



SC REVENUE PROCEDURE #93-5

SUBJECT: Penalties for Certain Violations Relative to Withholding of Income Taxes (Withholding)

TAX MANAGER: John P. McCormack

EFFECTIVE DATE: Applies to all period open under the statute.

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

REFERENCE: S.C. Code Ann. Section 12-9-40 (Supp. 1992)
S.C. Code Ann. Section 12-9-310 (Supp. 1992)
S.C. Code Ann. Section 12-9-390 (Supp. 1992)
S.C. Code Ann. Section 12-9-420 (Supp. 1992)
S.C. Code Ann. Section 12-9-510 (Supp. 1992)
S.C. Code Ann. Section 12-9-530 (Supp. 1992)
S.C. Code Ann. Section 12-9-610 (Supp. 1992)
S.C. Code Ann. Section 12-9-620 (1976)
S.C. Code Ann. Section 12-9-630 (Supp. 1992)
S.C. Code Ann. Section 12-9-850 (Supp. 1992)
S.C. Code Ann. Section 12-9-860 (Supp. 1992)
S.C. Code Ann. Section 12-54-40 (Supp. 1992)
S.C. Code Ann. Section 12-54-190 (Supp. 1992)
S.C. Code Ann. Section 12-54-210 (Supp. 1992)
S.C. Code Ann. Section 12-54-155 (Supp. 1992)
S.C. Code Ann. Section 12-54-90 (Supp. 1992)
S.C. Code Ann. Section 12-54-1010 (Enacted 1993)

AUTHORITY: S.C. Code Ann. Section 12-4-320 (Supp. 1992)
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 Department of Revenue.

PURPOSE: To establish guidelines to assist Department of Revenue ("Department") employees in the application of civil penalties in cases where withholding agents fail to file withholding returns, fail to deposit withholding tax, fail to pay withholding tax, fail to file annual reconciliations of income tax withheld, fail to furnish withholding statements to payees, or fail to file withholding statements with the Department.

I. BACKGROUND:

There are both civil and criminal penalties which may apply to certain activities, or failure to perform certain activities, relative to withholding of income taxes. This document concerns only civil penalties found in Chapters 9 and 54 of Title 12 of the Code of Laws.

II. WITHHOLDING LAW:

A. **DUTY TO WITHHOLD**

1. Sales of Real Property Owned by Nonresidents

Code Section 12-9-510 requires the buyer to withhold and pay over to the Department (on Form I-290) a certain percentage of the amount realized on the sale of real property and associated tangible personal property owned by a nonresident. For additional information, see SC Revenue Ruling #90-3.

2. Nonresident S-Corporation Shareholders and Partners

For taxable years beginning after 1991, Code Section 12-9-40 requires S-corporations and partnerships to withhold income tax from nonresident S-corporation shareholders' and nonresident partners' shares of South Carolina taxable income. For additional information, see SC Revenue Procedure #92-5.

3. Nonresident Beneficiary of an Estate or Trust

Code Section 12-9-310(A)(4) requires estates and trusts to withhold income tax from nonresident beneficiaries on any distribution of South Carolina taxable income. A trust exempt from federal income taxes under Internal Revenue Code Section 501 is not required to withhold income taxes from a nonresident beneficiary under this section.

4. All Other Withholding Situations

Code Section 12-9-310 requires certain persons to deduct and withhold income taxes upon wages; rentals or royalties paid to nonresidents; prizes or winnings; and payments to nonresident contractors.

B. **DUTY TO FILE RETURNS**

1. Sales of Real Property Owned by Nonresidents

Code Section 12-9-530 requires payment to the Department of tax withheld on the sale of real and associated tangible personal property owned by a nonresident on or before the fifteenth day of the month following the month in which completion of the sale occurs using forms developed for reporting and remitting (Form I-290).

2. Nonresident S-Corporation Shareholders and Partners

In accordance with Code Section 12-9-40, if S-corporations have a duty to withhold income taxes from nonresident shareholders' shares of South Carolina taxable income, then the S-corporations are required to make returns (Form SC 1120S-WH) and remit the taxes withheld.

