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**State of South Carolina**  
**Department of Revenue**  
**301 Gervais Street, P.O. Box 125, Columbia, South Carolina 29214**

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SC REVENUE PROCEDURE #98-1

**SUBJECT:** Qualified Subchapter S Subsidiaries  
(All Taxes)

**EFFECTIVE DATE:** Applies to all periods open under the statute.

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

**REFERENCES:** S. C. Code Ann. Section 12-6-40 (Supp. 1997)  
S. C. Code Ann. Section 12-20-20 (Supp. 1997)  
S. C. Code Ann. Section 12-20-50 (Supp. 1997)  
S. C. Code Ann. Section 12-20-60 (Supp. 1997)

**AUTHORITY:** S. C. Code Ann. Section 12-4-320 (Supp. 1997)  
SC Revenue Procedure #97-8

**SCOPE:** A Revenue Procedure is a statement which provides information of a procedural nature. It is valid and remains in effect until superseded or modified by a change in the statute or regulations or a subsequent court decision, Revenue Procedure or Revenue Ruling.

## **BACKGROUND**

The Small Business Job Protection Act of 1996 made significant changes to the S corporation requirements contained in the Internal Revenue Code. Effective for tax years beginning after December 31, 1996, Internal Revenue Code '1361(b)(3)(B) allows an S corporation to own a qualified subchapter S subsidiary ("QSSS"). For federal tax purposes, the QSSS is not treated as a separate corporation. All of its assets, liabilities, and items of income, deduction, and credit are treated as assets, liabilities, and items of income, deduction, and credit of the parent S corporation.

The purpose of this ruling is to provide guidance as to the South Carolina tax implications of a valid federal QSSS election. **This revenue procedure only applies to persons subject to tax under Title 12, Chapter 6 of the South Carolina Code of Laws.**

## **1. INCOME TAX**

Code '12-6-40(B) provides:

All elections made for federal income tax purposes in connection with Internal Revenue Code Sections adopted by this State automatically apply for South Carolina income tax purposes unless otherwise provided. A taxpayer may not make an election solely for South Carolina income tax purposes except for elections not applicable for federal purposes, including filing a combined or composite return as provided in Sections 12-6-5020 and 12-6-5030, respectively.

Based on the above, an S corporation having a valid QSSS election for federal income tax purposes is deemed to have a valid QSSS election for South Carolina income tax purposes. This federal election is automatic for South Carolina purposes. If the federal election is not made, the election may not be made solely for South Carolina purposes.

Since South Carolina has adopted the Subchapter S provisions contained in Internal Revenue Code '1361 et. seq., South Carolina will treat the assets, liabilities, income, and deductions of the QSSS as they are treated for federal purposes. For South Carolina income tax purposes, including the determination of nexus for income tax purposes, the parent and subsidiary will be treated as one entity.

### **PROCEDURE FOR FILING SUBCHAPTER S INCOME TAX RETURN**

The Department has developed the following procedure for filing a South Carolina S Corporation Income Tax Return for taxpayers who elect to treat the parent and the QSSS as one S corporation.

1. File a South Carolina S Corporation Income Tax Return (SC1120S) in the name of the parent corporation. Do not file a separate SC1120S for each entity.
2. Compute the items of income, deduction, and credit using the apportionment ratio(s) of the “composite” S corporation. In other words, the items of income, deduction, and credit of the subsidiary are treated as if the subsidiary was a division of the S Corporation.
3. At the top of the SC1120S, print “QSSS ELECTION,” unless there is an appropriate block to check indicating a valid QSSS election has been made.

## **2. CORPORATE LICENSE FEE AND ANNUAL REPORT**

Code '12-20-20 provides for the filing of an annual report and reads, in part:

...every domestic corporation, every foreign corporation qualified to do business in this State, and any other corporation required by Section 12-6-530 to file income tax returns shall file an annual report with the department.

Code '12-20-30 provides the form and contents of the annual report.

Code '12-20-50 imposes the license fee on corporations and reads, in part:

...every corporation required to file an annual report shall pay an annual license fee of fifteen dollars plus one dollar for each thousand dollars, or fraction of a thousand dollars, of capital stock and paid-in-capital surplus of the corporation on the first day of the taxable year in which the report is filed. In no case may the license fee provided by this section be less than twenty-five dollars. The license fee must be paid on or before the original due date for filing the annual report.

