2. BUSINESS INCOME TAX

PART A: GENERAL TAX PROVISIONS AND ADMINISTRATION OF CREDITS

1. FEDERAL TAX CONFORMITY

South Carolina income tax laws conform substantially to the federal income tax laws. Generally each year, South Carolina's income tax laws have been amended to conform to the Internal Revenue Code of 1986, as amended through the immediately preceding December 31st, with the exception of Internal Revenue Code Section provisions listed in S.C. Code Ann. § 12-6-50 that are specifically not adopted by South Carolina.[1] As of the date this publication was edited, S.C. Code Ann. § 12-6-40 provides that South Carolina's income tax laws conform to the Internal Revenue Code of 1986, as amended through December 31, 2021, subject to the exceptions listed in S.C. Code Ann. § 12-6-50. The effective date provisions contained in the Internal Revenue Code are also generally adopted. Therefore, except as otherwise provided, when the annual South Carolina conformity amendment becomes effective, Internal Revenue Code provisions that went into effect during the preceding year are retroactively adopted and considered to have the same effective date as they had for federal income tax purposes. S.C. Code Ann. § 12-6-40(A)(1)(c). S.C. Code Ann. §§ 12-6-40 and 12-6-50 should be reviewed annually by taxpayers to determine if federal changes to Internal Revenue Code provisions or other uncodified federal tax provisions have been adopted or limited by South Carolina. See also, *South Carolina's Guide to IRC Conformity from 2018-2020*, available at www.dor.sc.gov/policy/index/policy-manuals.

This conformity simplifies the filing of returns by adopting federal taxable income as a starting point for South Carolina income tax purposes. With some exceptions, South Carolina income tax liability is determined in accordance with the same set of statutes and rules used in determining federal income tax liability. Subject to certain modifications, the South Carolina gross income and taxable income of a business is the business's gross income and taxable income as determined under the Internal Revenue Code.

2. CORPORATE INCOME TAX RATES

South Carolina corporate income tax is imposed upon the South Carolina taxable income of domestic and foreign corporations. Once a business has determined its South Carolina taxable income, it must apply the South Carolina corporate income tax rate to determine the amount of South Carolina corporate income tax due. South Carolina has a 5% corporate income tax rate.

[1] Among the Internal Revenue Code sections that are specifically not adopted by South Carolina are the bonus depreciation provisions of I.R.C. § 168(k) and the interest limitation rules of I.R.C. § 163(j).

3. TAXATION OF OTHER ENTITIES

S.C. Code Ann. § 12-6-550 exempts a number of corporations from South Carolina income tax. Exempt corporations include insurance companies, certain nonprofit corporations organized for the purpose of providing water supply and/or sewer disposal, banks, building and loan associations, and certain electric cooperatives. Some of these entities may be subject to other types of South Carolina tax. Also, South Carolina does not generally tax the income of a tax exempt organization qualifying under I.R.C. §§ 501 through 528, although the unrelated business income of such an entity is taxed. The taxation of pass-through entities and limited liability companies generally conforms to the federal income tax laws. The South Carolina taxation of pass-through entities and withholding requirements are discussed below.

a. S Corporations

South Carolina recognizes a valid federal Subchapter S election. S.C. Code Ann. § 12-6-590 provides that a corporation having a valid election under Subchapter S of the Internal Revenue Code is not subject to South Carolina income tax to the extent it is exempt from federal corporate income tax. Further, a termination or revocation of an "S" election for federal purposes automatically terminates or revokes the election for South Carolina income tax purposes.

A corporation subject to the corporate income tax under Title 12, Chapter 6 of the South Carolina Code that has a valid qualified Subchapter S subsidiary (QSub) election for federal income tax purposes is deemed to have a valid QSub election for South Carolina income tax purposes. Therefore, for South Carolina income tax, license fee, and annual report purposes, including the determination of nexus, the parent and each QSub are treated as one entity. S.C. Code Ann. § 12-2-25(B)(2). See also SC Revenue Ruling #05-11 for information on the license fee computation for a QSub.

b. Partnerships

Partnerships are not subject to South Carolina income tax under S.C. Code Ann. § 12-6-600. The gross income, adjusted gross income, and taxable income of a partnership and its partners are determined in accordance with applicable provisions of the Internal Revenue Code. Partners include in their South Carolina taxable incomes their proportionate share of the partnership's South Carolina taxable income. See SC Revenue Ruling #97-7 for information on a resident partner reporting personal service income received from South Carolina and one or more states. Note, partnerships and other qualifying pass-through entities may now elect to pay income tax at the entity level. See S.C. Code Ann. § 12-6-545(G) and SC Revenue Ruling #21-15.

c. Limited Liability Companies

South Carolina follows the federal tax treatment of limited liability companies. If a limited liability company is treated as a corporation for federal income tax purposes it is treated as a corporation for South Carolina income tax purposes and is subject to a corporate license fee. S.C. Code Ann. § 12-2-25 provides that a partnership includes a limited liability company taxed for all South Carolina income tax purposes as a partnership. Accordingly, a limited liability company that is treated as a partnership for federal income tax purposes is not subject to South Carolina income tax or the corporate license fee.

