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## **.03 Corporate Income Tax Rate and Imposition**

### **A. Corporations Subject to Income Tax and Rate**

The South Carolina corporate income tax is imposed annually at the rate of five percent (5%) on the South Carolina taxable income of every corporation, and any other entity taxed using the rates of a corporation for federal income tax purposes, other than those which are specifically exempted.<sup>1</sup>

South Carolina's corporate income tax applies to transacting, conducting, or doing business within this State or having income within this State, regardless of whether these activities are carried on in intrastate, interstate, or foreign commerce. The terms "transacting," "conducting," and "doing business" include transacting or engaging in any activity for the purpose of financial profit or gain.<sup>2</sup> The South Carolina Supreme Court has construed this language as extending South Carolina's authority to tax foreign corporations to the limits of the Constitution.<sup>3</sup>

South Carolina gross income, taxable income, and the unrelated business income of a corporation exempt from taxation under Internal Revenue Code Section 501 *et seq.*, is computed as determined under the Internal Revenue Code<sup>4</sup> with certain modifications<sup>5</sup> and subject to allocation and apportionment.<sup>6</sup>

Subject to modifications, allocation, and apportionment, the taxation of S corporations,<sup>7</sup> partnerships,<sup>8</sup> and limited liability companies<sup>9</sup> generally conforms to federal income tax laws

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<sup>1</sup>SC Code §§12-6-530 and 12-6-540.

<sup>2</sup>SC Code §12-6-530.

<sup>3</sup>*Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13 (S.C. 1993) *cert. denied* 114 S. Ct. 550 (1993).

<sup>4</sup>SC Code §12-6-580. See Section .04 A. of this portfolio for a discussion of South Carolina's adoption of the Internal Revenue Code.

<sup>5</sup>SC Code Title 12, Chapter 6, Article 9. See Section .04 of this portfolio.

<sup>6</sup>SC Code Title 12, Chapter 6, Article 17. See Section .05 of this portfolio.

<sup>7</sup>SC Code §12-6-590. See Section .03 C. 2. of this portfolio. See also Sections .07 B., .08, and .09 C. and D. of this portfolio for a discussion of S corporation composite returns, license fees, and withholding, respectively.

<sup>8</sup>SC Code §12-6-600.

<sup>9</sup>SC Code §12-2-25. See also Section .08 E. b. (i) for a discussion of when limited liability companies must pay license fees.

## **B. Corporations Exempt from Tax**

The following corporations are exempt from South Carolina income tax:<sup>10</sup>

1. Banks;<sup>11</sup>
2. Building and loan associations;<sup>12</sup>
3. Insurance companies;<sup>13</sup>
4. Nonprofit corporations financed by certain federal or state loans for the purpose of providing water supply and sewerage disposal or a combination of those services;<sup>14</sup> and
5. Certain electric cooperatives.<sup>15</sup>

South Carolina only taxes the income of tax exempt organizations qualifying under Internal Revenue Code §§501 through 528, and cooperatives described in Internal Revenue Code §1381 to the extent of their unrelated business income, or the income determined pursuant to Internal Revenue Code §§1382 and 1383, respectively.<sup>16</sup> This income is subject to certain modifications<sup>17</sup> and to the allocation and apportionment provisions<sup>18</sup> before being subject to South Carolina income taxes at a 5% rate.<sup>19</sup>

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<sup>10</sup>SC Code §12-6-550.

<sup>11</sup>Banks are defined in SC Code §12-11-10, and are subject to the bank tax in SC Code Title 12, Chapter 11. See Section .03 C. 5. a. of this portfolio.

<sup>12</sup>Building and loan associations include savings and loans and are defined in SC Code §12-13-10, and are subject to a building and loan income tax in SC Code Title 12, Chapter 13. See Section .03 C. 5. b. of this portfolio.

<sup>13</sup>Insurance companies are subject to license fees and premium taxes. See SC Code Title 38, Chapter 7. See Section .03 C. 4. of this portfolio.

<sup>14</sup>These corporations must be organized pursuant to SC Code Title 33, Chapter 36.

<sup>15</sup>SC Code §33-49-120.

<sup>16</sup>SC Code §12-6-540.

<sup>17</sup>SC Code Article 9, Chapter 6, Title 12. See Section .04 of this portfolio.