In accordance with Code Section 12-9-40, if partnerships have a duty to withhold income taxes from nonresident partners' shares of South Carolina taxable income, then the partnerships are required to make returns (Form SC 1065 - Sch. WH or Form SC 4868) and remit the taxes withheld.

3. Nonresident Beneficiary of an Estate or Trust

In accordance with Code Section 12-9-310(A)(4), if an estate or a trust has a duty to withhold income taxes from a nonresident beneficiary's distribution of South Carolina taxable income, then the estate or trust must remit the taxes withheld on its annual return (Form SC1041).

4. All Other Withholding Situations

Code Section 12-9-390 requires a withholding agent, who must make a return or deposit and pay taxes to the Internal Revenue Service, to make a return (Form WH-1605) or deposit and pay to the Department any taxes deducted and withheld under Code Section 12-9-310.

Pursuant to Code Section 12-9-630, every withholding agent (except those covered in Paragraphs 1, 2 and 3 of this Section) must file with the Department a recapitulation and reconciliation statement of taxes withheld and paid during the year (Form WH-1606). This statement must be filed on or before the thirty-first day of January next succeeding the year for which amounts were withheld, or may be filed at the time the withholding agent notifies the Department that he is no longer required to file withholding reports.

C. DUTY TO PROVIDE INFORMATION

1. Sales of Real Property Owned by Nonresidents

SC Revenue Ruling #90-3 requires buyers to complete four copies of Form I-290 for each sale. One copy is sent with the payment to the Department by the fifteenth of the month following the month of the closing. Two copies are given to the seller - one for his records and one to be attached to his South Carolina income tax return. The buyer keeps the remaining copy for his records.

2. Nonresident S-Corporation Shareholders and Partners

Code Section 12-9-40 requires S-corporations and partnerships, which have withheld income taxes from nonresident shareholders or partners, to furnish withholding statements (Federal Form 1099-MISC.) to the shareholders or partners from whom the taxes were withheld. S-corporations are required to furnish the statements to shareholders on or before the fifteenth day of the third month following the close of the S-corporations' tax year. S-corporations must also attach copies of

withholding statements furnished to shareholders with their withholding tax returns (Form SC 1120S-WH) when filed. Partnerships are required to furnish withholding statements to nonresident partners on or before the fifteenth day of the fourth month following the close of the partnerships' tax year. Partnerships must also attach copies of withholding statements furnished to partners with their tax returns (Form SC 1065 - Sch. WH or Form SC 4868) when filed.

3. Nonresident Beneficiary of an Estate or Trust

An estate or trust withholding income taxes from a nonresident beneficiary must prepare a Form SC41, "Fiduciary Report of Nonresident Beneficiary Tax Withheld". A copy of this form must be forwarded to the nonresident beneficiary so that the beneficiary may attach it to his or her South Carolina income tax return. Estates and trusts must also attach copies of all such forms (SC41) furnished to partners with their tax returns (Form SC1041).

4. All Other Withholding Situations

In accordance with Code Section 12-9-610, withholding agents are required to furnish copies of withholding statements to payees on or before January thirty-first of the year succeeding collection of the tax. Likewise, Code Section 12-9-620 requires the original copies of these withholding statements to be filed with the Department within the same period of time. These copies should be attached to annual reconciliation statements which serve as transmittal documents.

D. CONFLICTING PROVISIONS

Code Section 12-54-190 states, "unless otherwise specified, the provisions of this chapter take precedence over all other related statutory provisions."

A review of civil penalties relative to withholding of income taxes reveals the penalties found in Chapter 54 are controlling with the exception of the penalties at Code Sections 12-9-850 and 12-9-860, which are not addressed in Chapter 54. Also, the provisions of Code Section 12-9-420 are applicable since Chapter 54 does not address the liability of the withholding agent.

III. PROCEDURES AND PENALTIES:

A. LIABILITY OF THE WITHHOLDING AGENT

Code Section 12-9-420 provides that every withholding agent who fails or neglects to withhold or pay to the Department any sums required to be withheld and paid is personally and individually liable therefor. Further, any sums withheld as required by Sections 12-9-310 through 12-9-370 are to be held in trust for the State. **The term "withholding agent" includes "an officer or employee of a corporation, or member or employee of a partnership, who as such officer, employee or member is under a duty to perform the act in respect of which the violation occurs."** See Code Section 12-9-420.

