



STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE
**ACTIVE TRADE OR BUSINESS INCOME
REDUCED RATE COMPUTATION**

I-335
(Rev. 12/8/06)
3410

(Complete one I-335 for each return)
(Attach I-335 and all supporting Worksheets to SC1040 or SC 1041)

For the year January 1 - December 31, 2006, or fiscal tax year beginning		2006 and ending	2007
Print your name	Spouse's first name	Your Social Security number	
		Spouse's Social Security number	
1a. Enter amount from Worksheet 1, line 3		1a. \$	_____00
1b. Enter total of amounts from Worksheets 2, line 22, Column C		1b. \$	_____00
1c. Add lines 1a and 1b		1c. \$	_____00
2a. Enter any adjustments necessary because of at-risk rules, South Carolina net operating losses, and/or passive activity losses. <Enter in brackets if the adjustment is negative.> Enter -0- if no adjustments are necessary		2a. \$	_____00
2b. Enter the amount of one half of self-employment tax on partnership income related to South Carolina. Do not include the amount on line 2 of Worksheet 1.		2b. \$	_____00
2c. Line 2a minus line 2b. <Enter in brackets if negative.>		2c. \$	_____00
3. Add lines 1c and 2c. If zero or negative, STOP – DO NOT PROCEED...		3. \$	_____00
4. Enter amounts reasonably related to personal services of the taxpayer, the taxpayer's spouse, or any person claimed as dependent on the taxpayer's income tax return (see Rules for Using Safe Harbor below). Do not include amounts from W-2s or 1099s or guaranteed payments for personal services		4. \$	_____00
<input type="checkbox"/> Check here if using Safe Harbor			
5. Subtract line 4 from line 3. If greater than zero, enter on SC1040, line 43; Schedule NR, line 39; or SC1041, Part I, line 2d. If zero or negative, STOP – DO NOT PROCEED		5. \$	_____00
6. Tax Year 2006 rate on qualifying active trade or business income		6.	<u>6.5% (.065)</u>
7. Multiply line 5 by line 6 (enter here and on SC1040, line 8; or on SC1041, line 9)		7. \$	_____00



STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE

WORKSHEET 1
PASS-THROUGH INCOME FROM A SOLE PROPRIETORSHIP
(Complete one Worksheet 1 for all Schedules C, C-EZ and F)
(Attach Worksheet 1 to your return)

I-335A
(Rev. 12/8/06)
3421

For the year January 1 - December 31, 2006, or fiscal tax year beginning		2006 and ending	2007
Print your name	Spouse's first name	Your Social Security number	
		Spouse's Social Security number	

In order to use the flat tax rate on active trade or business income, an individual, estate or trust with pass-through income from one or more sole proprietorships or single-member LLCs not taxed as corporations must complete Worksheet 1.

A taxpayer needs to complete only one Worksheet 1 for all federal Schedules C, C-EZ and F.

1. South Carolina net profit (loss) all federal Schedules C, C-EZ and F 1. \$_____00
2. One half of the self-employment tax related to line 1 (enter the amount from line 27 of federal Form 1040 if all business income is taxable to South Carolina) 2. \$_____00
3. Subtract line 2 from line 1 and enter here and on I-335, line 1a 3. \$_____00

Instructions to Worksheet 1

- Line 1** Enter total of South Carolina amounts from federal Schedule C, line 31; Schedule C-EZ line 3; and Schedule F, line 36.
- Line 2** Enter the amount from Form 1040, line 27 that applies to line 1. The entire amount applies unless one or more of the Schedules C and F are from a multi-state business or business not taxable to South Carolina.
- Line 3** Subtract line 2 from line 1. Enter this amount on I-335, line 1a.



STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE
WORKSHEET 2
PASS THROUGH INCOME FROM A PARTNERSHIP
OR S CORPORATION
(Complete a separate Worksheet 2 for each SCK-1)
(Attach each Worksheet 2 to your return)

I-335B
(Rev. 12/8/06)
3422

For the year January 1 - December 31, 2006, or fiscal tax year beginning		2006 and ending	2007
Print your name	Spouse's first name	Your Social Security number	
		Spouse's Social Security number	

In order to use the flat rate on active trade or business income, an individual, estate or trust with pass-through income from one or more partnerships, S corporations, or LLCs taxed as partnerships or S corporations must complete a separate Worksheet 2 for each partnership, S corporation or LLC.

Complete a separate Worksheet 2 for each SCK-1.