<sup>18</sup>SC Code Article 17, Chapter 6, Title 12. See Section .05 of this portfolio.

<sup>19</sup>SC Code §12-6-540.

In addition, South Carolina exempts South Carolina Business Development Corporations and subsidiaries created pursuant to SC Code Title 33, Chapter 37, from income taxes.<sup>20</sup> A South Carolina Business Development Corporation is a corporation of 25 or more persons, a majority of whom are South Carolina residents, created for the purpose of promoting, developing, and advancing the prosperity and economic welfare of South Carolina. It is specifically authorized to organize and incorporate a subsidiary corporation for the purposes, and with the powers, expressly granted as provided for by SC Code Title 33, Chapter 37.

## **C. Special Treatment of Certain Entities**

### **1. Introduction**

Some corporations exempt from South Carolina income tax may be subject to other types of South Carolina tax; *e.g.*, banks and insurance companies. The taxation of partnerships,<sup>21</sup> S corporations,<sup>22</sup> and limited liability companies<sup>23</sup> generally conforms to the federal income tax laws, although in some cases there are additional withholding requirements.<sup>24</sup>

### **2. S corporations and Qualified Subchapter S Subsidiaries**

#### **a. S Corporations**

Except as provided below, a corporation with 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. 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 South Carolina income modifications, and allocation and apportionment.<sup>25</sup> If Internal Revenue Code §§1374 (Tax Imposed on Certain Built-In Gains and Capital Gains) or 1375 (Tax Imposed on Certain Passive Investment Income) imposes a federal income tax, a 5% South Carolina income tax is similarly imposed.<sup>26</sup>

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<sup>20</sup>SC Code §33-37-70.

<sup>21</sup>SC Code §12-6-600.

<sup>22</sup>SC Code §12-6-590.

<sup>23</sup>SC Code §12-2-25.

<sup>24</sup>See Section .09 C. of this portfolio concerning withholding on nonresident shareholders of S corporations.

<sup>25</sup>SC Code §12-6-590(A) and Articles 9 and 17, respectively of Chapter 6, Title 12 and Sections .04 and .05 of this portfolio.

<sup>26</sup>SC Code §§12-6-590(B) and 12-6-530.

If a South Carolina corporation had a valid S election in effect for federal tax purposes before January 1, 1985,<sup>27</sup> it may, at its option, continue to be taxed as a subchapter C corporation; *i.e.* subject to the 5% corporate tax provided in SC Code §12-6-530, or it may elect South Carolina S corporation status. The election may be made by filing a statement or a copy of the federal S corporation election form, Form 2553, with all of the shareholders consenting to the State election, or all shareholders can indicate their consent by reporting the S corporation income or loss on their individual or composite South Carolina return(s).<sup>28</sup> A federal S corporation can make the State S corporation election on a delinquent return, even though the corporation filed an income tax return as a subchapter C corporation, if all of the shareholders deducted the S corporation losses on their individual returns.<sup>29</sup>

**Comment:** Only corporations taxed under SC Code Title 12, Chapter 6, can elect South Carolina S corporation treatment. Therefore banks and savings and loan associations cannot be S corporations for South Carolina income tax purposes.

If an S election is made, a change in the taxable year of an S Corporation is not mandated for South Carolina income tax purposes under Internal Revenue Code §1378 unless mandated for federal purposes.<sup>30</sup>

Termination or revocation of an S election for federal purposes automatically terminates or revokes the election for South Carolina income tax purposes.<sup>31</sup>

Each shareholder must include his or her share of South Carolina S Corporation income on the shareholder's income tax return.

**Note:** SC Commission Decision #92-58 concerned an S corporation which generated fee income for providing financial services and other income from investing its assets. The Department held that the S corporation's business income was apportionable at the corporate level and its income from dividends was allocated to the individual shareholders' states of domiciles. In the authors' opinion this Commission Decision indicates that business income should be apportioned at the S corporation level, but that items which are allocated under SC Code §12-6-2220 to the principal place of business of a corporation or the domicile of an individual will be allocated based upon the shareholder's state of domicile.

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<sup>27</sup>The date South Carolina conformed to the Internal Revenue Code.

<sup>28</sup>SC Code 12-6-1210(F). See Section .07 B. 2. in this portfolio.

<sup>29</sup>SC Tech. Adv. Memo. #89-12.

<sup>30</sup>SC Code §12-6-4410.

