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SC REVENUE PROCEDURE #92-5

SUBJECT: Withholding on South Carolina Income of Nonresident Shareholders and Partners

TAX ANALYST: Deana West

EFFECTIVE DATE: Tax years beginning after 1991

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

REFERENCE: S.C. Code Ann. Section 12-9-40 (Enacted 1992)

AUTHORITY: S.C. Code Ann. Section 12-4-320 (Supp. 1991)
SC Revenue Procedure #87-3

SCOPE: A Revenue Procedure is a statement describing agency procedures and is applicable only to employees of the South Carolina Tax Commission.

PURPOSE: To provide guidelines that will assist Tax Commission employees in the administration of Code Section 12-9-40 and also assist taxpayers in maximizing compliance of the new withholding requirements.

THE LAW:

Code Section 12-9-40 was added to the South Carolina Code of Laws in June, 1992 to require S-corporations and partnerships to withhold income tax at the rate of 5% on nonresident S-corporation shareholders' and nonresident partners' share of South Carolina taxable income. The provisions of Code Section 12-9-40 are effective for taxable years beginning after 1991.

The following questions and answers are provided to give guidance in complying with Code Section 12-9-40.

GENERAL INSTRUCTIONS

1. WHO IS SUBJECT TO WITHHOLDING?

S-corporations. S-corporations are required to withhold and remit taxes on each nonresident shareholder's share of South Carolina taxable income of the S-corporation, whether distributed or undistributed.

Partnerships. Partnerships are required to withhold and remit taxes on each nonresident partner's share of South Carolina taxable income of the partnership, whether distributed or undistributed.

2. WHAT ARE THE EXCEPTIONS TO THE WITHHOLDING REQUIREMENTS?

There are three exceptions to the withholding requirements pursuant to Code Section 12-9-40.

- (1) An S-corporation or partnership is not required to withhold income taxes with respect to any shareholder or partner who submits an affidavit stating the nonresident shareholder or partner is subject to the personal jurisdiction of South Carolina, (see questions #10-16 of this document regarding the affidavit);
- (2) An S-corporation or partnership is not required to withhold income taxes with respect to any shareholder or partner for which the S-corporation or partnership reports the nonresident shareholder's or partner's income on a composite tax return, see questions #17-21 of this document regarding composite returns); and,
- (3) An S-corporation or partnership is not required to withhold income taxes under Code Section 12-9-40 on income attributable to the sale of real property which is subject to withholding under 12-9-510, et seq., "Withholding on Sales of Real Property and Associated Tangible Personal Property by Nonresidents".

3. WHAT IS THE WITHHOLDING RATE?

S-corporations and partnerships must withhold income taxes at the rate of 5% of the nonresident's share of South Carolina taxable income.

4. HOW IS THE WITHHOLDING COMPUTED AND REMITTED?

S-corporations. S-corporations should use form SC1120S-WH, "Withholding Tax on Income of Nonresident Shareholders", to compute the amount of South Carolina income allocated to nonresident shareholders.

S-corporations should remit the withholding tax with form SC1120S-WH. A form SC1120S-WH is not required to be filed with the Tax Commission if the S-corporation (1) has no South Carolina source income allocable or apportionable to any shareholder, (2) has previously filed an affidavit with the Tax Commission on behalf of all of its nonresident shareholders (a copy of the affidavit, form I-309, is attached to this document), (3) reports the income of all of its

nonresident shareholders on a composite return, or (4) has previously filed an affidavit on behalf of some of its nonresident shareholders and reports the income of the remainder of its nonresident shareholders on a composite return. (See question #14 for guidance on submitting additional affidavits in future years.)

A copy of form SC1120S-WH is included in the corporate coupon booklet. Additional copies may be obtained at any of the Tax Commission's Taxpayer Service Centers or by calling the Tax Commission's forms department at 803-737-5085.

Partnerships. Partnerships should use Schedule W-H on form SC1065, "Partnership Return of Income", to compute the withholding tax. The withholding tax on income of nonresident partners should be remitted with form SC1065.

