

REPORT OF THE SALES AND INCOME TAX SUBCOMMITTEE

SENATE BILL 627

S. 627 -- Senators Bennett, Adams, Kimbrell, M. Johnson, Davis, Turner, Campsen, Hembree, Alexander, Williams, Cromer, McElveen, Loftis, Climer, Talley, Rice, Garrett, Rankin, Leatherman, Young and Gustafson: A BILL TO AMEND SECTION 12-6-545, CODE OF LAWS OF SOUTH CAROLINA, 1976, RELATING TO INCOME TAX RATES FOR PASS-THROUGH TRADE AND BUSINESS INCOME, SO AS TO CREATE AN ELECTION TO TAX PARTNERSHIPS AND "S" CORPORATIONS AT THE ENTITY LEVEL; AND TO AMEND SECTION 12-6-3400, RELATING TO CREDIT FOR INCOME TAX PAID BY SOUTH CAROLINA RESIDENTS TO ANOTHER STATE, SO AS TO PROVIDE THAT AN ELECTING PASS-THROUGH BUSINESS ENTITY IS ELIGIBLE FOR THE CREDIT.

Received by Ways and Means: April 6, 2021

Summary of Bill:

This bill makes revisions to income tax provisions relating to pass-through trade and business income, tax partnerships, and "S" corporations. It will allow these entities to annually elect to pay state income taxes at the entity level as opposed to the current practice of individual shareholders and members paying their portion individually. Section 2 of the bill allows the electing entity to get a credit for taxes paid to another state where applicable.

Estimated Revenue Impact:

None - total revenue will remain the same, and this change will only shift revenue from individual income tax to corporate income tax.

Subcommittee Recommendation:

Favorable Report as amended on 4/28/21.

Other Notes/Comments:

Subcommittee Amendment was drafted in conjunction with DOR. The amendment cleans up the bill and makes changes to help DOR better implement the intended changes. It adds two new definitions to clarify what entity qualifies for the tax change and what type of income qualifies. The amendment also adds language to address basis in stock of those that elect to use the tax change.

HOUSE
AMENDMENT

THIS AMENDMENT
ADOPTED

ALLEN/DOWNEY
APRIL 29, 2021

CLERK OF THE HOUSE

THE SALES, USE, AND INCOME TAX SUBCOMMITTEE
PROPOSES THE FOLLOWING AMENDMENT No. TO S. 627
(USERS\KIMJACKSON\APPDATA\LOCAL\MICROSOFT\WINDOWS\INETCACHE\CONTENT.OUTLOOK\IG4C
3A04\627C001.BH.SA21):

REFERENCE IS TO PRINTER'S DATE 3/23/21-S.

**AMEND THE BILL, AS AND IF AMENDED, BY
STRIKING ALL AFTER THE ENACTING WORDS AND
INSERTING:**

**/ SECTION 1. SECTION 12-6-545 OF THE 1976
CODE IS AMENDED BY ADDING A NEW SUBSECTION
AT THE END TO READ:**

“(G)(1)(A) ‘QUALIFIED ENTITY’ MEANS A PARTNERSHIP OR ‘S’ CORPORATION INCLUDING A LIMITED LIABILITY COMPANY TAXED AS A PARTNERSHIP OR ‘S’ CORPORATION, WHERE ALL OF ITS OWNERS ARE QUALIFIED OWNERS OR PARTNERSHIPS, AND, WHERE THOSE PARTNERSHIPS ARE OWNED DIRECTLY OR THROUGH OTHER PARTNERSHIPS BY QUALIFIED OWNERS.

(B) ‘QUALIFIED OWNER’ MEANS A PARTNER OR SHAREHOLDER OF A QUALIFIED ENTITY THAT IS AN INDIVIDUAL, ESTATE, TRUST, OR ANY OTHER ENTITY EXCEPT THOSE TAXED OR EXEMPTED FROM TAX PURSUANT TO SECTIONS 12-6-530 THROUGH 12-6-540 AND 12-6-550 AND EXCEPT FOR ANY OTHER ENTITY EXEMPT FROM SOUTH CAROLINA INCOME TAX.

(2)A QUALIFIED ENTITY MAY ELECT ANNUALLY UNDER THIS SUBSECTION TO HAVE ITS INCOME TAXED ON ITS ACTIVE TRADE OR BUSINESS INCOME AT THE RATE PROVIDED IN SUBSECTION (B)(2) IMPOSED ON THE QUALIFIED

ENTITY ITSELF. SUCH ELECTIONS MUST BE MADE NO LATER THAN THE DUE DATE FOR FILING THE APPLICABLE INCOME TAX RETURN, INCLUDING ANY EXTENSIONS.