<sup>31</sup>SC Code §§12-6-590(A) and 12-6-4430. SC Code §12-6-4430 also provides that a taxpayer should provide the Department notice of its intent to be an S corporation by filing with the Department a copy of the election filed with the Internal Revenue Service.

## **b. Qualified Subchapter S Subsidiaries**

Internal Revenue Code §1361(b)(3) allows an S corporation to own a qualified subchapter S subsidiary (QSub). For federal income tax purposes, the QSub 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.

A corporation subject to the corporate income tax under SC Code Title 12, Chapter 6, which made a valid QSub election for federal income tax purposes is deemed to have made a valid QSub election for South Carolina income tax purposes. Therefore, for South Carolina income tax purposes, including the determination of nexus for income tax purposes, the parent and the subsidiary are treated as one entity.

**Note:** Therefore, nexus with the parent or any QSub results in nexus with the parent and all of its QSubs. On the other hand, the denominator of the apportionment factors will include the factors of the parent and all of its QSubs.

Form SC1120S (South Carolina S Corporation Income Tax Return) is filed in the name of the parent corporation reporting the income of the parent and the QSubs as one S corporation; a separate SC1120S is not filed for each entity.

**Note:** A QSub is not regarded as an entity separate from the S corporation that owns the stock of the QSub for all South Carolina tax purposes.<sup>32</sup> Therefore, for example, no sales taxes are due from sales between a QSub and its parent, and no deed recording fees are due from transfers of real estate between a QSub and its parent.

**Note:** For payroll and other withholding purposes, the Department will allow a parent and QSub to remit withholding taxes using the taxpayer name and federal identification number used for federal purposes.<sup>33</sup>

## **3. Limited Liability Companies<sup>34</sup>**

### **a. General Provisions**

Treasury regulations govern how an organization is classified for federal income tax purposes, including determining the classification of an unincorporated business organization as either a partnership or a corporation. Under these regulations an unincorporated entity can choose to be taxed as a partnership (or disregarded as an entity separate from its owner if it is a

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<sup>32</sup>SC Code §12-2-25(B)(2).

<sup>33</sup>See Section .10 B. of the portfolio for a discussion of QSub withholding.

<sup>34</sup>See Worksheet 5 for a more complete discussion of LLC tax issues in South Carolina.

single member LLC), or elect to be taxed as a corporation. This process is referred to as “check the box.” The Department follows the federal “check the box” regulations.<sup>35</sup>

South Carolina has adopted the partnership and corporate provisions (subchapters K, C and S) of the Internal Revenue Code and Internal Revenue Code §7701 which defines “partnership” and “corporation.”

As used in SC Code Title 12 (Taxation) and unless otherwise required by the context:

1. “Partnership” includes a limited liability company taxed for South Carolina income tax purposes as a partnership.
2. “Partner” includes any member of a limited liability company taxed for South Carolina income tax purposes as a partnership.
3. “Corporation” includes a limited liability company or professional or other association taxed for South Carolina income tax purposes as a corporation.
4. “Shareholder” includes any member of a limited liability company taxed for South Carolina income tax purposes as a corporation.<sup>36</sup>

If a Limited Liability Company (LLC) is treated as a corporation for federal income tax purposes, it is treated as a corporation for South Carolina income tax purposes and all other South Carolina tax purposes. Likewise, if an LLC is treated as a partnership for federal income tax purposes, it is treated as a partnership for South Carolina income tax purposes and all other South Carolina tax purposes.

Moreover, if a single member LLC is disregarded as an entity separate from its owner for federal income tax purposes, it is not regarded as an entity separate from its owner for all South Carolina tax purposes.<sup>37</sup> Therefore, if single member LLC does not elect to be treated as a corporation, it will be treated as part of its owner; *e.g.*, as a sole proprietorship if it is owned by an individual, a division of a corporation if it is owned by a corporation, and a division of a partnership if it is owned by a partnership.

**Note:** Assume that corporation A does not have nexus<sup>38</sup> with South Carolina. Then A creates a single member LLC, B, to do business in South Carolina. If A does not elect to have B treated as a corporation, it will be disregarded as an entity separate from A. Since B is a part of A and doing business in South Carolina, South Carolina is likely to take the

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<sup>35</sup>See SC Info.Ltr. #96-25.

<sup>36</sup>SC Code §12-2-25(A).

