



SC PRIVATE LETTER RULING #88-12

TO: Mr. & Mrs. X

SUBJECT: Taxability of corporate distribution from out of state corporation and deductibility of interest expense incurred to buy out-of-state stock.

REFERENCE: S.C. Code Ann. Section 12-7-1120 (Supp. 1987)  
S.C. Code Ann. Section 12-7-410 (Supp. 1987)  
S.C. Code Ann. Section 12-7-430 (Supp. 1987)  
S.C. Code Ann. Section 12-7-435 (Supp. 1987)  
S.C. Code Ann. Section 12-7-235 (Supp. 1987)

AUTHORITY: S.C. Code Ann. Section 12-3-170 (1976)  
SC Revenue Procedure #87-3

SCOPE: A Private Letter Ruling is a temporary document issued to a taxpayer, upon request, and it applies only to the specific facts or circumstances related in the request. Private Letter Rulings have no precedential value and are not intended for general distribution.

Question:

1. Are 1987 distributions from a nonresident "S" corporation representing income from the corporation taxable in South Carolina?
2. Is the \$60,000 of interest expense incurred to purchase the corporation's stock deductible in South Carolina?

Facts:

Mrs. X, a South Carolina resident, owns approximately 45% of XYZ, Inc., a Tennessee corporation. XYZ is a "S" corporation and does 100% of its business in Tennessee. For tax year ended December 31, 1987, Mrs. X's K-1 will reflect \$436,500 as her share of XYZ, Inc's 1987 corporate taxable income. She also received approximately \$523,000 in distributions from XYZ for stock she owned, some of which represented distributions of corporate income for the year 1986. The funds used to purchase the stock in XYZ borrowed by the taxpayer in 1987. This loan is collateralized by the corporation's stock. During the year 1987, the taxpayer paid interest in the approximate amount of \$60,000 on this loan.

## Discussion:

1. S.C. Code of Laws Ann. Section 12-7-410 (Supp. 1987) states that the South Carolina gross income, adjusted gross income, and taxable income of an individual is the same as that determined for federal purposes with the modifications specified in 12-7-430 and 12-7-435. Section 12-7-430(e) provides that if the income of a taxpayer is subject to allocation or apportionment, or both, the South Carolina taxable income is modified as provided in Article 9 of Chapter 7. Section 12-7-1120 as amended provides guidance in the modification. In general, interest, dividends, and gains and losses from the sale of intangible personal property not connected with the business of the taxpayer are allocated to the individual taxpayer's domicile in addition to income received by residents for personal services. All other income is allocated or apportioned to the state in which it is earned.

Section 12-7-235(b) provides Subchapter S treatment for electing small businesses in South Carolina. Pursuant to Subchapter S, shareholders are treated in essentially the same manner as partners in a partnership. Certain items of income, loss, and deduction are "passed-through" to the shareholders. Each such item is treated as if it were realized by the shareholder directly from the source from which it was realized by the corporation or as if it were incurred by the shareholder in the same manner as incurred by the corporation. When reading this provision in conjunction with Section 12-7-1120, only interest, dividends, or proceeds from the sale of intangible property flowing through to the shareholder from a nonresident Subchapter S corporation would be taxed.

2. As the treatment of Subchapter S income is essentially the same as partnership income, the treatment of expenses relating to such income is likewise similar. In the case of Wallace B. Dalton and Shirley B. Dalton v. South Carolina Tax Commission, Opinion No. 1129, the Court of Appeals upheld the Commission's matching doctrine. In that case interest expense incurred for the purchase of partnership interests was disallowed as expenses related to partnership income allocable to another state. Thus, in the instant case, the interest expense incurred to acquire Subchapter S stock is related to the Subchapter S income and is thus not deductible as the income is not taxable.

## Conclusion:

1. The 1987 distributions to a South Carolina resident from a nonresident "S" corporation representing income from the corporation would not be taxable in South Carolina unless distributed in the form of salaries, dividends, interest, or gains and losses from the sale of intangible personal property not connected with the taxpayer's business
2. Interest expense in the amount of \$60,000 incurred to purchase the corporation's stock is not deductible since the income to which it relates is not taxable in South Carolina.

SOUTH CAROLINA TAX COMMISSION

s/S. Hunter Howard Jr.  
S. Hunter Howard, Jr., Chairman

s/John M. Rucker  
John M. Rucker, Commissioner

s/A. Crawford Clarkson Jr.  
A. Crawford Clarkson, Jr., Commissioner

Columbia, South Carolina  
June 23, 1988