(3)IN COMPUTING SOUTH CAROLINA TAXABLE INCOME, A QUALIFIED OWNER SHALL EXCLUDE ACTIVE TRADE OR BUSINESS INCOME FROM AN ELECTING QUALIFIED ENTITY PROVIDED THAT THE QUALIFIED ENTITY PROPERLY FILED AN INCOME TAX RETURN AND PAID THE TAXES PURSUANT TO THIS SUBSECTION THAT INCLUDED THE ACTIVE TRADE OR BUSINESS INCOME OR LOSS.

(4)ACTIVE TRADE OR BUSINESS LOSSES OF THE QUALIFIED OWNER FROM OTHER PASS-THROUGH ENTITIES THAT ARE REPORTED DIRECTLY BY SUCH OWNER MAY NOT REDUCE TAX AT A RATE HIGHER THAN THE RATE PROVIDED IN SUBSECTION (B)(2).

(5)ACTIVE TRADE OR BUSINESS INCOME FOR WHICH THIS SUBSECTION IS ELECTED SHALL BE APPORTIONED BY THE PASS-THROUGH ENTITY

PURSUANT TO 12-6-2240, AND NONE OF IT SHALL BE TREATED AS INCOME FROM PERSONAL SERVICES THAT IS ALLOCATED PURSUANT TO 12-6-2220(6).

(6) SECTION 12-8-590, DEALING WITH TAX WITHHOLDING ON DISTRIBUTIONS TO NONRESIDENT SHAREHOLDERS OF 'S' CORPORATIONS AND NONRESIDENT PARTNERS, DOES NOT APPLY TO ELECTING QUALIFIED ENTITIES TO THE EXTENT OF THE TAX THE ELECTING ENTITIES PAY ON THEIR ACTIVE TRADE OR BUSINESS INCOME.

(7) FOR TAX YEARS BEGINNING AFTER 2021, AN ELECTING QUALIFIED ENTITY SHALL SUBMIT ESTIMATED TAX PAYMENTS PURSUANT TO SECTION 12-6-3910.

(8) IF THE ELECTING ENTITY FAILS TO PAY THE AMOUNT OWED TO THE DEPARTMENT WITH RESPECT TO INCOME AS A RESULT OF THE ELECTION, THE DEPARTMENT MAY COLLECT THE AMOUNT FROM THE ELECTING ENTITY OR ITS DIRECT OR INDIRECT OWNERS BASED UPON THEIR PROPORTIONATE SHARE OF THE INCOME, OR BOTH.

(9) THE BASIS OF BOTH RESIDENT AND NONRESIDENT SHAREHOLDERS OF A QUALIFIED S CORPORATION IN THEIR STOCK OF THE QUALIFIED S CORPORATION SHALL BE DETERMINED AS IF THE ELECTION UNDER SUBSECTION (G)(2) HAD NOT BEEN MADE AND EACH OF THE SHAREHOLDERS OF THE QUALIFIED S CORPORATION HAD PROPERLY TAKEN INTO ACCOUNT EACH SHAREHOLDER'S PRO RATA SHARE OF THE QUALIFIED S CORPORATION'S ITEMS OF INCOME, LOSS, AND DEDUCTION IN THE MANNER REQUIRED WITH RESPECT TO AN S CORPORATION FOR WHICH NO SUCH ELECTION IS IN EFFECT. THE BASIS OF A QUALIFIED PARTNERSHIP, INCLUDING A LIMITED LIABILITY COMPANY TAXED AS A PARTNERSHIP SHALL BE DETERMINED IN THE SAME MANNER."

SECTION 2. THIS ACT TAKES EFFECT UPON APPROVAL BY THE GOVERNOR AND FIRST APPLIES TO TAX YEARS BEGINNING AFTER 2020.

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RENUMBER SECTIONS TO CONFORM.

AMEND TITLE TO CONFORM.



SOUTH CAROLINA REVENUE AND FISCAL AFFAIRS OFFICE
STATEMENT OF ESTIMATED FISCAL IMPACT
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This fiscal impact statement is produced in compliance with the South Carolina Code of Laws and House and Senate rules. The focus of the analysis is on governmental expenditure and revenue impacts and may not provide a comprehensive summary of the legislation.

Bill Number:	S. 0627	Introduced on March 2, 2021
Author:	Bennett	
Subject:	Pass Through Trade and Business Income	
Requestor:	Senate Finance	
RFA Analyst(s):	Jolliff	
Impact Date:	March 16, 2021	

Fiscal Impact Summary

This bill amends §12-6-545 relating to income taxes for pass-through businesses to allow taxpayers to elect to file and pay taxes on active trade or business income at the entity level. The Department of Revenue (DOR) anticipates that the changes required in the bill can be accomplished with existing staff and resources. However, the agency noted that as the bill is effective for tax year 2021, which has already begun, this may present a challenge in providing timely guidance for taxpayers and implementing the necessary programming changes in time for tax filing.