Code '12-20-60 addresses the apportionment of the license fee for multi-state business and reads, in part:

When a corporation does business partly within and partly without this State or uses its capital partly within and partly without this State, the amount of the license fee provided for in Section 12-20-50 must be apportioned in accordance with the ratio prescribed for income tax purposes in the taxable year preceding the year in which the annual report is filed. The minimum license fee, however, may not be apportioned (emphasis added.)

## **PROCEDURE FOR FILING AN ANNUAL REPORT AND LICENSE FEE**

Based on the above, a QSSS is a separate corporation for South Carolina license fee and annual report purposes. In other words, the election is disregarded for license fee and annual report purposes. The parent and each subsidiary that has nexus with South Carolina, when considered separately, is each required to pay a South Carolina license fee and file an annual report.

The Department has developed the following procedure for filing an annual report and paying the license fee for taxpayers who elect to treat the parent and the QSSS as one S corporation for income tax purposes.

1. Complete an annual report - Schedule D on Form SC1120S- for each entity required to file an annual report by Code Section 12-20-20. The QSSS election is disregarded for annual report purposes. Attach each separate annual report(s) to the SC1120S filed in the name of the parent.

NOTE: If the parent or any subsidiary participating in the QSSS election does not have nexus with South Carolina when considered separately, then the above procedures for filing a Subchapter S income tax return and filing an annual report and license fee should be followed, except that the parent or subsidiary that does not have nexus with South Carolina when considered separately should not complete an annual report (Schedule D) and should not pay a license fee.

2. Compute the license fee for each entity. Each entity must pay the license fee based on the total capital and paid-in or capital surplus of each corporation considered separately. The total capital and paid-in surplus is multiplied by a separately computed income tax apportionment ratio. The parent and the subsidiaries each determine and report their license fee based on their own separate attributes. Attach a schedule to the SC1120S filed in the name of the parent showing the license fee computation for each entity. The \$25 minimum license fee applies to each entity.
3. One check may be remitted to the Department for the total license fee liability of all entities included in the QSSS election.

### **EXAMPLE OF LICENSE FEE COMPUTATION**

This example is based on the following facts:

1. A parent S corporation makes a valid QSSS election for its subsidiaries.
2. The parent has some operations in South Carolina and \$100,000 of capital stock and paid in capital.
3. QSSS-1 has all of its operations in South Carolina and \$30,000 of capital stock and paid in capital.
4. QSSS-2 has no nexus with South Carolina when considered separately and \$70,000 of capital stock and paid in capital.
5. The one entity has a 40% South Carolina income tax apportionment ratio. However, for license fee purposes, each corporation must compute its own apportionment ratio. In this example, based on separate attributes, the parent has a 35% apportionment ratio, QSSS-1 has a 100% apportionment ratio, and QSSS-2 has no nexus with South Carolina and is therefore not subject to the license fee.

The South Carolina license fee for each separate corporation is computed as follows:

	Parent	QSSS-1	QSSS-2
Capital Stock/Paid in Capital	\$100,000	\$30,000	\$70,000
Apportionment Ratio for SC Income Tax Purposes Disregarding the QSSS election	35%	100%	N/A
SC Proportion	\$35,000	\$30,000	N/A
License Fee - (SC Proportion x .001, plus \$15 each)	\$50	\$45	N/A

The total license fee liability of all entities included in the QSSS election is \$95.

Part II of the SC1120S should be fully completed with the first two lines completed as follows:

Line 14: Total Capital and Paid in Surplus	\$130,000
Line 15: Fee Due	\$ 95

Remit one check for \$95 to the Department of Revenue.

### **3. REGISTERING WITH THE DEPARTMENT AND THE INITIAL ANNUAL REPORT**

Code '12-20-40 requires an initial annual report to be filed with initial articles of incorporation or application for certificate of authority, and reads:

(A) An initial annual report and the minimum license fee required by Sections 12-20-50 and 12-20-100(C) must be filed with the Secretary of State with the initial articles of incorporation filed by a domestic corporation or an application for certificate of authority filed by a foreign corporation. The initial annual report must be submitted to the department by the Secretary of State and contain the information required by Section 12-20-30(A).

(B) A corporation that does not file an application for certificate of authority with the Secretary of State shall file the initial annual report and pay the minimum license fee required by Sections 12-20-50 and 12-20-100 to the department on or before sixty days after initially doing business, or using a portion of its capital in this State.