B. FAILURE TO WITHHOLD TAX

Generally, any person who is required to withhold any tax under Chapter 9, who fails to do so, also fails to deposit or pay the withholding taxes due. As such, that person is subject to the penalties cited below in Section C - "FAILURE TO DEPOSIT OR PAY WITHHOLDING TAX".

C. FAILURE TO DEPOSIT OR PAY WITHHOLDING TAX

1. Failure to Pay Nonresident Withholding Deducted and Withheld on Sales of Real Property

In accordance with Code Section 12-54-40(b)(2)(a), in the case of failure by a withholding agent to pay withholding taxes **shown** on a return (Form I-290) on or before the date prescribed by law (determined, if applicable, with regard to any extension of time for paying), there must be added to the tax due, a penalty of one-half of one percent (0.5%) of the amount of the tax if the failure is for not more than one month, with an additional one-half of one percent (0.5%) for each additional month or fraction thereof during which the failure continues, not to exceed twenty-five percent (25%).

In accordance with Code Section 12-54-40(b)(2)(b), in the case of failure by a withholding agent to pay withholding taxes **required to be shown** on a return (Form I-290) which is not so shown within ten days of the notice and demand for payment, there must be added to the tax stated in the notice and demand a penalty of one-half of one percent (0.5%) of the amount of the tax if the failure is for not more than one month, with an additional one-half of one percent (0.5%) for each additional month or fraction thereof during which the failure continues, not to exceed twenty-five percent (25%).

2. Failure to Pay Income Tax Withheld from Nonresident S-Corporation Shareholders and Nonresident Partners

In accordance with Code Section 12-54-40(b)(2)(a), in the case of failure by a withholding agent to pay withholding taxes **shown** on a return (e.g. Forms SC 1120S-WH, SC 1065 - Sch. WH, or SC 4868) on or before the date prescribed by law (determined, if applicable, with regard to any extension of time for paying), there must be added to the tax due, a penalty of one-half of one percent (0.5%) of the amount of the tax if the failure is for not more than one month, with an additional one-half of one percent (0.5%) for each additional month or fraction thereof during which the failure continues, not to exceed twenty-five percent (25%).

In accordance with Code Section 12-54-40(b)(2)(b), in the case of failure by a withholding agent to pay withholding taxes **required to be shown** on a return (e.g. Forms SC 1120S-WH, SC 1065 - Sch. WH, or SC 4868) which is not so shown within ten days of the notice and demand for payment, there must be added to the tax stated in the notice and demand a penalty of one-half of one percent (0.5%) of the amount of the tax if the failure is for not more than one month, with an additional one-half of one percent (0.5%) for each additional month or fraction thereof during which the failure continues, not to exceed twenty-five percent (25%).

3. Failure to Pay Income Tax Withheld from Nonresident Beneficiary of an Estate or Trust

In accordance with Code Section 12-54-40(b)(2)(a), in the case of failure by a withholding agent to pay withholding taxes **shown** on a return (Form SC1041) on or before the date prescribed by law (determined, if applicable, with regard to any extension of time for paying), there must be added to the tax due, a penalty of one-half of one percent (0.5%) of the amount of the tax if the failure is for not more than one month, with an additional one-half of one percent (0.5%) for each additional month or fraction thereof during which the failure continues, not to exceed twenty-five percent (25%).

In accordance with Code Section 12-54-40(b)(2)(b), in the case of failure by a withholding agent to pay withholding taxes **required to be shown** on a return (Form SC1041) which is not so shown within ten days of the notice and demand for payment, there must be added to the tax stated in the notice and demand a penalty of one-half of one percent (0.5%) of the amount of the tax if the failure is for not more than one month, with an additional one-half of one percent (0.5%) for each additional month or fraction thereof during which the failure continues, not to exceed twenty-five percent (25%).

4. Failure to Deposit or Pay During the Quarter Withholding Tax Deducted and Withheld

In accordance with Code Section 12-54-40(b)(7), in the case of a failure to make a deposit or pay during the quarter (Form WH-1601 or Electronic Funds Transfer) withholding tax deducted and withheld as required by Code Sections 12-9-310 through 12-9-370, the Department may, at its discretion, impose a penalty on the withholding agent of not less than ten dollars (\$10) nor more than one thousand dollars (\$1,000).