Other Information To Include With Remittance. In addition to remitting the withheld funds on the forms prescribed by the Tax Commission, the S-corporation or partnership must submit a schedule to the Tax Commission disclosing each nonresident shareholder's or partner's (1) name, (2) address, (3) taxpayer identification number, (4) South Carolina taxable income and (5) amount of tax withheld.

See question #6 for guidance on computing and remitting the withholding tax if the S-corporation or partnership return is extended.

5. WHEN IS THE WITHHOLDING TAX DUE?

S-corporations. S-corporations should remit the withheld funds on or before the fifteenth day of the third month following the close of its tax year.

Partnerships. Partnerships should remit the withheld funds on or before the fifteenth day of the fourth month following the close of its tax year.

Extension of Time to File. An extension of time to file the S-corporation or partnership tax return does not extend the time to pay the withholding tax.

6. HOW IS THE WITHHOLDING TAX COMPUTED AND REMITTED IF THE S-CORPORATION OR PARTNERSHIP TAX RETURN IS EXTENDED?

S-corporations. S-corporations that extend the time to file their form SC1120S, "S-Corporation Income Tax Return", must estimate the nonresident shareholders share of South Carolina taxable income and pay the withholding tax on this estimated amount. The estimated amount of South Carolina income to be allocated to nonresident shareholders and the amount of tax due should be computed on the appropriate lines of form SC1120S-WH. The word "ESTIMATED" should be written on the top of form SC1120S-WH.

Partnerships. Partnerships that extend the time to file their form SC1065, "Partnership Return of Income", must estimate the nonresident partners share of South Carolina taxable income and pay the withholding tax on this estimated amount. The estimated amount of South Carolina income

to be allocated to nonresident partners and the amount of tax due should be computed on a schedule prepared by the partnership. This schedule and the withholding tax due should be remitted when the partnership files its form SC4868, "Request For Extension of Time to File South Carolina Tax Return". When filing the form SC1065 by its extended due date, the partnership should indicate on Schedule W-H that the withholding was remitted at the time the extension was filed and the amount that was remitted.

7. WHAT INFORMATION MUST BE PROVIDED TO THE SHAREHOLDER OR PARTNER BY THE S-CORPORATION OR PARTNERSHIP?

The S-corporation or partnership must provide each nonresident shareholder or partner for whom tax was withheld and the Tax Commission a federal form 1099-MISC. This form 1099-MISC is to be used for South Carolina purposes only and "SC ONLY" should be marked on the top of the form. The information reported on form 1099-MISC should include the respective shareholder's or partner's name, address, social security number and amount of income tax withheld on his behalf.

S-corporations. S-corporations must remit the form 1099's to the shareholders and the South Carolina Tax Commission by the fifteenth day of the third month following the close of its tax year.

Partnerships. Partnerships must remit the form 1099's to the partners and the South Carolina Tax Commission by the fifteenth day of the fourth month following the close of its tax year.

8. WHEN MAY SHAREHOLDERS AND PARTNERS CREDIT THE AMOUNT WITHHELD AGAINST THEIR TAXES?

Taxes withheld in the name of the nonresident shareholder or partner must be used as a credit against taxes due at the time the nonresident files income taxes for the taxable year. Each shareholder or partner will account for the taxes withheld in his tax year in which the S-corporation's or partnership's tax year ends.

For example:

1. Calendar year taxpayers. A calendar year S-corporation remits withholding taxes for 1992 on March 15, 1993. The individual shareholder may claim a credit on his 1992 individual income tax return (generally filed on or before April 15, 1993) for the taxes withheld by the S-corporation on his behalf.
2. Other than calendar year taxpayers. A calendar year partnership remits the withholding taxes for 1992 on April 15, 1993 and has a corporate partner with a March 31 year end. The corporate partner may claim a credit in its entirety on its SC1120 corporate income tax return for the year ended March 31, 1993 (generally filed on or before June 15, 1993) for the taxes withheld by the partnership on its behalf.

3. Other than calendar year entity. An S-corporation with a January 31, 1993 year end remits the withholding taxes on behalf of its nonresident shareholders on April 15, 1993. The calendar year end shareholder may claim a credit on his 1993 individual income tax return (generally filed on or before April 15, 1994) for the taxes withheld by the S-corporation on his behalf.