Based upon discussions with DOR, there may be some small change in income tax revenue as a result of a change from taxation at the individual level to the entity level in how credits are taken and the losses that may be deducted by an individual compared to an entity, but these changes are not expected to substantively change total tax revenue. While we largely anticipate that total revenue will remain the same, this change is expected to shift revenue from individual income tax to corporate income tax for entities that are 'S' corporations. Data are not available currently to estimate the portion of the \$260,685,223 in active trade or business income tax that may shift from individual income tax to corporate income tax.

Explanation of Fiscal Impact

Introduced on March 2, 2021

State Expenditure

This bill amends §12-6-545 relating to income taxes for pass-through businesses to allow taxpayers to elect to file and pay taxes on active trade or business income at the entity level. DOR anticipates that the changes required in the bill can be accomplished with existing staff and resources. However, the agency noted that as the bill is effective for tax year 2021, this may present a challenge in providing guidance for taxpayers and implementing the necessary programming changes.

State Revenue

This bill allows pass-through businesses to elect to file and pay taxes on active trade or business income at the entity level beginning in tax year 2021 as opposed to the current process of passing through income to each individual partner or shareholder. This election is available to a

partnership or 'S' corporation, including a limited liability company taxed as a partnership or 'S' corporation. The entity may make the election annually, and the election only applies to active trade or business income as outlined in §12-6-545.

Currently, individuals with active trade or business income from a pass-through business may choose to pay taxes on this income at the flat 3 percent rate pursuant to §12-6-545 as opposed to the marginal individual income tax rates that range from 0 percent to 7 percent in §12-6-510. Under this bill, the partnership or 'S' corporation may elect to have this income taxed at the entity level at the 3 percent flat rate. The election must be made no later than the due date for filing the applicable income tax return, including any extensions.

By allowing taxpayers to elect to pay income taxes at the entity level, this bill would permit these entities to claim a deduction for the full amount of state and local taxes paid in determining federal taxable income. Under the federal Tax Cuts and Jobs Act of 2017, individual taxpayers are limited to claiming only \$10,000 of state and local taxes, frequently referenced as the SALT limitation. This limitation does not apply to corporations. The Internal Revenue Service has specified that if a state allows for taxation of pass-through businesses at the entity level, the taxpayers may also file an entity-level federal return and will not be subject to the SALT limitation, thus reducing the federal income taxes for these entities. Because South Carolina does not allow a deduction for state income taxes paid, this change is not expected to impact South Carolina income taxes as a result of this deduction for federal income taxes. Based upon discussions with DOR, there may be some change in income tax revenue as a result of a change from taxation at the individual level to the entity level in how credits are taken and the losses that may be deducted and at which level of taxation, but these changes are not expected to substantively change total tax revenue.

While we largely anticipate that total revenue will remain the same, this change is expected to shift revenue from individual income tax to corporate income tax for entities that are 'S' corporations. For tax year 2018, there were approximately 90,731 'S' corporations that filed a corporate income tax return. For tax year 2019, 108,955 individual income tax returns reported a total of \$8,689,507,433 in active trade or business income equating to \$260,685,223 in individual income tax at the 3 percent tax rate. Data are not available to estimate the portion of the \$260,685,223 that may shift from individual income tax to corporate income tax.

Further, DOR noted several concerns with implementation of the bill. The bill is effective for tax year 2021, which has already begun, and may present a challenge in providing timely guidance for taxpayers and implementing the necessary programming changes in time for tax filing. Because the election may be made annually, there may be issues with taxpayers paying as an individual prior to the election by an entity to pay at the entity level, which would significantly complicate administration of the taxes and potentially affect timing of revenue collections.

Local Expenditure and Local Revenue

N/A



Frank A. Rainwater, Executive Director

South Carolina General Assembly
124th Session, 2021-2022

S. 627

STATUS INFORMATION

General Bill

Sponsors: Senators Bennett, Adams, Kimbrell, M. Johnson, Davis, Turner, Campsen, Hembree, Alexander, Williams, Cromer, McElveen, Loftis, Climer, Talley, Rice, Garrett, Rankin, Leatherman, Young and Gustafson