S.C. Code Ann. § 12-2-25 further provides that a single member limited liability company that is not taxed as a corporation for South Carolina income tax purposes is not regarded as an entity separate from its owner. Accordingly, if the single member limited liability company does not make a federal election to be taxed as a corporation, it will not be treated as a separate entity. Instead, it will be treated as a sole proprietorship if owned by an individual, a division of the corporation if owned by a corporation, or a division of the partnership if owned by a partnership. For example, if a corporation owns a single member limited liability company that is disregarded for South Carolina tax purposes, the limited liability company does not owe a corporate license fee. The limited liability company is treated as part of the corporation which owns it. If the single member limited liability company has elected to be taxed as a corporation, then it is treated as a 100% owned subsidiary and is subject to a separate corporate license fee.

Note, with respect to the preferential assessment ratio allowed to owner-occupied residential property, the South Carolina Supreme Court has ruled that a single member limited liability company is disregarded in determining whether the single member of the limited liability company can qualify for the 4% owner-occupied residential assessment ratio for such property under S.C. Code Ann. § 12-43-220. See, *CFRE, LLC v. Greenville County Assessor,* 395 S.C. 67, 716 S.E.2d 877 (2011).

See SC Revenue Ruling #98-11 for information on income tax, license fee, and deed recording fee implications of a single member limited liability company. Questions concerning the taxation of limited liability companies, other than single member limited liability companies, are addressed in SC Information Letter #96-25. Questions concerning conversion of a partnership to a limited liability company are discussed in SC Revenue Ruling #95-9. See also South Carolina Limited Liability Companies and Limited Liability Partnerships, published by the South Carolina Bar.

d. Withholding for Pass-through Entities

South Carolina requires the withholding of tax on the pass through of income to nonresident shareholders and partners at the rate of 5%. SC Revenue Procedure #17-2 addresses withholding on distributed or undistributed South Carolina income of shareholders and partners, and exceptions to the withholding requirements.

There are several exceptions to the withholding requirements in S.C. Code Ann. § 12-8-590. The exceptions are:

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. The Department has a preprinted affidavit, Form I-309, "Nonresident Shareholder or Partner Affidavit and Agreement Income Tax Withholding," available for use by shareholders and partners.

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 Section 8 below for information on composite returns.

3. An S corporation or partnership is not required to withhold income taxes under S.C. Code Ann. § 12-8-590 on income attributable to the sale of real property which is subject to withholding under S.C. Code Ann. § 12-8-580, "Withholding by buyer of real property or associated tangible personal property from nonresident seller." See SC Revenue Ruling #09-13 for more information on withholding on sales of property by nonresidents.

4. An S corporation or partnership is not required to withhold income taxes with respect to any nonresident shareholder or partner that provides a statement that the shareholder or partner is an organization exempt from income taxes under I.R.C. § 501(a).

4. NEXUS

a. Public Law 86-272

Nexus is a sufficient connection between a person and a state, and a sufficient connection between an activity, property, or transaction and a state, that allows the state to subject the person and the activity, property, or transaction to its taxing jurisdiction. The Due Process and Commerce Clauses of the United States Constitution, 15 U.S.C. § 381 (Public Law 86-272), and other federal statutes provide limitations on states' powers to tax out-of-state corporations.

Public Law 86-272 prohibits a state from taxing the income of a taxpayer if the taxpayer's only business activities within the state consist of the solicitation of orders for sales of tangible personal property that are sent outside the state for approval and are filled and shipped from outside the state.

The Department published guidelines in SC Revenue Ruling #97-15, similar to those published by the Multistate Tax Commission in 1994, to assist in determining whether Public Law 86-272 protects certain activities from South Carolina taxation. Only the solicitation to sell tangible personal property is afforded immunity under Public Law 86-272. The leasing, renting, licensing or other disposition of tangible personal property or transactions involving real property or

intangibles, such as franchises, patents, copyrights, trademarks, service marks and the like are not protected activities under Public Law 86-272. The selling or providing of services is also not protected.

The sale or delivery, and the solicitation for the sale or delivery, of any type of service that is not either (1) ancillary to solicitation or (2) otherwise set forth as a protected activity in SC Revenue Ruling #97-15 is also not protected under Public Law 86-272.

b. Geoffrey

Over the years, the courts have provided limitations and guidelines in determining whether certain activities create nexus with a state. For example, see, *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.,* 505 U.S. 214 (1992), *Burger King Corp. v. Rudzewicz,* 471 U.S. 462 (1985), *Helicopteros Nacionales de Columbia, S.A. v. Hall,* 466 U.S. 408 (1984), *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977), and *Geoffrey, Inc. v. South Carolina Tax Commission,* 437 S.E. 2d 13 (S.C. 1993) *cert. denied* 114 S. Ct. 550 (1993).

In *Geoffrey,* the South Carolina Supreme Court determined that the licensing of trademarks and symbols to a South Carolina retailer and the maintaining of accounts receivable in South Carolina by a nonresident taxpayer created nexus for South Carolina income tax purposes even though the taxpayer lacked physical presence in South Carolina. The Court determined that Geoffrey purposely directed its activities toward South Carolina, and that Geoffrey owned and used business intangible property in South Carolina. Each of these activities was held to be sufficient to satisfy the nexus requirements of the Due Process Clause and the Commerce Clause.