5. Failure to Pay Withholding Taxes Shown, or Required to be Shown, on the Quarterly Return (Form WH-1605)

In accordance with Code Section 12-54-40(b)(2)(a), in the case of failure by a withholding agent to pay withholding taxes **shown** on a return (e.g. Forms SC 1120S-WH, WH-1605, SC 1065 - Sch. WH, or SC 4868) on or before the date prescribed by law for filing the quarterly return (determined, if applicable, with regard to any extension of time for paying beyond the due date of the quarterly return), there must be added to the tax due, a penalty of one-half of one percent (0.5%) of the amount of the tax if the failure is for not more than one month, with an additional one-half of one percent (0.5%) for each additional month or fraction thereof during which the failure continues, not to exceed twenty-five percent (25%).

In accordance with Code Section 12-54-40(b)(2)(b), in the case of failure by a withholding agent to pay withholding taxes required to be shown on a return (e.g. Forms SC 1120S-WH, WH-1605, SC 1065 - Sch. WH, or SC 4868) which is not so shown within ten days of the notice and demand for payment, there must be added to the tax stated in the notice and demand a penalty of one-half of one percent (0.5%) of the amount of the tax if the failure is for not more than one month, with an additional one-half of one percent (0.5%) for each additional month or fraction thereof during which the failure continues, not to exceed twenty-five percent (25%).

D. **FAILURE TO FILE A WITHHOLDING TAX RETURN (Forms WH-1605, I-290, SC 1120S-WH, SC 1065 - Sch. WH, SC 4868 or SC1041)**

In accordance with Code Section 12-54-40(b)(1), in the case of failure to file a withholding tax return (e.g. Forms WH-1605, I-290, SC 1120S-WH, SC 1065 - Sch. WH, SC 4868 or SC 1041) on or before the date prescribed by law (determined, if applicable, with regard to any extension of time for filing), there must be added to the amount required to be shown as tax on the return, a penalty of five percent (5%) of the amount of the tax if the failure is for not more than one month, with an additional five percent (5%) for each additional month or fraction thereof during which the failure continues, not to exceed twenty-five percent (25%).

The statute also establishes a minimum amount for the above penalty if the withholding agent fails to file a return within sixty (60) days of the return's due date. This minimum penalty must not be less than the lesser of one hundred dollars (\$100) or one hundred percent (100%) of the amount required to be shown as tax on the return. For example, if a taxpayer failed to timely file a withholding tax return and later filed the return one and one-half months after the return became delinquent, the penalty for failure to file the return would be ten percent (10%) of the amount of the tax. However, if, for example, a taxpayer files a withholding tax return seventy-five (75) days late, the penalty is fifteen percent (15%) of the amount of the tax required to be shown on the return. Also, since the return was not filed within sixty (60) days of the due date, the minimum penalty is the lesser of one hundred percent (100%) of the tax required to be shown on the return or one hundred dollars (\$100).

For the purpose of this penalty, the amount of tax required to be shown on the return must be reduced by the amount of any part of the tax which is paid or deposited on or before the date prescribed for payment of the tax and by any amount of any credit against the tax which may be claimed upon the return.

E. **FAILURE TO FILE AN ANNUAL RECONCILIATION (Form WH-1606)**

Under Code Section 12-54-210, for failure to file the annual reconciliation of income tax withheld (Form WH-1606), the Department may impose a penalty upon the withholding agent in an amount not to exceed five hundred dollars (\$500).

F. **FAILURE TO FURNISH WITHHOLDING STATEMENTS TO PAYEES OR FAILURE TO FILE WITHHOLDING STATEMENTS WITH ANNUAL RECONCILIATIONS OF INCOME TAX WITHHELD**

The withholding agent may be penalized for failure to furnish withholding statements to payees or failure to file withholding statements with the Department in accordance with Code Section 12-9-860. Each withholding statement which is not furnished to a payee or filed with the reconciliation constitutes a separate offense. For failure to furnish withholding statements to payees, the withholding agent is subject to a penalty of not less than one hundred dollars (\$100) nor more than one thousand dollars (\$1,000). For failure to file withholding statements with reconciliations of income tax withheld, the withholding agent is subject to a penalty of not less than one hundred dollars (\$100) nor more than two thousand dollars (\$2,000).