<sup>37</sup>SC Code §12-2-25(B)(1).

<sup>38</sup>See Section .02 of this portfolio for a discussion of nexus.

position that A has nexus in South Carolina. Even if it were determined that A did not have nexus with South Carolina, assuming A and B carried on a unitary business,<sup>39</sup> South Carolina would likely take the position that the income tax return filed for B would have to include A's income and apportionment factors.

Forming a limited liability company (LLC) in South Carolina is a simple process. Any person may organize a domestic LLC simply by filing the articles of organization<sup>40</sup> with the Secretary of State on the Secretary of State form<sup>41</sup> entitled "Articles of Organization Limited Liability Company." This person does not have to be a member of the LLC. Currently, a \$110 fee is due upon filing the articles of organization with the Secretary of State.<sup>42</sup>

Any person may qualify a foreign LLC to do business in South Carolina by filing an "Application for Certificate of Authority by Foreign Limited Liability Company to Transact Business in South Carolina" with the Secretary of State. By applying for a certificate of authority to transact business in South Carolina, the foreign LLC agrees to be subject to the jurisdiction of the Department and the South Carolina courts to determine its South Carolina tax liability, including withholding and estimated taxes, together with any related interest and penalties, if any. Applying for a certificate of authority is not an admission of tax liability.<sup>43</sup> A \$110 fee is due upon filing an application for a certificate of authority to transact business in South Carolina.<sup>44</sup> Except as provided in SC Code §12-2-25 for a single member LLC, the laws of the state or other jurisdiction under which a foreign LLC is organized govern its organization and internal affairs, and the liability of its managers, members, and their transferees.<sup>45</sup>

## **b. Miscellaneous Issues<sup>46</sup>**

### **(i) Comment: An Owners's Liability for a Single Member LLC's Taxes**

There is a question of whether an owner of a single member LLC which is disregarded as an entity separate from its owner can be held liable for the LLC's taxes. The question arises from the conflict between an LLC being disregarded for tax purposes, which arguably includes tax

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<sup>39</sup>See Section .05 F. of this portfolio for a discussion of the unitary business doctrine in South Carolina.

<sup>40</sup>SC Code §33-44-203.

<sup>41</sup>Secretary of State forms can be obtained from the Secretary of State's office. They may be reached at [www.scsos.com](http://www.scsos.com), PO Box 11350 Columbia, SC 29211, or 803-734-2170.

<sup>42</sup>SC Code §33-44-1204.

<sup>43</sup>SC Code §33-44-1002.

<sup>44</sup>SC Code §33-44-1204.

<sup>45</sup>SC Code §33-44-1001.

<sup>46</sup>See Worksheet 5 for a more complete discussion of LLC tax issues in South Carolina.

collection purposes, and an LLC generally being considered a separate entity for liability and other state law purposes.

The answer is unclear. In South Carolina relevant statutory authorities are:

1. SC Code §12-2-25(B)(1) provides that a single member LLC which is not taxed as a corporation will be ignored for all South Carolina tax purposes.
2. SC Code §33-44-201 provides that “[e]xcept as provided in Section 12-2-25 for single-member limited liability companies, a limited liability company is a legal entity distinct from its members.”<sup>47</sup>
3. SC Code §33-44-1001 provides that “[e]xcept as provided in Section 12-2-25 for single-member limited liability companies, the laws of the State or other jurisdiction under which a foreign limited liability company is organized govern its organization and internal affairs and the liability of its managers, members, and their transferees.”<sup>48</sup>
4. On the other hand SC Code § 33-44-303 provides that “... the debts, obligations, and liabilities of a limited liability company, whether arising in contract, tort, or otherwise, are solely the debts, obligations and liabilities of the company. A member or manager is not personally liable for a debt, obligation, or liability of the company solely by reason of being or acting as a member or manager.”

If the LLC statute is not clarified, the authors believe that this issue will eventually be litigated.

## **(ii) Income Tax Consequences of the Conversion of a Corporation to a Limited Liability Company**

There are no tax-free reorganizations from corporations to partnerships and, therefore, no tax-free reorganizations from C or S corporations to LLCs taxed as a partnership. A conversion from a corporation to an LLC taxed as a partnership will be viewed as:

1. A distribution of assets to the shareholders followed by their contribution to the LLC;
2. A contribution of the assets from the corporation to the LLC in exchange for interests in the LLC and then distribution by the corporation to its shareholders of the LLC interests; or
3. A contribution of stock in the corporation to the LLC followed by a liquidation of the corporation.