In SC Revenue Ruling #08-1, the Department addressed some of the common questions that have arisen relating to taxpayers concerned about the implications of *Geoffrey*. Specifically, this document provides examples that show activities or relationships, which will not, by themselves, create income tax nexus with South Carolina.

c. Income Tax Nexus Creating Activities

SC Revenue Ruling #16-11 provides guidance concerning corporate income tax nexus creating activities. It addresses types of business activities or relationships that, by themselves, may or may not create corporate income tax nexus. This document does not address the imposition of any license fee, filing requirements, withholding responsibilities, or the consequences of unity and foreign commerce.

The following categories of nexus creating activities are discussed:

1. General Activities

2. Registration with State Agencies/Departments

3. Ownership/Leasing In-state Property

4. Ownership Interest of In-state Pass-through Entities

5. Licensing Intangibles

6. Employee Activities – Sales Related

7. Employee Activities – Non-sales Related

8. Activities of Unrelated Parties

9. Distribution and Delivery

10. Financial Activities/Transactions

11. Transactions with South Carolina Printers

12. Cloud Computing or Software as a Service (SAAS) Transactions

13. Internet-Based Activities

See Appendix I for a summary of the Department's responses to corporate income tax nexus creating questions contained in SC Revenue Ruling #16-11.

Since developments in this area are constantly taking place, any response is subject to change due to a future statute, regulation, court decision, or advisory opinion.

5. ALLOCATION AND APPORTIONMENT OF INCOME

a. General Provisions

SC Code Ann. § 12-6-2210 provides for the determination of whether taxable income of a business will be apportioned. A taxpayer whose entire business is transacted or conducted in South Carolina is subject to income tax based on the entire taxable income of the business for the taxable year. A taxpayer that transacts or conducts its business partly within and partly outside of South Carolina is subject to income tax based on the portion of its business carried on in South Carolina. This portion is determined through allocation and apportionment of income. The sum of these amounts is South Carolina taxable income.

S.C. Code Ann. §§ 12-6-2220 and 12-6-2230 provide that certain classes of income, less related expenses, are allocated. Items directly allocated include nonbusiness interest, nonbusiness dividends, nonbusiness rents and royalties from the lease or rental of real estate or tangible

personal property, gains and losses from the sale of real property, and nonbusiness gains and losses from sales of intangible property.

The income remaining after allocation is apportioned in accordance with S.C. Code Ann. § 12-6-2240. South Carolina generally requires the use of one of the following apportionment methods:

1. A single factor apportionment method (based on sales) for taxpayers whose principal business in South Carolina is dealing in tangible personal property. This method is typically used by businesses that manufacture, sell, or rent tangible personal property. See, S.C. Code Ann. §§ 12-6-2252, 12-6-2280, and 12-6-2295.

2. A "gross receipts" apportionment method for taxpayers not dealing in tangible personal property. This method is typically used by financial businesses and service businesses, including businesses that install or repair tangible personal property, and contractors. See S.C. Code Ann. §§ 12-6-2290 and 12-6-2295.

3. A "special" apportionment method provided in S.C. Code Ann. § 12-6-2310 for certain companies, such as railroad companies, telephone companies, pipeline companies, airline companies, and shipping lines.

4. An individualized apportionment method tailored to a particular taxpayer (a) because the standard method for that taxpayer does not fairly represent the extent of the taxpayer's business in South Carolina, or (b) as an economic incentive allowed the taxpayer. See subsections (b) and (c) below for more information on alternative apportionment provisions.

◆ Apportionment Methods

Single Sales Factor Apportionment Method. S.C. Code Ann. § 12-6-2252 (*i.e.,* the single sales factor apportionment method) provides that a taxpayer whose principal business in South Carolina is manufacturing or any form of collecting, buying, assembling, or processing goods and materials in this state or whose principal business in South Carolina is selling, distributing or dealing in tangible personal property within South Carolina shall apportion income to South Carolina by multiplying the net income remaining after allocation under S.C. Code Ann. §§ 12-6-2220 and 12-6-2230 by the sales factor defined in S.C. Code Ann. § 12-6-2280. However, if a sales factor does not exist, the remaining net income is apportioned to the business's principal place of business. The single sales factor apportionment method is typically used by manufacturers and retailers having income in South Carolina, as well as other businesses that make or deal with tangible personal property.

"Principal place of business" means "the domicile of a corporation. However, when none of the business of the corporation is conducted in the state of domicile, the department shall

determine the principal place of business of the corporation based upon the available evidence."

Gross Receipts Apportionment Method. S.C. Code Ann. § 12-6-2290 provides for the "gross receipts" formula and states:

> If the principal profits or income of a taxpayer are derived from sources other than those described in S.C. Code Ann. §§ 2-6-2252 or 12-6-2310, the taxpayer shall apportion its remaining net income using a fraction in which the numerator is gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year. For purposes of this section, items included in gross receipts are as provided in S.C. Code Ann. § 12-6-2295.