Name of business:	Column A Federal K-1 amounts	Column B SCK-1 amounts	Column C SC active trade or business amounts
1. Ordinary business income (loss)			1.
2. Net rental real estate income (loss)			2.
3. Other net rental income (loss)			3.
4. Guaranteed payments *			4.
5. Interest income			5.
6. Ordinary/qualified dividends			
7. Royalties			7.
8. Net short-term capital gain (loss)			
9a. Net long-term capital gain (loss)			
9b. Collectibles (28%) gain (loss)			
9c. Unrecaptured section 1250 gain			
10. Net section 1231 gain (loss)			10.
11. Other income (loss)			11.
12. Section 179 deduction			12.
13. Other deductions			
14. Self-employment earnings (loss) *			
15. Credits			
16. Foreign transactions			16.
17. Alternative minimum tax (AMT) items			17.
18. Tax exempt income and nondeductible expenses *			
19. Distributions *			
20. Items affecting shareholder basis **			
21. Other information			
22. Total of Column C			22.

Note: Worksheet 2 combines elements of federal K-1s for Forms 1065 and 1120-S.

* identifies items on Form 1065, Schedule K-1 but not on Form 1120-S, Schedule K-1.

** identifies items on Form 1120-S, Schedule K-1 but not on Form 1065, Schedule K-1.

Ownership Interest: _____%

INSTRUCTIONS

General purpose: An individual, estate or trust receiving income from one or more pass-through businesses can choose to have active trade or business income taxed at a flat income tax rate instead of the graduated income tax rate that applies to ordinary income. I-335 identifies active trade or business income and calculates the tax.

Important: For tax year 2006, a taxpayer with South Carolina taxable income less than or equal to \$12,850 cannot benefit from the flat 6.5% rate for active trade or business income because the highest graduated tax rate for income less than or equal to \$12,850 is only 6%. **Do not complete I-335 if your South Carolina taxable income is less than or equal to \$12,850.**

Summary of law: Section 12-6-510 imposes a graduated rate on the South Carolina taxable income of an individual, estate or trust. The graduated rate begins at 2.5% and increases to as much as 7%.

Starting with Tax Year 2006, new Section 12-6-545 allows an individual, estate or trust to choose instead to use a flat tax rate on active trade or business income from pass-through businesses. The flat rate is 6.5% for tax years beginning in 2006, 6% for tax years beginning in 2007, 5.5% for tax years beginning in 2008, and 5% for tax years after 2008. A pass-through business is a sole proprietorship, partnership, S corporation, or LLC taxed as a sole proprietorship, partnership or S corporation.

Whether or not to use the flat rate is a choice the taxpayer can make annually. The choice applies to both spouses when filing a joint return.

Active trade or business income or loss does not include passive investment income or expenses related to passive investment, capital gains or losses, guaranteed payments for personal services, or amounts reasonably related to personal services.

A Safe Harbor is available if the pass-through businesses combined have South Carolina gross income of less than \$1,000,000 and South Carolina taxable income of less than \$100,000. A taxpayer who qualifies for the Safe Harbor can use the Safe Harbor amount as active trade or business income without having to determine the actual amount of personal service income. See Rules for Using Safe Harbor below.

A composite return is filed by a pass-through business on behalf of nonresident individuals, trusts or estates who are partners, shareholder or members. A decision whether or not to use the Safe Harbor on a composite return is made by the partner, shareholder or member – not by the pass-through business. The Safe Harbor cannot be used on a composite return by any person who has South Carolina income from other sources. If the partner, shareholder or member does not provide an I-338 affidavit stating he has no other South Carolina income, then the flat tax rate on active trade or business income is available, but the federal standard or itemized deductions and personal exemptions cannot be taken into account.

A shareholder, partner or member participating in a composite return can choose to report the same income on his individual income tax return (where he may elect the safe harbor) and take a credit for any tax paid on his behalf on the composite return. Attach the "Form 1099-MISC for SC purposes only" received from the pass-through business.

Tax credits that can be used against the graduated income tax normally imposed on individuals, trusts and estates also can be used against the optional flat tax available for active trade or business income.

Purpose of I-335: I-335 identifies active trade or business income and calculates the optional flat tax rate imposed on active trade or business income.

In order to use the flat tax rate on active trade or business income, an individual, estate or trust with pass-through income from one or more sole proprietorships or single-member LLCs not taxed as a C corporation must complete one Worksheet 1.

In order to use the flat tax rate on active trade or business income, an individual, estate or trust with pass-through income from one or more partnerships, S corporations, or LLCs taxed as partnerships or S corporations must complete a separate Worksheet 2 for each business.

Worksheets 1 and 2 identify pass-through income and remove passive investment income and expenses related to passive investment, capital gains and losses, and guaranteed payments for personal services.