A copy of form 1099-MISC must be attached to the nonresident shareholder's or partner's South Carolina income tax return as verification for claiming credit for the withholding taxes paid.

9. HOW DOES THE WITHHOLDING AFFECT ESTIMATED PAYMENTS?

The amount withheld by the entity on behalf of the shareholder or partner is deemed a payment of estimated tax. An equal part of the amount is deemed paid on each estimated tax due date for the previous taxable year.

SPECIFIC QUESTIONS CONCERNING THE AFFIDAVIT

10. WHAT IS THE PURPOSE OF THE AFFIDAVIT?

South Carolina form I-309, "Nonresident Shareholder or Partner Affidavit and Agreement", is to be used by any nonresident S-corporation shareholder or partner to request an exemption from withholding required under Code Section 12-9-40.

11. IS THERE A PRESCRIBED AFFIDAVIT FORM?

The Tax Commission has a preprinted affidavit, form I-309, entitled "Nonresident Shareholder or Partner Affidavit and Agreement" available for use by shareholders and partners. A copy of the affidavit is attached to this revenue procedure. In lieu of the Tax Commission's affidavit, an affidavit containing the same information as the Tax Commission's will be accepted.

12. WHAT DOES A SHAREHOLDER OR PARTNER AGREE TO WHEN SIGNING THE AFFIDAVIT?

In filing the affidavit, the shareholder or partner agrees to timely file appropriate South Carolina tax returns and make payment of all South Carolina taxes required by law and agrees to be subject to the personal jurisdiction of the Tax Commission and the courts of South Carolina for the purpose of determining and collecting any South Carolina taxes, including estimated taxes, interest and penalties.

13. HOW, WHERE AND WHEN DO SHAREHOLDERS OR PARTNERS EXECUTE THE AFFIDAVIT?

A nonresident shareholder or partner should fully complete the affidavit. The affidavit should be signed by an officer of a corporate partner. A separate affidavit must be submitted by each partner or shareholder for stock that is jointly owned.

The shareholder or partner should submit the affidavit directly to the S-corporation or partnership as soon as possible.

The shareholder or partner should file an affidavit with the S-corporation or partnership only in the first year in which the shareholder or partner agrees to the terms contained in the affidavit.

14. HOW, WHEN AND WHO SUBMITS THE AFFIDAVITS TO THE TAX COMMISSION?

The S-corporation or partnership should remit all affidavits to the South Carolina Tax Commission at one time.

S-corporations. S-corporations should attach the affidavits to form SC1120S-WH, "Withholding Tax on Income of Nonresident Shareholders" and file with the Tax Commission on or before the fifteenth day of the third month following the close of the S-corporation's tax year. Affidavits should not be attached to form SC1120S, "S-Corporation Income Tax Return", or form SC1120-T, "Tentative Corporation Tax Return and Conditional Extension". In future years if the S-corporation needs to file additional affidavits, the affidavits must be filed with form SC1120S-WH even though the S-corporation may not otherwise be required to file a form SC1120S-WH (see question #4). Any additional affidavits should be filed with the Tax Commission on or before the fifteenth day of the third month following the close of the S-corporation's tax year.

Partnerships. Partnerships should attach the affidavits to form SC1065, "Partnership Return of Income", or form SC4868, "Request for Extension of Time to File South Carolina Tax Return" and file with the Tax Commission on or before the fifteenth day of the fourth month following the close of the partnership tax year.

15. HOW LONG IS AN AFFIDAVIT VALID?

Once remitted to the Tax Commission, affidavits remain valid for all subsequent tax years and should not be resubmitted to the S-corporation, partnership or Tax Commission.

The affidavit is not valid if (1) the shareholder's or partner's nonresident status changes, (2) the shareholder's or partner's request for the withholding exemption is revoked by the Tax Commission, or (3) the shareholder or partner revokes the affidavit in writing and notifies the S-corporation or partnership and the Tax Commission.