The "gross receipts" ratio is most commonly used by service businesses. The sourcing of gross receipts was reviewed in *Lockwood Greene Engineers v. South Carolina Tax Commission,* 361 S.E.2d 346 (1987). The court held that in sourcing income of a multistate engineering firm, "gross receipts from within this State" were to be determined according to where the services were performed rather than according to where the customers were located. See also, *Geoffrey, Inc. v. South Carolina Tax Commission,* 313 S.C. 15 ,437 S.E.2d 13 (1993), *cert. denied* 114 S. Ct. 550 (1993), SC Private Letter Ruling #13-3, and *DIRECTV, Inc. & Subsidiaries v. South Carolina Department of Revenue,* 421 S.C. 59, 804 S.E.2d 633 (Ct. App. 2017), and *Dish DBS Corporation, f/k/a Echostar, DBS Corp. and Affiliates v. South Carolina Department of Revenue,* (Unpublished Opinion No. 2018-UP-404) (Ct. App. October 31, 2018), concerning sourcing of receipts of subscription network/broadcasting/programming and advertising services associated with television providers. See also, S.C. Code Ann. § 12-6-2295(A)(7) (overruling the holding in *DIRECTV* to establish sourcing of receipts from the provision of direct broadcast satellite service and also addressing receipts from the operation of a cable system (as defined in S.C. Code Ann. § 58-12-300) and video service (as defined in S.C. Code Ann. § 58-12-300).

b. Fairness Based Alternative Apportionment Provisions

S.C. Code Ann. § 12-6-2320 provides for alternative methods to fairly apportion income for companies who do business in more than one state. Any taxpayer who believes that the statutory apportionment formula does not fairly represent the extent of the taxpayer's business within this State may apply to the Department for approval of an alternative method. On the other hand, if the Department does not believe the statutory apportionment formula fairly represents the extent of the taxpayer's business in this State, the Department may require an alternative method.

Under S.C. Code Ann. § 12-6-2320(A), a taxpayer may petition for, or the Department may require, with respect to all or any part of the taxpayer's business activity, one of the following alternatives for reporting:

1. Separate accounting;

2. The exclusion of one or more factors;

3. The inclusion of one or more factors; or

4. The use of another allocation and apportionment method.

The procedure to apply for the use of an alternative method is explained in detail in SC Revenue Procedure #15-2. Written approval of the new method must be received prior to using it to determine income allocated, or apportioned to South Carolina. The new method will also be used to determine the taxpayer's corporate license fee.

In *Media General Communications, Inc. v. South Carolina Department of Revenue*, 388 S.C. 138, 694 S.E.2d 525 (2010), the South Carolina Supreme Court was asked to consider whether the Department of Revenue had the power under S.C. Code Ann. § 12-6-2320(A) to allow Media General to use combined entity apportionment as a method of allocating and apportioning its income.[2] In particular, the question was whether item (4) of the statute which allows the use of "any other method to effectuate an equitable allocation and apportionment of the taxpayer's income" provided for combined apportionment. The South Carolina Supreme Court held that combined entity apportionment was a method that could be used to provide equitable allocation and apportionment of the taxpayer's income. See also, *CarMax Auto Superstores West Coast, Inc. v. South Carolina Department of Revenue*, 411 S.C. 79, 767 S.E. 2d 195 (2014) modifying 397 S.C. 604, 725 S.E. 2d 711 (Ct. App. 2012) addressing who bears the burden of proving that the standard apportionment formula does not fairly represent a taxpayer's business activity in the State and that an alternative method is reasonable, and *Rent-A-Center West, Inc. v. South Carolina Department of Revenue*, 418 S.C. 320, 792 S.E. 2d 260 (Ct. App. 2016) adopting the same line of reasoning as the *CarMax* case.

c. Economic Development Based Alternative Apportionment Provisions

S.C. Code Ann. § 12-6-2320 also provides for alternative methods to apportion income of multistate companies who are planning new facilities or expansions in South Carolina. The procedure to request approval of an economic development based alternative allocation or apportionment method is provided in SC Revenue Procedure #15-3. The new method will also be used to determine the taxpayer's corporate license fee, if any. The three incentive based methods are:

◆ New Facility or Expansion – 5 Year Formula

S.C. Code Ann. § 12-6-2320(B)(1) provides that the Department may enter into an agreement not to exceed five years that allows a business to use a method other than the standard

[2] Under the combined entity apportionment method, all income and loss of all entities that form part of the unitary business are combined.

apportionment method in determining its South Carolina taxable income. In order to use an alternative method for five years, the following requirements must be met:

1. The business must be planning a new facility or an expansion of an existing facility in South Carolina.

2. The business must ask the Department to enter into a contract reciting an allocation and apportionment method.

3. The Coordinating Council for Economic Development at the Department of Commerce ("Council") must certify that the new facility or expansion will have a significant beneficial economic effect on the region for which it is planned and that its benefits to the public exceed its costs.

◆ New Facility or Expansion – 10 Year Formula

S.C. Code Ann. § 12-6-2320(B)(3) provides that the Department may enter into an agreement not to exceed ten years that allows a taxpayer to use a method other than the standard apportionment method in determining its South Carolina taxable income. In order to use an alternative method for ten years, the following requirements must be met:

1. The taxpayer must be planning a new facility or an expansion of an existing facility in South Carolina that results in (1) a total investment of $10 million or more and (2) the creation of at least 200 new, full-time jobs with an average cash compensation level of more than three times the per capita income of the state at the time the jobs are filled. (The job requirement must be met within 5 years of the Council's certification.)