G. NEGLIGENCE

In accordance with Code Section 12-54-40(c), if any part of an underpayment is due to negligence or disregard of regulations, there must be added to the tax due a penalty equal to five percent (5%) of the underpayment and a penalty equal to fifty percent (50%) of the interest due under Code Section 12-54-20. The negligence penalty cannot be assessed against any portion of the underpayment attributable to fraud for which a penalty is imposed under Code Section 12-54-40(d). See Section J.2. of this document.

"Negligence" is defined under the statute to include any failure to make a responsible attempt to comply with the provisions of Title 12 and "disregard" is defined to include any careless, reckless, or intentional disregard.

H. SUBSTANTIAL UNDERSTATEMENT

In accordance with Code Section 12-54-155, if there is a substantial understatement of tax for any taxable period, there must be added to the tax an amount equal to twenty-five percent (25%) of the amount of any underpayment attributable to the understatement. A substantial understatement for the taxable period is one in which the amount of the understatement for the taxable period exceeds the greater of ten percent (10%) of the tax required to be shown on the return for the taxable period or five thousand dollars (\$5,000.00), or ten thousand dollars (\$10,000.00) in the case of a corporation other than an S corporation or a personal holding company as defined in IRC Section 542. Code Section 12-54-155 defines the term "understatement" to mean "the excess of the amount of the tax required to be shown on the return for the taxable period over the amount of the tax imposed which is shown on the return." The understatement "must be reduced by that portion of the understatement which is attributable to (i) the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment or (ii) any item with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return."

I. REVOCAION OF LICENSES

In accordance with Code Section 12-54-90, the Department may revoke one or more licenses (i.e. retail license, tobacco tax license, admissions tax license) held by any person who fails, neglects, violates, or refuses to comply with a provision of the withholding tax law or regulations.

For tax years and licensing periods beginning after December 31, 1993, the Department, in accordance with Code Sections 12-54-1010 and 12-54-1020, may also seek revocation or suspension of any license issued by another "agency" (i.e. county business license, municipal business license) to any person that has neglected or refused to file a return or pay a tax as required under the withholding tax laws administered by the Department. However, the Department can not seek revocation or suspension of the license if the taxpayer has filed in good faith a pending application for abatement of the tax or a pending petition before the appropriate authority contesting the tax. "Agency" for purposes of this section includes every department, board, commission, division, authority, district, or other agency of the State of South Carolina or its subdivisions (including a municipality or a district).

J. CIVIL FRAUD

1. Willful or Fraudulent Failure to Withhold Tax

Generally, any person who is required to withhold any tax under Chapter 9, who willfully or with fraudulent intent fails to do so, also fails to deposit or pay the withholding taxes due. As such, that person is subject to the penalties cited below in Section 2 - "Fraudulent Underpayment of Tax".

2. Fraudulent Underpayment of Tax

In accordance with Code Section 12-54-40(d), if any part of an underpayment of tax required to be shown on a withholding tax return is due to fraud, there must be added to the tax an amount equal to seventy-five percent (75%) of the portion of the underpayment due to fraud and an amount equal to fifty percent (50%) of the interest payable under Code Section 12-54-20 from the date the tax was due to the date it is assessed or paid, whichever is earlier.

If this civil fraud penalty is assessed, then no penalty relating to failure to file the return or pay the tax can be assessed with respect to the portion of the underpayment attributable to fraud.

3. Fraudulent Exemption Certificate Filed by an Employee

In accordance with Code Section 12-9-850, if an employee files a fraudulent exemption certificate with intent to evade the tax, the employee is liable for a penalty of not less than fifty dollars (\$50) nor more than one thousand dollars (\$1,000) for each fraudulent exemption claimed.

THE APPLICATION AND THE AMOUNT OF ALL OF THE ABOVE PENALTIES FOR CIVIL FRAUD (SECTION J OF THIS DOCUMENT) MUST BE APPROVED BY THE CRIMINAL INVESTIGATION DEPARTMENT OF THE POLICY AND SPECIAL PROCEDURES DIVISION BEFORE THEY ARE ASSESSED.