16. DOES AN AFFIDAVIT HAVE TO BE FILED FOR SHAREHOLDERS OR PARTNERS WHO REPORT THEIR INCOME ON A COMPOSITE RETURN?

No, the affidavit should not be completed by shareholders or partners whose income will be reported on a composite return.

SPECIFIC QUESTIONS CONCERNING A COMPOSITE RETURN

17. WHAT IS THE PURPOSE OF A COMPOSITE RETURN?

A composite return allows S-corporations or partnerships to compute and report the South Carolina income and tax attributable to their nonresident shareholders or partners on a single tax return.

S-corporations and partnerships are not required to withhold income tax pursuant to Code Section 12-9-40 on behalf of any nonresident shareholder or partner whose income is reported on the composite return.

18. WHO MAY PARTICIPATE IN FILING A COMPOSITE RETURN?

Nonresident fiduciary and individual shareholders and partners may participate in filing a composite return. All participating shareholders and partners must have the same tax year. A composite return may be filed even if some of the nonresident fiduciary and individual shareholders and partners eligible to participate in filing a composite return choose not to participate.

Corporate partners may not be included on the composite return since they are required to file an annual report and pay a license fee. In addition, shareholders or partners having income within South Carolina from sources other than the partnership or S-corporation may not be included in the composite return.

19. WHAT FORM IS USED TO FILE THE COMPOSITE RETURN?

A form SC1040NR, "South Carolina Nonresident Individual Income Tax Return", should be used to file a composite return on behalf of fiduciary and individual shareholders and partners.

20. HOW IS A COMPOSITE RETURN COMPLETED?

Generally, the individual taxpayer's name, address and social security number is required to be filled in on form SC1040NR. When filing a composite return, however, the S-corporation or partnership should put the S-corporation's or partnership's name, address, and federal identification number on these lines.

The composite return must be signed by an officer of the S-corporation or by a general partner of the partnership.

There are two methods in which the tax may be computed on a composite return. Each method is briefly explained below.

Method 1: The first method is to compute each participating shareholder's or partner's tax in the same manner as if he was separately reporting his own income and deductions. In other words, each shareholder or partner would be entitled to his prorated share of the standard or itemized

deductions as well as his prorated personal exemption amount from his federal return pursuant to Code Sections 12-7-410 and 12-7-450. After separately computing each shareholder's or partner's tax, these amounts should be added together to arrive at the total tax due on the composite return. This total tax amount should be entered on the "TAX" line on page 1 of the SC1040NR. A modified South Carolina taxable income amount does not have to be entered on page 1 of the SC1040NR, however, a schedule must be attached to the composite return showing each shareholder's or partner's name, address, social security number, South Carolina taxable income, prorated exemptions and deductions and amount of tax separately computed.

Method 2: The S-corporation or partnership may choose to report each participating shareholder's or partner's entire share of South Carolina income without regard to the proration of deductions and exemptions. Each participating shareholder's or partner's tax should be separately computed (i.e. apply the tax table separately to each shareholder's or partner's taxable income). The separate tax amounts should then be added together to arrive at the total tax due on the composite return. This total tax amount should be entered on the "TAX" line on page 1 of the SC1040NR. A modified South Carolina taxable income amount does not have to be entered on page 1 of the SC1040NR, however, a schedule must be attached to the composite return showing each participating shareholder's or partner's name, address, social security number, South Carolina taxable income and amount of tax separately computed.

21. WHEN IS THE COMPOSITE RETURN DUE?

The composite return is due on or before the fifteenth day of the fourth month following the shareholders' or partners' taxable year end. This will generally be a calendar year with the composite return due on or before the following April 15.

The composite return may be extended by filing form SC4868, "Request For Extension of Time to File South Carolina Tax Return". Any tax estimated to be due must be paid with the timely filed extension.

The tax due in connection with the composite return is subject to the declaration of estimated tax rules. In general, composite estimated tax payments are required to be made by the S-corporation or partnership on behalf of any nonresident shareholder or partner participating in the composite return whose expected amount of tax owed with the composite return will be \$100 or more. (See forms SC1040ES or SC1041ES and instructions for additional estimated tax information.)