2. The Department must agree by contract to the use of the new method.

3. The Council must certify that the new facility or expansion will have a significant beneficial economic effect on the region for which it is planned and that its benefits to the public exceed its costs.

◆ Special Industry Formulas

1. Certain Recycling Facilities

   S.C. Code Ann. § 12-6-2320(C) provides special rules that allow a taxpayer constructing or operating a qualified recycling facility to request an alternative allocation or apportionment method. In order to qualify as a qualified recycling facility, the facility must invest at least $300 million and meet certain other requirements.

2. Life Sciences Facilities and Renewable Energy Manufacturing Facilities

   S.C. Code Ann. § 12-15-40 provides special rules that allow a taxpayer establishing a life sciences facility or a renewable energy manufacturing facility to request the Department enter into an agreement for up to 15 years to establish an alternative allocation or apportionment method pursuant to S.C. Code Ann. § 12-6-2320.

   S.C. Code Ann. § 12-15-20(A) defines a "life sciences facility" as a business engaged in pharmaceutical, medicine, and related laboratory instrument manufacturing, processing, or research and development, including a business under North American Industry Classification System Manual Code 3254 (Pharmaceutical and Medical Manufacturing) or 334516 (Analytical Laboratory Instrument Manufacturing.)

   S.C. Code Ann. § 12-15-20(B) defines a "renewable energy manufacturing facility" as a business which manufactures qualifying machinery and equipment for use by solar and wind turbine energy producers. It also includes a facility manufacturing qualifying advanced lithium ion, or other batteries for alternative energy motor vehicles as described in S.C. Code Ann. § 12-6-3377 or for other vehicles certified by the South Carolina Energy Office.

d. Corporate License Fees

S.C. Code Ann. § 12-20-50 imposes an annual license fee on the capital and paid-in surplus of a corporation. The license fee is $15 plus $1 for each $1,000, or fraction, of capital stock and paid-in or capital surplus shown on the corporate records on the first day of the tax year. The minimum license fee is $25. The license fee is computed in advance of the taxpayer's income tax year.

If a "consolidated" return is filed, then the license fee is measured by the capital stock and paid-in or capital surplus of each corporation considered separately without offset for investment of one corporation in the capital or surplus of another corporation in the consolidated group. The minimum license fee applies to each corporation in the consolidated group.

S.C. Code Ann. § 12-20-60 provides that the license fee imposed by S.C. Code Ann. § 12-20-50 must be apportioned in accordance with the ratio prescribed for income tax purposes. The $25 minimum license fee; however, may not be apportioned. A business using an alternative method to apportion income (see above discussion) will generally use that alternative method to compute the South Carolina corporate license fee.

S.C. Code Ann. § 12-20-50(A) defines "paid-in or capital surplus" and "earned surplus." Subsection (C) provides an economic development incentive allowing a reduction in the base amount used to compute the license fee for certain capital contributions used for substantial expansions. This incentive allows a holding company to reduce its paid-in or capital surplus by the portion of contributions to capital received from its parent corporation used to finance a subsidiary's expansion. To qualify, the expansion must be: (1) located in an economic impact

zone (**NOTE:** effective June 23, 2010, the definition of "economic impact zone" contained in S.C. Code Ann. § 12-14-30(1) has been eliminated and there are no longer any economic impact zones in South Carolina), (2) cost over $100 million, and (3) completed within 3 years of the first contribution to capital received by the holding company. The 3-year limitation may be extended for good cause by the Department. If the expansion is not timely completed; however, the amounts previously excluded from the license fee base for the contributions must be included in the capital amount in the year following the completion deadline.

See SC Revenue Ruling #05-11 for a detailed question and answer document on computing and prorating the license fee based on capital stock and paid in or capital surplus as provided in S.C. Code Ann. § 12-20-50.

NOTE: S.C. Code Ann. § 12-20-100 imposes a license fee on every express company, street railway company, navigation company, waterworks company, power company, electric cooperative company, light company, gas company, telegraph company, or telephone company in lieu of the license fee imposed by S.C. Code Ann. § 12-20-50. This license fee is based on gross receipts from services rendered from regulated business in South Carolina and South Carolina property used in the conduct of business. The fee is $1 for each $1,000, or fraction, of fair market value of property owned and used within South Carolina in the conduct of business as determined for property tax purposes for the preceding tax year and $3 for each $1,000, or fraction, of gross receipts from services rendered from regulated business within South Carolina during the preceding tax year. The minimum license fee is $25.[3]

6. USE OF CREDITS

Most of South Carolina's income tax credits may be earned by C corporations, S corporations, partnerships, sole proprietors, and limited liability companies (regardless of how they are taxed). The types of taxes a credit may offset include corporate income tax, corporate license fee, individual income tax, wage withholding, bank tax, insurance premium tax, and sales and use taxes. S.C. Code Ann. §§ 12-6-3310 and 12-6-3480, as well as each specific credit statute, should be reviewed to determine credit eligibility and use. A brief overview of the general credit rules and some exceptions to these rules are discussed below:

a. General Use of Credit Rules

S.C. Code Ann. §§ 12-2-100, 12-6-3310 and 12-6-3480 provide rules relating to the use of tax credits. These rules include:

- A credit must be used to the extent possible in the year it is generated and cannot be refunded, unless otherwise provided by law. The job development credit (S.C. Code Ann.