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<sup>47</sup>Emphasis added.

<sup>48</sup>Emphasis added.

In several private letter rulings the Internal Revenue Service has adopted the second characterization.<sup>49</sup> The result of this treatment is that, under Internal Revenue Code §336, the corporation recognizes gain on the distribution of the property as if the corporation had sold the property and the shareholders must recognize gain to the extent the fair market value of the assets they receive exceed the basis in their stock. Therefore, the conversion of a corporation into an LLC will be taxable at both the corporate and the shareholder levels.

The result is the same if an LLC taxed as a corporation, elects pursuant to the “check the box” regulations, to be taxed as a partnership in the future.

South Carolina is expected to follow the federal tax treatment for an LLC which is taxed as a corporation and is converted to a corporation. If the conversion qualifies as an F reorganization under Internal Revenue Code §368(a)(1)(F), of South Carolina will also treat it as an F reorganization.<sup>50</sup>

### **(iii) Corporate License Fees, Withholding, etc.**

LLCs may or may not be subject to corporate license fees or withholding on the income of its nonresident owners.<sup>51</sup>

## **4. Insurance Companies**

Insurance companies are exempt from South Carolina income taxes.<sup>52</sup> Insurance companies are subject to premium taxes and license fees that are administered by the South Carolina Department of Insurance.<sup>53</sup>

Insurers, other than benevolent aid associations and fraternal associations, must pay a license fee of \$800 before transacting business in this State. After that initial payment, every insurer must pay to the Insurance Commission a license fee of \$800 by March first every other year.<sup>54</sup> There are additional license fees depending on the kinds of insurance for which the insurer is licensed to do business in South Carolina. Generally, the license fee is \$400 for each kind of insurance for which the insurer is licensed.<sup>55</sup>

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<sup>49</sup>See, for example, Internal Revenue Service Private Letter Rulings 9404021 and 9409016.

<sup>50</sup>Although not directly on point, see Internal Revenue Service Private Letter Ruling 9636007.

<sup>51</sup>See Sections .08 E. and .09 C. of this portfolio for discussions of corporate license fees and withholding on nonresident owners. The rules for withholding on nonresident members of an LLC taxed as a partnership are the same as the rules for nonresident shareholders of an S corporation.

<sup>52</sup>SC Code §12-6-550(3).

<sup>53</sup>See Contact Information, Worksheet 1.

<sup>54</sup>SC Code §38-7-10.

<sup>55</sup>SC Code §38-7-10.

In addition, each insurance company is required to pay an insurance premium tax based upon total premiums, other than workers' compensation insurance premiums, and annuity considerations, written by the company in South Carolina during each calendar year. For life insurance, the insurance premium tax is three-fourths of one percent of the total premiums written. For most types of insurance, the premium tax is one and one-fourth percent of the total premiums written. In computing total premiums, return premiums on risks and dividends paid or credited to policyholders are excluded.<sup>56</sup> Workers' compensation insurers pay a two and one-half percent premium tax.<sup>57</sup> Fire insurers have to pay additional premium taxes.<sup>58</sup> There are special rates for captive insurance companies.<sup>59</sup>

An insurance company exempt from federal income tax pursuant to Internal Revenue Code §501(c)(3) or (4), and which insures only churches and their property, is exempt from the taxes levied on insurance companies.<sup>60</sup>

Any income tax credits under Chapter 6 of Title 12<sup>61</sup> may be applied against any insurance taxes, license fees, and other assessments. Any credits which are earned by one member of a controlled group of corporations may be used and applied by that member and any other members of the controlled group of corporations.<sup>62</sup>

If any other state subjects, or would subject, insurance companies chartered by South Carolina to fees, taxes, obligations, conditions, restrictions, or penalties for the privilege of doing business in that state which are greater than those required by South Carolina of similar insurers, then all similar insurers organized or domiciled in that state are subjected to the greater requirements which are or would be imposed by that state on similar South Carolina insurers.

This determination is based upon a comparison of the aggregate requirements imposed by the state to the aggregate requirements imposed by South Carolina.<sup>63</sup>

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<sup>56</sup>SC Code §38-7-20.

<sup>57</sup>SC Code §38-7-50.

