the federal credits for South Carolina.

Federal credits may only be claimed after a building is placed in service. Developers can either retain federal credits as financing for buildings or allocate them to investors (e.g., individuals, corporations, insurance companies) in exchange for equity.

OVERVIEW OF SOUTH CAROLINA HOUSING TAX CREDIT

The credit in Code Section 12-6-3795 was enacted to encourage investment in low-income housing located in South Carolina. The credit is only available to taxpayers who place a qualified project in service after January 1, 2020 and before December 31, 2030. The credit is equal to the federal credit allowed under IRC Section 42 and may be claimed against South Carolina income taxes, bank franchise taxes, corporate license fees, and insurance premium and retaliatory taxes.⁴

To qualify for the credit, a low-income building must receive an “eligibility statement” from the SC Housing Authority certifying that it qualifies for the credit and detailing the amount of the credit allowed. The credit first applies to tax year 2020. There is no carryback of the credit.

If the owner of the building is a pass-through entity, the credit passes through to the partners, shareholders, or members of the pass-through entity. If a portion of the federal credit is required to be recaptured, a proportional amount of the state credit must also be recaptured.

For reference, Code Section 12-6-3795 is attached.

QUESTIONS AND ANSWERS

PART 1 - QUALIFIED PROJECT

1. Q. What is a “project”?

A. A “project” is a housing project that has restricted rents that do not exceed 30% of income for at least 40% of its units occupied by persons or families having incomes of 60% or less of the median income, or at least 20% of the units occupied by persons or families having incomes of 50% or less of the median income. Code Section 12-6-3795(A)(4).

“Median income” means those incomes that are determined by the federal Department of Housing and Urban Development guidelines and adjusted for family size. Code Section 12-6-3795(A)(3).

⁴ The insurance premium tax is administered by the SC Department of Insurance. Questions concerning the use of the credit against insurance premium taxes should be directed to the SC Department of Insurance.

2. Q. What is a “qualified project”?
 - A. A “qualified project” is a qualified low-income building⁵ as that term is defined in IRC Section 42 which is located in South Carolina and receives approval for tax credits from the SC Housing Authority. Code Section 12-6-3795(A)(5).
3. Q. What requirements must a building meet to be eligible for the credit?
 - A. To be eligible for the credit, a building must:
 - a. Be placed in service January 2, 2020 to December 30, 2030; and
 - b. Obtain a credit “eligibility statement” from the SC Housing Authority after May 14, 2020.

PART 2 - ELIGIBILITY STATEMENT

4. Q. What is an “eligibility statement”?
 - A. An “eligibility statement” is a statement authorized and issued by the SC Housing Authority certifying that a building qualifies for the credit and stating the amount of the credit allowed. Code Section 12-6-3795(A)(1) and (C)(1).

Code Section 12-6-3795(C) provides that the SC Housing Authority shall promulgate rules establishing criteria upon which eligibility statements will be issued which must include consideration of evidence of local support for the building.

Questions concerning the eligibility statement should be directed to the Development Director of the SC Housing Authority at 803-896-9001.
5. Q. When is an eligibility statement issued?
 - A. Code Section 12-6-3795(C)(2) provides that the SC Housing Authority may not issue an eligibility statement until the “taxpayer” provides a report to the SC Housing Authority detailing how the state credit will benefit the tenants at the building once placed in service including, but not limited to, reduced rent, or why the state credit is necessary to undertake the building. The SC Housing Authority has confirmed it will not issue an eligibility statement prior to the date the building is placed in service.

The “taxpayer” (i.e., the building owner) may be a sole proprietorship, partnership, corporation, limited liability company, or association taxable as a business entity that is subject to South Carolina taxes pursuant to Code Sections 12-6-510 (individual income tax), 12-6-530 (corporate income tax), Chapter 11, Title 12 (bank franchise tax), or Chapter 7, Title 38 (insurance premium tax). An individual is not listed in the statute as an eligible building owner. Code Section 12-6-3795(A)(6).

⁵ The terms “project” and “building” are used interchangeably in this advisory opinion unless the context requires otherwise.