From the results of Worksheets 1 and 2, I-335 identifies active trade or business income or loss and calculates the optional flat rate of tax.

I-335 instructions:

Before completing I-335, complete:

- (a) one Worksheet 1 for **all** South Carolina pass-through income from Schedules C, C-EZ and F; and
- (b) one Worksheet 2 for each SCK-1.

Line 1 Totals from Worksheets.

Line 1a. Enter the total from line 3 of Worksheet 1 and line 12, Column C of each Worksheet 2.

Line 1b. Enter the total of all amounts from Worksheets 2, line 12, Column C.

Line 1c. Enter the total of lines 1a and 1b.

Line 2 Adjustments and one half of self-employment tax.

Line 2a. An adjustment may be required in determining the amount subject to the reduced rate. The adjustment may be positive or negative.

An example of a positive adjustment is a current year South Carolina suspended loss flowing through from a pass-through business that the taxpayer is not allowed to use because: (1) the taxpayer does not have basis, (2) the taxpayer does not have sufficient at-risk amounts, or (3) the loss is a passive activity loss under IRC Section 469.

Examples of negative adjustments are (1) previously suspended losses from a pass-through business that the taxpayer is now allowed to use because the taxpayer now has basis or is at risk, or (2) a net operating loss carryforward from ownership of a sole proprietorship that the taxpayer may now use, if the losses carried forward are South Carolina active trade or business losses.

Enter brackets around the adjustment on line 2a if the adjustment is a negative amount. Enter -0- on line 2a if no adjustments are necessary.

Line 2b. One of half of self-employment tax is a business expense. Enter the amount from federal Form 1040, line 27 attributable to income from a partnership or LLC taxed as a partnership and related to South Carolina. Do not include the amount already included on line 2 of Worksheet 1.

Line 2c. Line 2a minus line 2b.

Line 3 Totals after adjustments. If the adjustment in line 2c is positive, add lines 1c and 2c. If the adjustment in line 2c is negative, subtract line 2c from line 1c. Do not proceed if the result is zero or negative because that means you have no income to be taxed at the flat rate and that all your income will be taxed at the graduated rate.

Line 4 Amounts reasonably related to personal services.

Enter amounts reasonably related to personal services of the taxpayer, the taxpayer's spouse, and any person claimed as a dependent on the taxpayer's income tax return. Do not include amounts from W-2s or 1099s or guaranteed payments for personal services. See SC Revenue Ruling 06-12 for more information.

If you qualify and choose to use the Safe Harbor, you may use 50% of your qualifying income as being not reasonably related to personal services instead of identifying the actual amount related to personal services. See the Rules for Using Safer Harbor below.

Check the box if you elect to use the Safe Harbor.

Line 5 Active trade or business income deduction.

Subtract line 4 from line 3 and enter on line 5. If the amount is greater than zero, enter the amount as a deduction on either SC1040, line 43; Schedule NR, line 39; or SC1041, Part I, line 2d, whichever applies. Do not proceed if the result is zero or negative because that means you have no income to be taxed at the flat rate and that all your income will be taxed at the graduated rate.

Line 6 Active trade or business income tax rate. The flat tax rate on active trade or business income for the tax year beginning in 2006 is 6.5%.

Line 7 Active trade or business income tax. Multiply the amount on line 5 by tax rate on line 6. Enter on line 7 and on SC1040, line 8, or on SC1041, Part I, Line 2d.

INSTRUCTIONS FOR WORKSHEET 1

See Worksheet 1.

INSTRUCTIONS FOR WORKSHEET 2

Enter amounts from K-1 in Column A. Enter amounts from SCK-1 in Column B. Do not enter in Column C any capital gains or losses or passive investment income or losses.

Line 1 Ordinary business income (loss).

In Column C, enter amounts from Column B that are not capital gains or losses or passive investment income or losses.

Lines 2 and 3 Net rental real estate income (loss)/other net rental income (loss).

In Column C, enter from Column B only rental income derived in the active trade or business of renting property if, based on all the facts and circumstances, the pass-through business either provides significant services or incurs substantial costs in the rental business. The determination is based in part on the number of persons employed to provide services and the types and amounts of expenses incurred other than depreciation. Examples of qualifying rents are those from operating a hotel or a short-term car rental business. See IRC section 1362(d) and applicable regulations.

Line 4 Guaranteed payments (from partnerships).

In Column C, enter Column B guaranteed payments for use of capital that are not passive investment income. Do not enter in Column C guaranteed payments for services.

Line 5 Interest income.