Document Path: f:\council\bill\df\13035sa21.docx

Companion/Similar bill(s): 3978

Introduced in the Senate on March 2, 2021

Introduced in the House on April 6, 2021

Last Amended on March 23, 2021

Currently residing in the House Committee on **Ways and Means**

Summary: Pass through trade and business income

HISTORY OF LEGISLATIVE ACTIONS

<u>Date</u>	<u>Body</u>	<u>Action Description with journal page number</u>
3/2/2021	Senate	Introduced and read first time (Senate Journal-page 6)
3/2/2021	Senate	Referred to Committee on Finance (Senate Journal-page 6)
3/17/2021	Senate	Committee report: Favorable with amendment Finance (Senate Journal-page 12)
3/23/2021	Senate	Committee Amendment Adopted (Senate Journal-page 32)
3/23/2021	Senate	Read second time (Senate Journal-page 32)
3/23/2021	Senate	Roll call Ayes-45 Nays-0 (Senate Journal-page 32)
3/24/2021	Senate	Read third time and sent to House (Senate Journal-page 15)
4/6/2021	House	Introduced and read first time (House Journal-page 130)
4/6/2021	House	Referred to Committee on Ways and Means (House Journal-page 130)

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VERSIONS OF THIS BILL

[3/2/2021](#)

[3/17/2021](#)

[3/23/2021](#)

1 ~~Indicates Matter Stricken~~

2 Indicates New Matter

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4 COMMITTEE AMENDMENT ADOPTED

5 March 23, 2021

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S. 627

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9 Introduced by Senators Bennett, Adams, Kimbrell, M. Johnson,

10 Davis, Turner, Campsen, Hembree, Alexander, Williams, Cromer,

11 McElveen, Loftis, Climer, Talley, Rice, Garrett, Rankin and

12 Leatherman

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14 S. Printed 3/23/21--S.

15 Read the first time March 2, 2021.

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A BILL

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TO AMEND SECTION 12-6-545, CODE OF LAWS OF SOUTH CAROLINA, 1976, RELATING TO INCOME TAX RATES FOR PASS-THROUGH TRADE AND BUSINESS INCOME, SO AS TO CREATE AN ELECTION TO TAX PARTNERSHIPS AND "S" CORPORATIONS AT THE ENTITY LEVEL; AND TO AMEND SECTION 12-6-3400, RELATING TO CREDIT FOR INCOME TAX PAID BY SOUTH CAROLINA RESIDENTS TO ANOTHER STATE, SO AS TO PROVIDE THAT AN ELECTING PASS-THROUGH BUSINESS ENTITY IS ELIGIBLE FOR THE CREDIT.

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Amend Title To Conform

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Be it enacted by the General Assembly of the State of South Carolina:

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SECTION 1. Section 12-6-545 of the 1976 Code is amended by adding a new subsection at the end to read:

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"(G)(1) Notwithstanding Section 12-6-510 and any other provision of this section, a partnership or 'S' corporation, including a limited liability company taxed as a partnership or 'S' corporation, may elect annually under this subsection to have income tax on its active trade or business income at the rate provided in subsection (B)(2) imposed on the pass-through business entity itself. Such elections must be made no later than the due date for filing the applicable income tax return, including any extensions.

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(2) Also notwithstanding Section 12-6-510, in computing South Carolina taxable income, an individual shall exclude net income or losses from an electing entity of which the individual is a shareholder, partner, or member provided that the entity properly filed an income tax return and paid the taxes pursuant to this subsection that included the net income or loss.

1 (3) A pass-through business entity making an election under
2 this subsection shall report to each of its owners the owner's pro rata
3 or distributive share of the trade or business income on which the
4 pass-through business entity paid tax under this subsection. To the
5 extent of the share, the net active trade or business losses of the
6 owner from other pass-through entities that are reported directly by
7 such owner may not reduce tax at a rate higher than the rate provided
8 in subsection (B)(2).

9 (4) An owner of a pass-through business entity making an
10 election under this subsection is not allowed a credit under Section
11 12-6-3400 for taxes paid to another state on the entity's active trade
12 or business income taxed to the entity pursuant to the election, but
13 the entity itself is allowed a credit under Section 12-6-3400 for the
14 taxes that would otherwise be creditable to its owners under the
15 section in the absence of such election, subject to the limitation
16 contained in that section applied at the entity level.

17 (5) Section 12-8-590, dealing with tax withholding on
18 distributions to nonresident shareholders of 'S' corporations and
19 nonresident partners, does not apply to electing entities regarding
20 their active trade or business income.

21 (6) For tax years beginning after 2021, an electing entity shall
22 submit estimated tax payments pursuant to Section 12-6-3910.

23 (7) If the electing entity fails to pay the amount owed to the
24 department with respect to income as a result of the election, the
25 department may collect the amount from the electing entity or the
26 shareholders, partners, or members based upon their proportionate
27 share of the income, or both."

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29 SECTION 2. Section 12-6-3400(A)(2)(b) of the 1976 Code is
30 amended to read:

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32 "(b) the income tax actually paid to the other state, either
33 directly by the individual or by a pass-through business entity and
34 passed through by the entity to the individual, on income taxed
35 under this chapter."

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37 SECTION 3. This act takes effect upon approval by the Governor
38 and first applies to tax years beginning after 2020.

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