PART 3 - TAX CREDIT

6. Q. Must the eligibility statement be obtained prior to claiming the credit?
- A. Yes. The building owner must obtain a South Carolina eligibility statement from the SC Housing Authority prior to claiming the state credit. The eligibility statement issued by the SC Housing Authority will state the amount of the credit allowed for the building.
7. Q. What is the credit amount?
- A. The credit is an amount equal to the federal credit allowed under IRC Section 42 with respect to the building. Code Section 12-6-3795(B)(1).
8. Q. Can the state credit be allocated to partners of the partnership⁶ owning the building in a different manner than the federal credit is allocated?
- A. Yes. Code Section 12-6-3795(B)(4) provides that the state credit must be allocated among some or all of the partners of the partnership owning the qualified project in any manner agreed to by such partners, regardless of whether a partner is allocated or allowed any portion of the federal credit with respect to the building. This applies to all partnerships investing directly or indirectly in the partnership owning the project and allows for an allocation of the state credit on an annual basis.
9. Q. What is the credit period and when may the credit first be claimed?
- A. The credit is available to be claimed each year for 10 years beginning with the tax year the building is placed in service, or at the election of the building owner, the following tax year.
- IRC Section 42 allows the building owner to make an irrevocable election to begin the federal credit in the year after the building is placed in service. This election is also applicable for South Carolina income tax purposes.
- If the SC eligibility statement required to claim the credit is issued after the building owner's South Carolina tax return has been filed for the first tax year of the credit period, then the taxpayer must file an amended South Carolina tax return to claim the state credit.
10. Q. What taxes can the credit offset?
- A. The credit may be claimed against individual income tax (Code Section 12-6-510), corporate income tax (Code Section 12-6-530), corporate license fees (Chapter 20, Title 12), bank franchise tax (Chapter 11, Title 12), and insurance premium and retaliatory taxes (Chapter 7, Title 38). Code Section 12-6-3795(B)(1).

⁶ Limited liability companies taxed as partnerships and their members will be treated the same way as partnerships and their partners.

11. Q. How much of a taxpayer's tax liability may the credit offset?
- A. The credit claimed each year may offset 100% of the taxpayer's tax liability (or 100% of a married couple's joint income tax liability) for the year. The credit, however, may not be applied against any prior years' tax liability. Code Section 12-6-3795(B)(3).
12. Q. What credit ordering rules apply to taxpayers claiming the South Carolina housing credit and other South Carolina credits?
- A. Unless otherwise provided in a particular credit statute, a taxpayer may apply tax credits in any order. Any limitation upon the amount of liability for taxes or license fees that can be reduced by the use of a credit must be computed one credit at a time before another credit is used to reduce any remaining tax or license fee liability under Chapter 6 or Chapter 20 of Title 12. Code Sections 12-6-3480, 12-2-100, and 12-6-3310.
13. Q. What additional credit rules apply to a corporate taxpayer claiming the credit?
- A. Additional credit rules applicable to a corporate taxpayer claiming the state credit are:
- a. Corporations (C or S) with Both an Income Tax and License Fee Liability. For a taxpayer subject to the corporate income tax and the corporate license fee, the credit may be used against either one or both the corporate income tax liability and the license fee imposed under Code Section 12-20-50 or 12-20-100. The taxpayer may apply the credit in any order. Code Sections 12-6-3480(3) and 12-6-3310(B)(1).
- b. Consolidated ("Combined") Corporate Income Tax Return Participants. For a corporation included in a consolidated ("combined") corporate income tax return under Code Section 12-6-5020 who earned the credit, the credit must be used and applied against the consolidated tax, unless otherwise specifically provided. See Code Section 12-6-3480(2) for additional information.
14. Q. What is the credit carryforward period?
- A. Any unused credit may be carried forward for five years. Code Section 12-6-3795(B)(3).

PART 4 - MISCELLANEOUS PROVISIONS - CREDIT TRANSFER AND RECAPTURE

15. Q. Can a person who acquires a qualified project (building) or an interest in the building during the 15-year compliance period claim any remaining credit?
- A. Yes. If a person acquires the building (e.g., by purchase or foreclosure), or an interest in the building, during the 15-year compliance period, the person may claim any remaining allowable credit, provided the building is operated in compliance with IRC Section 42, SC Housing Authority guidelines, and Code Section 12-6-3795.

16. Q. Can the credit be sold or transferred?

- A. No. After receiving a credit allocation for a period, a taxpayer cannot sell⁷ or transfer any portion of the current credit allocation or carryforward to anyone, even an affiliate or related party.

The sale or transfer of an equity interest in a pass-through entity who owns the building earning the credit is not considered the sale of the credit. However, any credit carryforward attributable to a credit claimed in a prior year remains with the taxpayer who owned the equity interest for the year the credit was originally claimed.

17. Q. Can a taxpayer claim the SC housing tax credit and other South Carolina building rehabilitation credits for expenses incurred for the same building?

- A. Yes. For example, a taxpayer eligible to claim the abandoned building revitalization credit (Chapter 67, Title 12), textile rehabilitation credit (Chapter 65, Title 12), or historic tax credit (Code Section 12-6-3535) may also claim the SC housing tax credit for that building, provided the credit requirements for each applicable credit are met.

18. Q. Are there recapture provisions for the state credit?

- A. Yes. As discussed in the overview of the federal credit above, failure to maintain the housing in compliance with IRC Section 42 requirements for the entire compliance period can result in the recapture of a portion of the federal credit allowable in prior years.