[3] In *Alltel Communications, Inc. v. South Carolina Department of Revenue, et al*., 399 S.C. 313, 731 S.E.2d 869 (2012), the South Carolina Supreme Court determined that a cellular telephone service provider was not a telephone company for purposes of the license tax imposed under S.C. Code Ann. § 12-20-100.

§ 12-10-80) and the job retraining credit (S.C. Code Ann. § 12-10-95) (both of which are credits against withholding tax) are refundable to the extent of withholding actually paid. There are certain other credits (e.g. port volume credit, increase in purchase of SC grown products) that may be applied against withholding tax that are also refundable to the extent of withholding actually paid. The milk producer credit (S.C. Code Ann. § 12-6-3590) and the agricultural use of anhydrous ammonia credit (S.C. Code Ann. § 12-6-3582) (both of which are credits against income tax) are refundable.

- Unless otherwise provided in the particular credit statute, the taxpayer may apply tax credits in Chapter 6 (The Income Tax Act) or Chapter 14 (Economic Impact Zone Community Development Act) in any order.

- The taxpayer may apply a credit that is allowed for use against both income taxes and corporate license fees in any order, unless otherwise specifically provided, and against either the income tax, the license tax, or both, in any given year, subject to specific limitations in the applicable credit statute and S.C. Code Ann. § 12-6-3480(3).

- No credit may be used more than once.

- Any limitations on the total 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 liability in Chapter 6 or license fee liability in Chapter 20. Accordingly, a taxpayer may choose to use a credit that does not have an income tax liability limitation before or after any credit with an income tax liability limitation, unless otherwise provided in either of the credit provisions.

  NOTE: Some particular credit provisions, such as the research and development credit in S.C. Code Ann. § 12-6-3415 limit the application of the credit to the applicable remaining tax liability after all other credits have been applied.

The following example illustrates how these general rules regarding the use of credits operate.

Example 1 – Income Limitation Credit by Credit Computation. Assume a taxpayer has a $10,000 income tax liability and has generated two tax credits in Chapter 6 that are limited to 50% of its tax liability - a $6,000 jobs tax credit and a $6,000 child care credit. The amount of credits that can be claimed could be computed as follows:

Step 1		Step 2	
Tax Liability	$10,000	Limited Liability	$5,000
1st Limitation %	50%	2nd Limitation %	50%
Limited Liability	$ 5,000	Limited Liability	$2,500

Only $7,500 ($5,000 + 2,500) of the liability may be offset by the credits. The first limitation amount of $5,000 applies to either credit the taxpayer chooses. The second limitation amount of $2,500 applies to the remaining credit.

Example 2 – Choice of Credit Ordering. Assume the same facts as Example 1 and further assume that the taxpayer has a conservation credit (a credit with no specific income limitation) equal to $8,000. Based on Example 1, the taxpayer has the option to:

1. Use the $8,000 conservation credit first since it does not have a tax liability limitation percentage and then apply the limitation percentages of the job tax credit and the child care credit to the $2,000 remaining tax liability (resulting in the ability to use $1,500 of the combined jobs tax and child care credits), or

2. Apply the limitation percentages to the jobs tax credit and the child care credit first (using $7,500 combined jobs tax and child care credits) and then reduce the $2,500 remaining tax liability to $0 with the conservation credit.

- Any credits under Title 38 (Insurance – including the taxation of insurance companies) may be used against income taxes imposed under Chapter 6 or license fees imposed under Chapter 20.

b. Special Use of Credit Rules

Except as otherwise provided, a credit must be used by the taxpayer who earns it. Exceptions to these rules exist for the following: (1) taxpayers participating in a consolidated corporate income tax return, (2) pass-through entities eligible to earn and use a credit, (3) certain limited liability companies not expressly eligible to earn a credit, and (4) transfers of permitted credits, such as the conservation credit. Exceptions 1 - 3 are briefly discussed below. Exception 4 is discussed throughout this chapter in the particular credit summary, as applicable.

◆ Consolidated Corporate Income Tax Participants

S.C. Code Ann. § 12-6-3480 provides that any income tax credit in Chapter 6 or Chapter 14 that is earned by a corporation included in a consolidated corporate income tax return under S.C. Code Ann. § 12-6-5020 must be used and applied against the consolidated tax (*i.e.,* the aggregate pre-credit tax liability of the participating taxpayers), unless otherwise specifically provided. (See Section 7 below for a discussion of credits used on a consolidated corporate tax return.)

◆ Pass-through Entity Specifically Qualifying for Credit

S.C. Code Ann. § 12-6-3310(B) contains special provisions concerning the use of income tax credits by pass-through entities. These rules include:

1. Unless specifically prohibited, an S corporation, limited liability company taxed as a partnership, or partnership that qualifies for a credit pursuant to Article 25 of Chapter 6, Title 12 may pass through the credit earned to each shareholder of the S corporation, member of the limited liability company, or partner of the partnership.