<sup>58</sup>SC Code §§38-7-30 and 38-7-40.

<sup>59</sup>*E.g.*, SC Code §§38-90-20, 38-90-140, and 38-90-145.

<sup>60</sup>SC Code §38-7-180.

<sup>61</sup>SC Code Title 12, Chapter 6, Article 25.

<sup>62</sup>SC Code §38-7-190.

<sup>63</sup>SC Code §38-7-90.

## 5. Financial Institutions

### a. Banks

Banks are defined as any person “engaged in a banking business, whether incorporated under the laws of this State, any other state or the United States or whether unincorporated, except cash depositories.”<sup>64</sup>

**Comment:** This definition is generally viewed as being limited to persons who are regulated by federal or state banking regulators.

Banks are exempt from South Carolina income taxes,<sup>65</sup> however, SC Code Title 12, Chapter 11, imposes a franchise tax based upon the “entire net income” of banks. The tax rate is 4.5% of the “entire net income” of the bank doing business in South Carolina or from the sales or rentals of property within South Carolina.<sup>66</sup> Although the chapter is entitled “Income Tax on Banks” and several of its sections refer to it as an income tax,<sup>67</sup> this tax has always been considered a franchise tax based upon net book income.<sup>68</sup> Banks are not subject to any taxes in South Carolina except this tax, use taxes, deed recording fees, and property taxes on real property.<sup>69</sup>

SC Reg. §117-1500.1 defines “entire net income” as income from any source whatsoever including interest on obligations of the United States, or its possessions or of any state or political subdivision. Banks are permitted to deduct all expenses incurred in the operation of their banks including federal and state income taxes. Banks may report on a cash or accrual basis, and those reporting on a cash basis may deduct federal estimated income tax payments in the year they are paid.<sup>70</sup>

**Note:** Since this bank tax is not part of the South Carolina income tax, banks are only entitled to the tax credits in SC Code Title 12, Chapter 6, which specifically refer to the

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<sup>64</sup>SC Code §12-11-10.

<sup>65</sup>SC Code §12-6-550(1).

<sup>66</sup>SC Code §12-11-20.

<sup>67</sup>SC Code §§12-11-30, 12-11-50, and 12-11-60.

<sup>68</sup>See South Carolina Attorney General’s Opinion dated March 12, 1948, Commission Decision I-D-189 (1975), and SC Form 1101B and instructions.

<sup>69</sup>SC Code §12-11-30.

<sup>70</sup>SC Reg. §§117-1500.2 and 117-1500.3; see also the South Carolina Attorney General’s Opinion dated March 12, 1948. These regulations have the “full force and effect of law.” SC Code §1-23-160. Unlike bank franchise taxes, federal and state income taxes are not deductible under South Carolina’s income tax.

bank tax. The credits that can be used against the bank tax are the community development corporation investment credit, the employee child care programs credit, the venture capital investment tax credit, and the palmetto seed capital corporation or palmetto seed capital fund limited partnership investment credit.<sup>71</sup>

Other adjustments from taxable income to net book income must be made for South Carolina bank tax purposes. For example, no deduction is allowed for a reserve for bad debts,<sup>72</sup> depreciation allowed is book depreciation, net operating losses and the dividends received deduction are not allowed, and travel and entertainment expenses which are not allowed for income tax purposes are allowed.<sup>73</sup>

For purposes of administration, allocation and apportionment, enforcement, collection, liens, penalties, and other similar provisions, all of the provisions of the South Carolina's income tax<sup>74</sup> that may be appropriate or applicable are adopted and made a part of the bank franchise tax for the purposes of enforcement and administration, including the requirement to make declarations of estimated tax and make estimated tax payments.<sup>75</sup>

**Note:** Banks cannot file “consolidated” tax returns.<sup>76</sup> In addition, it is the longstanding administrative policy of the Department that this provision does not permit banks to elect S corporation status.<sup>77</sup>

A bank which merges into another bank or consolidates with one or more banks, must file a final return for a portion of the year prior to the merger or consolidation and pay the tax due. The liability for filing the final return for the bank or banks ceasing to exist vests in the surviving bank.<sup>78</sup>

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<sup>71</sup>See Section .06 B.11, 12, 19, and 20 of this portfolio.

<sup>72</sup>Commission Decision I-D-118 (1967).