Generally interest income is not included in Column C. But in Column C, enter Column B interest income on obligations acquired from sale of stock in trade, inventory, or property held primarily for sale to customers or from performance of services in the ordinary course of a trade or business of selling the property or performing the services.

Line 5 Interest income.

Generally interest income is not included in Column C. But in Column C, enter Column B interest income on obligations acquired from sale of stock in trade, inventory, or property held primarily for sale to customers or from performance of services in the ordinary course of a trade or business of selling the property or performing the services.

Line 6 Ordinary/qualified dividends.

Dividends are not included in active trade or business income or loss because they are passive investment income.

Line 7 Royalties.

Generally royalties are not included in Column C. But in Column C, enter Column B royalties derived in the ordinary course of a trade or business of franchising or licensing property, or "active business computer software" royalties as defined in IRC Section 543(d) and applicable regulations.

Lines 8 through 9c

Net short-term and long-term capital gains (losses), collectibles (28%) gain (loss), and unrecaptured section 1250 gain.

Active trade or business income or loss does not include these amounts.

Line 10 Net section 1231 gain (loss).

After determining if gains and losses are capital, enter in Column C the net of ordinary gains and losses, but not capital gains or losses.

Line 11 Other income (loss).

In Column C, do not enter Column B capital gains or losses or passive investment income or losses.

Line 12 Section 179 deduction.

In Column C, enter amounts from Column B that are not capital gains or losses or passive investment income or losses.

Lines 13, 14, and 15 Other deductions, self-employment earnings (loss), and credits.

Active trade or business income or loss does not include these amounts.

Line 16 Foreign transactions.

In Column C, adjust for any Column B extraterritorial income exclusion to the extent it increases or decreases active trade or business income, but only if it affects taxable income other than passive investment income or expenses related to passive investment income.

Line 17 Alternative minimum tax (AMT) items.

In Column C, adjust for any Column B expenditure adjustment within the meaning of IRC section 59(e)(2).

Lines 18 through 21 Tax exempt income and nondeductible expenses, distributions, items affecting shareholder basis and other information.

Active trade or business income or loss does not include these amounts.

Line 22 Total of Column C.

Include all amounts from each Worksheet 2, line 22 on I-335, line 1b.

I-335 - RULES FOR USING SAFE HARBOR:

If you qualify and choose to use the Safe Harbor, it allows you to claim 50% of your qualifying income as being not reasonably related to personal services instead of identifying the actual amount related to personal services. A decision to use the Safe Harbor applies to both spouses filing a joint return.

Step 1 – Determine if the Safe Harbor is available.

In order to use the Safe Harbor:

- (1) all pass-through businesses combined must have South Carolina gross income of less than \$1,000,000 and South Carolina taxable income of less than \$100,000 (Option A in Example 2 below), or
- (2) the pass-through businesses for which you performed personal services must have combined South Carolina gross income of less than \$1,000,000 and combined South Carolina taxable income of less than \$100,000 (Option B in Example 2).

If you are married and filing a joint return, the gross and taxable income dollar limits apply to the pass-through businesses of both spouses.

If necessary, estimate the SC gross and taxable income of the pass-through business.

The Department recommends that partnerships, S corporations, and LLCs taxed as partnerships and S corporations provide the amounts of the South Carolina gross and South Carolina taxable income of the business on the partners', shareholders' or members' SCK-1s. If you are not provided with the amount of a pass-through business's South Carolina gross income, and you cannot easily obtain the amount by other means, you may estimate the amounts. Estimate the South Carolina gross income of a business by adding all items on the SCK-1, without subtracting any deductions, losses or credits, and dividing the sum by your ownership percentage. Estimate the South Carolina taxable income of a business by adding all items on the SCK-1, subtracting the deductions and losses, and dividing by your ownership percentage. For partnerships or LLCs taxed as partnerships, use your ownership percentage at the beginning or end of the business' tax year, whichever is higher. For S Corporations or LLCs taxed as S Corporations, use your percentage of ownership during the year (SCK-1, line A).

Example 1

During the tax year, Taxpayer A acquired and retained a 25% interest in a partnership. His SCK-1 income without any deductions, losses or credits is \$4,000. His deductions and losses total \$3,500.

Beginning-of-the-year ownership percentage:	0%
End-of-the-year ownership percentage:	25% (or 0.25)
Sum of income on SCK-1 without subtracting deductions, losses or credits:	\$4,000
Sum of deductions and losses:	\$3,500
Sum of income on SCK-1 after subtracting deductions and losses (\$4,000 minus \$3,500)	\$500
Business's estimated SC gross income (\$4,000/0.25):	\$16,000
Business's estimated SC taxable income (\$500/0.25):	\$2,000

Taxpayer A must base his estimates on his ownership percentage at the beginning or end of the partnership's tax year, whichever is higher. Taxpayer A estimates the partnership's gross income by determining the income on SCK-1 without subtracting deductions, losses or credits and dividing by 25%. To estimate the partnership's taxable income, Taxpayer A subtracts deductions and losses from the SCK-1 income, before applying credits, and divides the result by 25%.

