

FAQs: Catastrophe Savings Accounts

Catastrophe Savings Accounts allow South Carolina residents to prepare for the financial impact of a catastrophic storm and save on South Carolina income taxes. The purpose of this guide is to answer some frequently-asked questions about these accounts.

1. Why open a Catastrophe Savings Account?

Catastrophe Savings Accounts allow you to set money aside, state income tax-free, to pay for qualified catastrophe expenses.

Subject to the dollar limitations discussed below, the amount you contribute to your Catastrophe Savings Account can be deducted in computing your South Carolina taxable income.

Any interest earned by the Catastrophe Savings Account will be exempt from state income tax and should be subtracted in computing your South Carolina taxable income.

If you withdraw funds from your Catastrophe Savings Account to pay for qualified catastrophe expenses, you do not have to include the withdrawal in your South Carolina taxable income.

2. What are qualified catastrophe expenses?

Qualified catastrophe expenses are expenses paid or incurred by reason of a major disaster that has been declared by the Governor to be an emergency by Executive Order.

These expenses include payment of insurance deductibles and other uninsured risks of loss from hurricane, rising floodwaters or other catastrophic windstorm event damage.

Example 1. Tom has a \$1,000 insurance deductible. Tom established a Catastrophe Savings Account. Hurricane Devon made landfall in South Carolina and the Governor declared a State of Emergency. Tom can withdraw money from his Catastrophe Savings Account to pay for the \$1,000 insurance deductible. The \$1,000 withdrawal will not be included in his South Carolina taxable income for that year.

3. What are the requirements of a Catastrophe Savings Account?

The account must be labeled as “Catastrophe Savings Account.” A taxpayer can establish only one Catastrophe Savings Account and must specify that the purpose of the account is to cover insurance deductibles and other uninsured risks caused by hurricanes, rising flood water or other catastrophic windstorm events.

4. Who can contribute to a Catastrophe Savings Account?

South Carolina residents who own a single family residence (house, condo, townhouse, or modular or mobile home) that qualifies as a legal residence for South Carolina property tax purposes can contribute to a Catastrophe Savings Account.

5. Where can I establish a Catastrophe Savings Account?

Catastrophe Savings Accounts can be established at a state or federally chartered bank. The account must be kept separate from all other accounts (e.g., checking or savings accounts, IRAs, medical care savings accounts and so on). It must be maintained specifically for the purpose of qualified catastrophe expenses incurred by the account holder.

The account holder, not the financial institution, is required to maintain documentation to verify that the withdrawals from the Catastrophe Savings Account were used exclusively for qualified catastrophe expenses.

6. Can I invest my Catastrophe Savings Account in stocks and bonds?

No. Your Catastrophe Savings Account can only be an interest bearing account.

7. How much can be deposited in a Catastrophe Savings Account?

If your homeowners' insurance deductible for your legal residence is \$1,000 or less, then you can contribute up to \$2,000. You do not have to contribute the entire amount in one year, but the total contributions for all years cannot exceed \$2,000.

If your deductible for your legal residence is greater than \$1,000, then you may contribute an amount equal to twice the amount of your deductible not to exceed \$15,000. You do not have to contribute the entire amount in one year, but the total contributions for all years cannot exceed twice your deductible up to \$15,000.

Example 2. Jane has a \$10,000 deductible; she can contribute \$15,000 to her Catastrophe Savings Account.

Example 3. Sally has a \$6,000 deductible; she can contribute \$12,000 to her Catastrophe Savings Account.

If you self-insure your legal residence, you may contribute up to \$250,000 to your Catastrophe Savings Account. However, the amount contributed may not exceed the value of your home.

Example 4. Tom self-insures his \$100,000 legal residence; he may contribute up to \$100,000 to his Catastrophe Savings Account.

8. How do I report contributions to a Catastrophe Savings Account on my South Carolina income tax return?

One benefit of a Catastrophe Savings Account is that the amount placed in the account reduces the taxpayer's South Carolina taxable income and, as a consequence, reduces the South Carolina income tax that has to be paid.

The amount contributed to the Catastrophe Savings Account should be included with "Other Subtractions" in Part 2 - Subtractions from Federal Taxable Income on the SC 1040 form.

Example 5. Tom established a Catastrophe Savings Account and deposited \$6,000. Tom's federal taxable income is \$40,000 and this amount is reported on his South Carolina Form SC 1040, Line 1. Tom's \$6,000 contribution will be subtracted under "Other Subtractions" in Part 2 – Subtractions from Federal Taxable Income. His South Carolina taxable income is reduced from \$40,000 to \$34,000 based on the contribution.

This is only a deduction for South Carolina income tax purposes; it is not a deduction for federal income tax purposes.

9. How much will I save on state income taxes?

The amount of reduction in South Carolina income taxes depends on your tax bracket as shown in the two tables below:

Table 1: South Carolina Tax Bracket Rates (for 2007)*

Annual Taxable Income

Over	But not over	Calculation
\$0	\$ 2,630	\$0
\$2,630	\$5,260	3% times the amount less \$79
\$5,260	\$7,890	4% times the amount less \$131
\$7,890	\$10,520	5% times the amount less \$211
\$10,520	\$13,150	6% times the amount less \$316
\$13,150+		7% times the amount less \$448

*The South Carolina Department of Revenue Tax tables may change annually. Use this table as an approximation. Do not use this table to compute your South Carolina tax liability.

Table 2: Effects of Catastrophe Savings Account Contributions and Withdrawals on Taxable Income

Action	Federal	South Carolina
Homeowners' Contribution to Catastrophe Savings Account	No Effect	Deduct on Form SC 1040
Interest on Savings Account	Taxable	Not Taxable (Deduct on Form SC 1040)
Withdrawals for Qualified Catastrophe Expenses	No Effect	Not Taxable
Interest on Savings Account	Taxable	Not Taxable (Deduct on Form SC 1040)
Withdrawals for Ineligible Expenses	No Effect	Taxable and subject to 2.5% additional tax*

*Subject to certain exceptions.