   NOTE: The statutory language of a particular tax credit controls whether a credit generated by an entity may be used by a partner, shareholder, or member. See, *Centex International, Inc. v. South Carolina Dept. of Revenue*, 406 S.C. 132, 750 S.E. 2d 65 (2013), wherein the South Carolina Supreme Court held that under the infrastructure credit statute (S.C. Code Ann. § 12-6-3420) which provides that a corporation could claim a credit for construction or improvement of an infrastructure project against corporate income taxes for expenses paid or accrued by the taxpayer, the legislature intended that a corporation had to be the entity that incurred the expenses to generate the tax credit and thus, a partnership was precluded from earning the infrastructure credit.

2. Any credit earned by an S corporation owing corporate level income tax must first be used at the entity level. Only the remaining credit passes through to the shareholders of the S corporation.

   NOTE: Generally, a credit that is passed through is not affected by the generating entity's income and is not limited to a percentage of the generating entity's income tax. For example, an S corporation may pass through the job tax credit to its shareholders even if it has a South Carolina loss. Once a credit is passed through, however, it may not be later used by the entity generating the credit. See, SC Revenue Ruling #21-15, which among other things, addresses the use of credits when a pass-through entity elects to pay tax at the entity level.

3. The credit is allowed against the type of tax or taxes specifically provided for by the applicable credit.

4. Unless otherwise provided in the credit provision, the amount of the credit allowed a shareholder, partner, or member is equal to the percentage of the shareholder's stock ownership, partner's interest in the partnership, or member's interest in the limited liability company for the taxable year multiplied by the amount of the credit earned by the entity and available for pass through. Limitations upon reduction of income tax liability by use of a credit are computed based on the shareholder's, partners, or member's tax liability.

   NOTE: Exceptions to this rule apply for certain credits. Under S.C. Code Ann. § 12-2-100(B), to the extent a partnership or limited liability company taxed as a partnership earns the certified historic structure credit in S.C. Code Ann. § 12-6-3535, the textile facility revitalization credit in S.C. Code Chapter 65, Title 12, or the credit for residential low-income housing in S.C. Code Ann. § 12-6-3795, the credit, including any unused credit amount carried forward, may be passed through to the partners or members and may be allocated among any of its partners or members on an annual basis. This includes, without

limitation, an allocation of the entire credit or unused credit carryforward to any partner or member who was a partner or member at any time in the year in which the credit or unused credit was allocated. The allocation must be allowed without regard to any provision of the Internal Revenue Code, or regulation promulgated pursuant thereto, that may be interpreted as contrary to the allocation, including and without limitation, the treatment of the allocation as a disguised sale.

The abandoned buildings revitalization credit in S.C. Code Chapter 67, Title 12, contains a similar provision relating to the pass through of the credit.

S.C. Code Ann. § 12-2-100(B) applies to a qualified project placed in service after January 1, 2020, but before December 31, 2030, provided the qualified project is issued an eligibility statement after May 14, 2020.

◆ Limited Liability Company Not Specifically Qualifying For Credit

S.C. Code Ann. § 12-6-3310(C) contains special provisions concerning the qualification and use of credits by limited liability companies that are not organized as a legal entity that expressly qualifies for a credit in Article 25 of Chapter 6, Title 12.

NOTE: These special provisions do not apply to credits in other articles or titles of the South Carolina Code, such as Chapter 14 of Title 12 containing the economic impact zone credit, Chapter 65 of Title 12 containing the textile revitalization credit, or Chapter 67 of Title 12 containing the abandoned building rehabilitation credit. The rules include:

1. Limited Liability Company Taxed as a Partnership.

   Individual Member. The limited liability company may earn and pass through any credits allowed by Article 25 of Chapter 6, Title 12. The individual member will use any credits against individual income taxes imposed under S.C. Code Ann. § 12-6-510.

   Corporate Member. The limited liability company may earn and pass through any credits allowed by Article 25 of Chapter 6, Title 12. The corporate member will use any credits against corporate income taxes imposed under S.C. Code Ann. § 12-6-530.

   NOTE: S.C. Code Ann. § 12-6-3310(C) controls over the statutory language of a particular tax credit. For example, the infrastructure credit in S.C. Code Ann. § 12-6-3420 specifically states that the credit is claimed by a corporation against corporate income taxes imposed under S.C. Code Ann. § 12-6-530 or bank taxes imposed under S.C. Code Ann. § 12-11-20.

2. Limited Liability Company Taxed as a Corporation. The limited liability company taxed as a corporation is entitled to any credits applicable to corporations.

3. Disregarded Single Member Limited Liability Company.

   Individual Member. The individual member may claim any credit against individual income taxes.

   Corporate Member. The corporate member may claim any credit against corporate income taxes.

4. Limited Liability Companies Owned By Limited Liability Companies or Other Pass-through Entities. Items 1, 2, and 3 above are applied at each stage of ownership until the credit is applied against individual income taxes under S.C. Code Ann. § 12-6-510 or corporate income taxes under S.C. Code Ann. § 12-6-530.