Example 2

Taxpayer B has ownership interests in a partnership and two S corporations. The taxpayer performed personal services for the partnership and one of the S corporations, but not for the other S Corporation.

Option A – All pass-through businesses of the taxpayer:

	Partnership (personal services performed)	S Corporation 1 (personal services performed)	S Corporation 2 (no personal services performed)	Total of all pass through businesses
South Carolina Gross Income of Pass Through Business	\$200,000	\$50,000	\$600,000	\$850,000 (total SC gross income < \$1 million)
South Carolina Taxable Income or Loss of Pass Through Business	\$125,000	\$40,000	(\$150,000)	\$15,000 (total SC gross income < \$100,000)
Is the Safe Harbor Available to the Taxpayer?				Yes

Option B – All pass-through businesses for which the taxpayer performs personal services:

	Partnership (personal services performed)	S Corporation 1 (personal services performed)	Total of all pass through businesses for which taxpayer performs personal services
South Carolina Gross Income of Pass Through Business	\$200,000	\$50,000	\$250,000 (total SC gross income < \$1 million)
South Carolina Taxable Income or Loss of Pass Through Business	\$125,000	\$40,000	\$165,000 (total SC gross income < \$100,000)
Is the Safe Harbor Available to the Taxpayer?			No

Taxpayer B qualifies to use the Safe Harbor because of Option A.

Step 2 – Computation of personal service income and Safe Harbor.

Once you determine that the Safe Harbor is available in Step 1, then you can determine the amount of the Safe Harbor before deciding whether or not to use it. Do not include Schedules C or F or SCK-1s with losses, or SCK-1s from interests where no personal services are performed. Do not include personal service income from an entity in any amount greater than the amount of pass-through taxable income from that entity.

Example 3

Taxpayer and Spouse file a joint return and have interests in five different pass-through businesses. Taxpayer receives two SCK-1s – one indicating a \$25 loss from Partnership 1, and the other indicating a \$200 gain from Partnership 2, a business for which he performed no personal services. Taxpayer also files federal Schedule C. Spouse also has two SCK-1s – one indicating a \$50 gain from Partnership 3 for which she did perform personal services, and the other indicating a \$15 loss from an S corporation for which she also performed personal services.

Husband			+	Wife		=	TOTAL relevant South Carolina active trade or business
Partnership #1 SCK-1 amount from Worksheet 2, line 22)	Partnership #2 SCK-1	Schedule C (amount from Worksheet 1, line 3)		Partnership #3 SCK-1	S corporation SCK-1		
(\$25)*	\$200*	+\$100*		+\$50*	(\$15)*		\$150
Loss - N/A for personal service computation	No personal services performed - N/A for personal service computation	Personal services performed		Personal services performed	Loss - N/A for personal service computation		

* The income and loss amounts are determined based upon the guidance provided in SC Revenue Ruling 06-## and the instructions provided in I-335. No addback of compensation or guaranteed payments for services is required in this computation.

TOTAL relevant South Carolina active trade or business income	\$150 (Schedule C of \$100 + Partnerships #3 SCK-1 of \$50)
50% safe harbor	X 0.50
“Amounts reasonably related to personal services” (amount excluded from the flat tax rate computation on active trade or business income)	\$75

If Husband and Wife file a joint return and elect to use the Safe Harbor, they would enter \$75 on I-335, line 4.

Social Security Privacy Act Disclosure

It is mandatory that you provide your social security number on this tax form if you are an individual taking this credit. 42 U.S.C 405(c)(2)(C)(i) permits a state to use an individual's social security number as means of identification in administration of any tax. SC Regulation 117-201 mandates that any person required to make a return to the SC Department of Revenue shall provide identifying numbers, as prescribed, for securing proper identification. Your social security number is used for identification purposes. Our Website address is: **www.sctax.org**

The Family Privacy Protection Act

Under the Family Privacy Protection Act, the collection of personal information from citizens by the Department of Revenue is limited to the information necessary for the Department to fulfill its statutory duties. In most instances, once this information is collected by the Department, it is protected by law from public disclosure. In those situations where public disclosure is not prohibited, the Family Privacy Protection Act prevents such information from being used by third parties for commercial solicitation purposes.