10. Can I transfer money from my regular savings account into a Catastrophe Savings Account?

Yes. Funds contributed to the Catastrophe Savings Account can come from any source. Regardless of the source of the funds, the contribution can be deducted in computing your South Carolina taxable income.

11. How are interest earnings from my Catastrophe Savings Account reported on my tax returns?

Money in a Catastrophe Savings Account earns interest just like money in an ordinary savings account. The interest rate paid on the account is determined by the financial institution offering it.

Interest earnings in a Catastrophe Savings Account are not subject to South Carolina income tax if left in the account or if withdrawn for qualified catastrophe expenses.

Earnings from a Catastrophe Savings Account are reported on the financial institution's 1099 forms that are sent to account holders and to the Internal Revenue Service (IRS). Some financial institutions may send a separate 1099-INT form for the Catastrophe Savings Account. Others may include the Catastrophe Savings Account interest earnings on a form with other interest-bearing accounts owned by the taxpayer. The amount for the Catastrophe Savings Account should be separately stated by the payor on the 1099-INT form.

Interest earnings must be reported on the federal return and will be subtracted to determine South Carolina taxable income on the SC 1040. This interest should be included with "Other Subtractions" in Part 2 - Subtractions from Federal Taxable Income on the SC 1040.

12. What records do I need to keep regarding withdrawals from my Catastrophe Savings Account to pay for qualified catastrophe expenses?

Account holders who make a withdrawal from their Catastrophe Savings Account to pay for qualified catastrophe expenses should keep records to verify, in case of an audit, that withdrawals were properly used to pay qualifying expenses.

13. What if I withdraw the money in my account for purposes other than qualified catastrophe expenses?

Withdrawals from an account for any purpose other than qualified catastrophe expenses are subject to South Carolina income tax at your regular rate and an additional tax of 2.5% payable on your South Carolina income tax return for the year of withdrawal. This additional tax is reported on page one of the South Carolina 1040 under "Taxes." There are certain exceptions that allow withdrawals without paying any South Carolina income taxes and certain exceptions that allow withdrawals which require the taxpayer to pay the regular state income tax rate, but not the 2.5% additional tax. These exceptions are:

1. Taxpayer is 70 years or older and has a homeowners policy.

A withdrawal of funds from an account set up by a taxpayer who has a homeowners insurance policy and is 70 years old or older is not subject to the 2.5% additional tax. Furthermore, the withdrawal is not includible as ordinary income for South Carolina income tax purposes. Once a taxpayer 70 years or older makes a nontaxable withdrawal for other than qualified catastrophe expenses, the taxpayer cannot make any further contributions to a Catastrophe Savings Account.

Example 6. Beth has a \$2,000 insurance deductible. She deposited \$4,000 into her Catastrophe Savings Account and over time the account has earned \$500 in interest. After Beth turned 70, she withdrew \$4,500 from the account to pay for a car. The withdrawal is not subject to the 2.5% additional tax because Beth withdrew the money after she turned 70 years old. Furthermore, the amount is not included as ordinary

income for South Carolina income tax purposes because she had insurance and her Catastrophe Savings Account was based on the amount of her insurance deductible.

2. Taxpayer is 70 years or older and is self-insured.

A withdrawal from an account set up by a self-insured taxpayer is not subject to the 2.5% additional tax once the self-insured taxpayer is 70 years old. However, the amount withdrawn is included as ordinary income for South Carolina income tax purposes.

Example 7. Tim, who self-insures his legal residence, deposited \$100,000 into his Catastrophe Savings Account. When Tim was 72 years old, he withdrew \$100,000 from his account to pay his grandson's college tuition. The withdrawal is not subject to the 2.5% additional tax because he withdrew the money after he turned 70 years old. The \$100,000 withdrawal is subject to state income taxation.

3. Account holder no longer owns a legal residence.

A non-eligible withdrawal of funds made when the taxpayer no longer owns a legal residence is not subject to the 2.5% additional tax. However, the amount withdrawn is included in South Carolina taxable income.

Example 8. On January 1, 2007, Donna deposited \$6,000 into a Catastrophe Savings Account. On January 1, 2009, Donna sold her home and moved in with her sister. In February 2009, she withdrew \$6,000 from her Catastrophe Savings Account for a family emergency. The withdrawal is not subject to the 2.5% additional tax because she withdrew the amount when she no longer owned a home. The \$6,000 withdrawal is subject to South Carolina income taxation.

4. Death of the account holder.

A withdrawal upon the death of an account holder is not subject to the 2.5% additional tax. The account, however, is included in the South Carolina taxable income of the person who receives the account, unless that person is the surviving spouse of the taxpayer.

Summary

Catastrophe Savings Accounts can be established at a state or federally chartered bank. The money can only be held in an interest bearing account.

The money that is placed in a Catastrophe Savings Account and the annual interest earnings are not subject to state income taxation if left in the account or used for qualified catastrophe expenses. However, the amounts cannot be used to reduce federal income.

Withdrawals for any purchase other than a qualified catastrophe expense are treated as ordinary income and taxed accordingly at the state level. Withdrawals are also subject to a 2.5% additional tax unless the withdrawal falls under one of the exceptions mentioned earlier.

Remember, this information only attempts to address the kinds of questions people most frequently ask about Catastrophe Savings Accounts. As with any tax matter, and for specific questions regarding Catastrophe Savings Accounts, including which type, if any, is suitable for your situation and how opening an account would affect your particular tax liability, you should consult a tax professional.