<sup>73</sup>See SC Form 1101B and instructions.

<sup>74</sup>Chapter 6 of Title 12 of the SC Code.

<sup>75</sup>SC Code §12-11-40 and Commission Decision I-D-189 (1975).

<sup>76</sup>SC Code §12-6-5020(B).

<sup>77</sup>See Sections .03 C. 2. and .07 B. 2. of this portfolio.

<sup>78</sup>SC Reg. §117-1500.5.

## **b. Savings and Loan Associations**

A savings and loan association (association) includes any mutual or stock-chartered corporation insured by the Federal Savings and Loan Insurance Corporation or any corporation subject to regulatory supervision by the Federal Home Loan Bank, or the Savings and Loan Division of the South Carolina Board of Financial Institutions, other than banks taxed under Chapter 11 of Title 12 of the SC Code, or employees' credit unions.<sup>79</sup>

Associations are exempt from South Carolina's corporate income tax,<sup>80</sup> however, SC Code Chapter 13 of Title 12 imposes an income tax (not a franchise tax) on associations. The tax rate is 6% of the net income from all sources, except for income from municipal, state, or federal bonds or securities exempted by law from the tax, including interest earned on deposits at the Federal Home Loan Bank of Atlanta, or its successors, for those savings and loan associations which meet the qualified thrift lender test set forth in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (Public Law 101-73), as amended.<sup>81</sup>

Associations are exempt from this tax for the first three years of their operation.<sup>82</sup> This savings and loan income tax is imposed in lieu of all other taxes on associations, except use taxes, deed recording fees, and property taxes on real property.

Net income means taxable income as determined for a C corporation<sup>83</sup> after deducting all earnings accrued, paid, credited, or set aside for the benefit of holders of savings or investment accounts, any additions to reserves which are required by law, regulation, or direction of appropriate supervisory agencies, and a bad debt deduction.<sup>84</sup> The association has the burden to prove what the regulatory agency requires.<sup>85</sup> An association may deduct the amount which it actually set aside as an addition to its reserves calculated under one of several permissible methods prescribed by the Federal Home Loan Bank Board, despite the fact that it could have chosen another permissible method of calculation and set aside a lesser amount.<sup>86</sup>

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<sup>79</sup>SC Code §§12-13-10 and 12-13-40.

<sup>80</sup>SC Code §12-6-550(2).

<sup>81</sup>SC Code §12-13-30.

<sup>82</sup>SC Code §12-13-40.

<sup>83</sup>SC Code Title 12, Chapter 6.

<sup>84</sup>SC Code §12-13-20. See also *Lexington County Savings and Loan Association v. SC Tax Comm.*, 329 SE2d 786 (1985), with respect to deductions for reserves for bad debts.

<sup>85</sup>SC Reg. §117-1550.1, and Commission Decision 12 (1961).

<sup>86</sup>*Lexington County Sav. & Loan Ass'n. v. SCTC*, 285 SC 417, 329 S.E.2d 786 (SC App. 1985).

A deduction is allowed for earnings paid to shareholders in an amount equal to the earnings actually paid and/or credited to each shareholder's account. Earnings credited to a reserve account for future payments do not qualify for this deduction.<sup>87</sup>

**Comment:** This deduction allows mutual associations to deduct the earnings it distributes to its members which are the equivalent of interest.

The bad debt deduction allowable for South Carolina income tax purposes is the amount determined under the Internal Revenue Code. A state-organized association is allowed the same deductions for bad debt reserves as those allowed to federally organized associations.<sup>88</sup>

For the purposes of administration, enforcement, collection, liens, penalties, and other similar provisions, all of provisions of the South Carolina corporate regular income tax that may be appropriate or applicable apply to associations, including the requirement to make declarations of estimated tax and make estimated tax payments.<sup>89</sup>

**Note:** Associations cannot file "consolidated" returns.<sup>90</sup> In addition, it is the longstanding administrative policy of the Department that this provision does not permit associations to elect S corporation status.<sup>91</sup>

Returns must be filed with, and payment of the tax made to, the Department on or before the fifteenth day of the third month following the close of the accounting period of the association.<sup>92</sup>

### c. Other Financial Institutions

Other financially related corporations like finance companies, credit card companies, securities brokers and dealers, are taxed under the corporate income tax provisions in SC Code Chapter 6 of Title 12.