Therefore, a domestic corporation must file an initial annual report and pay the initial \$25 minimum license fee with the Secretary of State with the initial articles of incorporation and a foreign corporation must file an initial annual report and pay the \$25 minimum license fee with the Secretary of State on application for certificate of authority.

A foreign corporation that does not file an application for certificate of authority to do business in South Carolina with the Secretary of State, but is required to file a South Carolina income tax return, must file the initial annual report of corporations (SC Form CL-1) and pay the \$25 minimum license fee to the Department of Revenue.

**NOTE: A parent that is required to file an income tax return because of the QSSS election, but would not otherwise be required to pay a license fee, should register with the Department on SC Form CL-1. The \$25 minimum license fee due upon registration will be waived.** By completing the registration form, the Department will be able to establish an account in the name of the parent corporation prior to receiving its South Carolina income tax return and record in the Department's computer system that no license fees are due. Failure to complete the registration form will result in the automatic issuance of a proposed assessment by the Department for the initial license fee. However, if a subsidiary included in the QSSS election does not have nexus with South Carolina when considered separately, then the subsidiary should not file an initial annual report (SC Form CL-1) with the Department and should not pay a license fee. See above procedure for filing an annual report and paying the license fee.

## **QUESTIONS**

Questions concerning S corporation income tax returns, corporate license fee and annual reports, and registering with the Department should be directed to the Corporate Income Tax Section at 803-898-5705.

### **4. WITHHOLDING TAXES**

For payroll and other withholding purposes, the Department will allow a parent and QSSS to remit withholding taxes using the taxpayer name and federal identification number used for federal purposes. Specific questions and requests for exceptions should be directed to the Department's Withholding Section at 803-898-5752.

S corporations are reminded of the requirement to withhold and remit income tax at the rate of 5% on each nonresident shareholders' share of South Carolina taxable income of the S corporation, whether distributed or undistributed, pursuant to Code '12-8-590. An S corporation is not required to withhold income taxes with regard to any nonresident shareholder who (1) submits Form I-309 - Nonresident Shareholder or Partner Affidavit and Agreement or (2) participates in the filing of a composite nonresident income tax return. See "Shareholder Filing and Payment Requirements" below for more information on composite tax returns.

### **5. OTHER SOUTH CAROLINA TAXES**

As provided in this document, a parent and QSSS are treated as one entity for South Carolina income tax purposes only. A QSSS is treated as a separate corporation for all other State tax purposes, including license fees, sales and use taxes, and property taxes.

### **6. SHAREHOLDER FILING AND PAYMENT REQUIREMENTS**

Code '12-6-590(A) provides for the income tax treatment of S corporations and shareholders and reads, in part:

...an "S" Corporation having a valid federal election under the Internal Revenue Code Subchapter "S" is not subject to tax under this chapter to the extent it would be exempt from federal corporate income tax. Each shareholder shall include its share of South Carolina "S" Corporation income on the shareholder's income tax return. All of the provisions of the Internal Revenue Code apply to determine the gross income, adjusted gross income, and taxable income of an "S" Corporation and its shareholders subject to the modifications provided in Article 9 of this chapter and subject to allocation and apportionment as provided in Article 17 of this chapter (emphasis added.)

Accordingly, a corporation is exempt from corporate tax if the corporation makes a valid election under Subchapter S of the Internal Revenue Code. Under the election, for South Carolina purposes, resident and nonresident shareholders are taxable on their share of the corporation's South Carolina taxable income. Each shareholder is responsible for timely filing appropriate South Carolina tax returns and making payment of all South Carolina taxes, including estimated payments, required by law.

## **COMPOSITE INDIVIDUAL TAX RETURN**

Code '12-6-5030 allows an S corporation to compute and report the South Carolina income and tax attributable to their nonresident shareholder's on a single individual income tax return. Nonresident shareholders that are individuals, or trusts and estates in which the income is taxed to the trust or estate may participate in filing a composite return. Shareholders having income within South Carolina from sources other than the S corporation may not file as part of the composite return. See South Carolina Revenue Procedure #92-5 for further information on completing a composite return.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/Burnet R. Maybank  
Burnet R. Maybank, III, Director

Columbia, South Carolina  
March 16, 1998