Code Section 12-6-3795(B) provides that if under IRC Section 42, a portion of any federal credit taken on a building is required to be recaptured, the taxpayer claiming any state credit with respect to such building also is required to recapture a portion of the state credit. The state recapture amount is equal to the proportion of the state credit claimed by the taxpayer that equals the proportion the federal recapture amount bears to the original federal credit amount subject to recapture.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/W. Hartley Powell

W. Hartley Powell, Director

March 1 _____, 2021
Columbia, South Carolina

⁷ In regard to a “disguised sale,” the South Carolina Legislature included explicit language in the SC abandoned building credit statute to allow an allocation that is treated as a disguised sale under federal law to qualify for that credit. (See Code Section 12-67-140(B)(6)). However, the SC housing tax credit statute does not contain such language.

SC Code Section 12-6-3795

(A) As used in this section:

- (1) 'Eligibility statement' means a statement authorized and issued by the South Carolina Housing and Finance Development Authority certifying that a given project qualifies for the South Carolina housing tax credit.
- (2) 'Federal housing tax credit' means the federal tax credit as provided in Section 42 of the Internal Revenue Code of 1986, as amended.
- (3) 'Median income' means those incomes that are determined by the federal Department of Housing and Urban Development guidelines and adjusted for family size.
- (4) 'Project' means a housing project that has restricted rents that do not exceed thirty percent of income for at least forty percent of its units occupied by persons or families having incomes of sixty percent or less of the median income, or at least twenty percent of the units occupied by persons or families having incomes of fifty percent or less of the median income.
- (5) 'Qualified project' means a qualified low-income building as that term is defined in Section 42 of the Internal Revenue Code of 1986, as amended, that is located in South Carolina and receives approval for tax credits from the South Carolina Housing and Finance Development Authority provided pursuant to this section.
- (6) 'Taxpayer' means a sole proprietor, partnership, corporation of any classification, limited liability company, or association taxable as a business entity that is subject to South Carolina taxes pursuant to Section 12-6-510, Section 12-6-530, Chapter 11, Title 12, or Chapter 7, Title 38.

(B)(1) A state tax credit pursuant to this section may be claimed against income taxes imposed by Section 12-6-510 or 12-6-530, bank taxes imposed pursuant to Chapter 11, Title 12, corporate license fees imposed pursuant to Chapter 20, Title 12, and insurance premium and retaliatory taxes imposed pursuant to Chapter 7, Title 38, to be termed the South Carolina housing tax credit, and is allowed with respect to each qualified project placed in service after January 1, 2020, and before December 31, 2030, in an amount equal to the federal housing tax credit allowed with respect to such qualified project. In computing a tax payable by a taxpayer pursuant to Section 38-7-90, the credit allowed pursuant to this section must be treated as a premium tax paid pursuant to Section 38-7-20.

(2)(a) If under Section 42 of the Internal Revenue Code of 1986, as amended, a portion of any federal housing tax credit taken on a project is required to be recaptured, the taxpayer claiming any state tax credit with respect to such project also is required to recapture a portion of any state tax credit authorized by this section. The state recapture amount is equal to the proportion of the state tax credit claimed by the taxpayer that equals the proportion the federal recapture amount bears to the original federal housing tax credit amount subject to recapture.

(b) In the event that recapture of any South Carolina housing tax credit is required, any amended return submitted to the department, as provided in this section, shall include the proportion of the state tax credit required to be recaptured, the identity of each taxpayer subject to the recapture, and the amount of tax credit previously allocated to such taxpayer.

(3) The total amount of the tax credit allowed by this section for a taxable year may not exceed the taxpayer's income tax liability. Any unused tax credit may be carried forward to apply to the taxpayer's next five succeeding years' tax liability. The taxpayer may not apply the credit against any prior tax years' tax liability.

(4) The tax credit allowed by this section, and any recaptured tax credit, must be allocated among some or all of the partners, members, or shareholders of the entity owning the project in any manner agreed to by such persons, regardless of whether such persons are allocated or allowed any portion of the federal housing tax credit with respect to the project.

(C)(1) The authority shall promulgate rules establishing criteria upon which the eligibility statements are issued which must include consideration of evidence of local support for the project. The eligibility statement must specify the amount of the South Carolina housing tax credit allowed.

(2) The authority may not issue an eligibility statement until the taxpayer provides a report to the authority detailing how the state credit authorized by this section will benefit the tenants of the project, once placed in service including, but not limited to, reduced rent, or why the state credit authorized by this section is necessary to undertake the project.

(D) The department, in consultation with the South Carolina State Housing Finance and Development Authority, may adopt rules and policies necessary to implement and administer the provisions of this section.