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<sup>87</sup>SC Reg. §117-1550.2.

<sup>88</sup>SC Code §12-13-20.

<sup>89</sup>SC Code §12-13-60.

<sup>90</sup>SC Code §12-6-5020(B).

<sup>91</sup>See Sections .03 C. 2. and .07 B. 1. of this portfolio.

<sup>92</sup>SC Code §§12-13-80 and 12-13-90.

## 6. DISCs, FSCs, and Extraterritorial Income Exclusion

Before the Tax Reform Act of 1984, United States businesses doing business in foreign markets used Domestic International Sales Corporations (DISCs) to defer a portion of their foreign income from taxation in the United States. However, the advent of the General Agreement on Tariffs and Trade (GATT) led many to believe that DISC's created an "illegal export subsidy" for companies that were in reality doing business in the United States. In response to this criticism, Congress severely limited the use of DISCs and created a new type of entity referred to as a foreign sales corporation (FSC).

In 1998, the European Union requested the World Trade Organization (WTO) Dispute Settlement Panel to determine whether the FSC provisions were consistent with WTO rules. The Panel ruled that the FSC provisions did not comply with the United States' WTO obligations. The WTO Appellate Body affirmed the Panel's ruling. In response to this ruling, effective for transactions after September 30, 2000, Congress repealed the FSC provisions, and replaced them with an exclusion for certain extraterritorial income.<sup>93</sup>

In *Lowenstein v. South Carolina Tax Commission*,<sup>94</sup> the South Carolina Supreme Court refused to recognize the legitimacy of commission payments made to a commission DISC, finding that in this particular instance, the DISC was a mere "paper corporation" which lacked economic substance. Therefore, the court disallowed the deduction of the commission expenses finding that they were not ordinary and necessary business expenses. On the other hand, in SC Rev. Rul. #98-14, the Department upheld the deduction of commissions paid to a FSC as a legitimate business expense, and indicated it would also uphold the legitimacy of a buy-sell FSC, if the FSC met the requirements of the Internal Revenue Code and had economic substance.

Consistent with its substantial conformity with the Internal Revenue Code, South Carolina has replaced its FSC rules and adopted Sections 114 and 941 through 943 of the Internal Revenue Code which allow an exclusion from gross income for "extraterritorial income" that is "qualifying foreign trade income."<sup>95</sup> In the American Jobs Creation Act of 2004, Congress repealed Section 114, eliminating the exclusion from gross income for "extraterritorial income" and replacing it with a deduction from income for "domestic production activities."<sup>96</sup> The South Carolina legislature is currently considering a provision which would adopt the Internal Revenue Code through December 31, 2004, and that would not adopt Internal Revenue Code §199 for South Carolina purposes.<sup>97</sup>

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<sup>93</sup>FSC Repeal and Extraterritorial Income Exclusion Act of 2000 §§2 and 3.

<sup>94</sup>277 S.C. 561, 290 S.E. 2d 812 (1982).

<sup>95</sup>See SC Code Ann. § 12-6-40.

<sup>96</sup>See Internal Revenue Code §199.

<sup>97</sup>See SC House Bill 3768 of 2005.

## 7. Regulated Investment Companies and Real Estate Investment Trusts

Regulated investment companies, real estate investment trusts, and their respective owners are generally taxed by South Carolina the same way they are for federal income tax purposes.<sup>98</sup> There is one exception concerning the taxation of owners of regulated investment companies. If only a portion of a regulated investment company is invested in obligations producing tax exempt interest,<sup>99</sup> the portion of dividends received which is attributable to those obligations is exempt for South Carolina income tax purposes. The fund need not be invested 50% or more in exempt obligations in order for the taxpayer to receive a pass-through exempt treatment for the dividends received.<sup>100</sup>

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<sup>98</sup>See Internal Revenue Code §§851–855 for regulated investment companies, and Internal Revenue Code §§856–859 for real estate investment trusts. South Carolina has adopted these sections. See SC Code §§12-6-40 and 12-6-50.

<sup>99</sup>Generally obligations producing tax exempt interest for South Carolina income tax purposes are obligations which Congress has designated as nontaxable, obligations of the United States, and obligations of South Carolina and its political subdivisions to the extent they are nontaxable for federal income tax purposes. SC Rev. Rul. #91-15.

<sup>100</sup>SC Rev. Rul. #91-15.