7. CONSOLIDATED CORPORATE TAX RETURN

South Carolina uses an unusual method to compute the tax on a "consolidated" corporate income tax return, Form SC1120, which may be filed by certain affiliated corporations. South Carolina has not adopted the federal consolidation rules in I.R.C. §§ 1501 through 1505 or the regulations thereunder. There are no elimination adjustments for intercompany transactions such as those for federal consolidated income tax purposes. South Carolina's "consolidated" rules treat each corporation in an affiliated group as a separate taxpayer.

Generally, corporate taxpayers file separate returns and report their income separately. However, S.C. Code Ann. § 12-6-5020 provides that a consolidated return may be filed for the following controlled corporations:

1. A parent and substantially controlled subsidiary or subsidiaries.

2. Two or more corporations under substantially the entire control of the same interest.

The terms "substantially controlled" and "substantially the entire control" mean the ownership of at least 80% of the total combined voting power of all classes of stock of all corporations that are a party to a consolidated return.

Either a consolidated or a separate South Carolina income tax return can be filed even if a taxpayer files a consolidated return for federal purposes. Other South Carolina consolidated return requirements include:

1. The election to file a consolidated return or separate returns must be made on an original and timely filed return and may not be changed after the return is filed.

2. Once a consolidated return is filed, permission must be granted by the Department to file separate returns.

3. All corporations included in a consolidated return must use the same accounting year.

4. All corporations included in a consolidated return must be subject to South Carolina corporate income tax. In other words, each corporation must have nexus with South Carolina. Since banks and savings and loans are not subject to corporate income tax, they may not be included in a South Carolina consolidated return.

5. A corporation doing business entirely within South Carolina may file a consolidated return with a corporation doing a multistate business. Two or more corporations doing a multistate business may file a consolidated return.

6. A corporation using the gross receipts method of apportionment may file a consolidated return with a corporation using the single sales factor method, or a special method of allocation and apportionment.

NOTE: A corporation that has elected to be taxed under Subchapter S of the Internal Revenue Code may not join in the filing of a South Carolina consolidated return.

South Carolina's consolidated return is a single corporate income tax return for two or more corporations in which income or loss is determined as follows:

1. South Carolina taxable income or loss is computed separately for each corporation.

2. Allocable income or loss is allocated separately for each corporation.

3. Apportionable income or loss is computed utilizing separate apportionment factors (*e.g.,* gross receipts or the single sales factor method for each corporation).

4. Income or loss computed above is added together and reported on one return for the group.

5. Use of income tax credits, including the carryover of unused credits, must be determined on a combined basis. Limitations on credits which refer to the income or the income tax liability of a corporation are deemed to refer to the income or income tax liability of the consolidated group. Credits reduce the consolidated group's tax liability regardless of whether or not the corporation entitled to the credit contributed to the tax liability. (See Section 6 above for a discussion of credits used by a corporation included in a consolidated corporate income tax return.)

8. COMPOSITE RETURNS FOR NONRESIDENT PARTNERS AND SHAREHOLDERS

S.C. Code Ann. § 12-6-5030 allows S corporations or partnerships (including limited liability companies taxed as partnerships or S corporations) to separately compute South Carolina income and tax attributable to each participating nonresident shareholder or partner and report the total tax due on a single tax return, referred to as a "composite" return. S corporations and partnerships are not required to withhold income tax pursuant to S.C. Code

Ann. § 12-8-590 on behalf of any nonresident shareholder or partner whose income is reported on the composite return. See Section 3.d. above for a discussion of S.C. Code Ann. § 12-8-590.

Composite return requirements include:

1. Nonresident fiduciary and individual shareholders and partners may participate in filing a composite return.

2. All participating shareholders and partners must have the same tax year.

3. 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.

4. Corporate partners may not be included on the composite return since they are required to file an annual report and pay a license fee.

5. Shareholders or partners having income within South Carolina from sources other than the partnership or S Corporation may be included on the composite return.

Form SC1040, "South Carolina Individual Income Tax Return," is used to file a composite return on behalf of participating shareholders and partners and is signed by an authorized partner, S corporation officer, or member of a limited liability company. The S corporation, limited liability company or partnership may elect to determine each participant's tax due by one of the following methods:

Method 1: <u>For a participant who provides an affidavit to the Department through the entity stating that he has no income other than the income from the entity.</u> Compute the participant's South Carolina income tax as follows: (1) using the pro rata share of the standard deduction or itemized deduction and personal exemptions for each participant pursuant to S.C. Code Ann. § 12-6-1720(2) in the same manner as if it was being separately reported, or (2) without regard to any deductions or exemptions in the same manner as if it was being separately reported.

Method 2: <u>For a participant who does not provide an affidavit to the Department through the entity stating that he has no income other than the income from the entity.</u> Compute each participant's share of South Carolina income tax without regard to deductions or exemptions by using the active trade or business income rate provided in S.C. Code Ann. § 12-6-545 on his active trade or business income (3%), and using the highest marginal rate in S.C. Code Ann. § 12-6-510 for other income (*i.e.,* 7%).

The Department has a preprinted affidavit, Form I-338, "Composite Return Affidavit," available for use in complying with the composite return requirements. See also, the I-348 "Composite Filing Instructions."