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NEWBIE SEMINAR

Income Tax Basics

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South Carolina Corporate Income and License Tax Basics

INCOME AND LICENSE TAXES

The starting point of South Carolina taxation for corporations, partnerships, limited liability companies, individuals, estates, and trusts is federal taxable income. South Carolina law provides for modifications to be made from federal taxable income in determining South Carolina taxable income.

INCOME AND LICENSE TAX BASICS

South Carolina's corporate income tax rate of 5% is among the lowest income tax rate in the Southeast.

INCOME AND LICENSE TAX BASICS

South Carolina's license fee, or franchise tax, is imposed on the privilege of doing business as a corporation in South Carolina. The measure of the license fee is based on (1) the capital stock and paid-in or capital surplus of the corporation or (2) South Carolina gross receipts and property. Most corporations pay an annual license fee based on capital (.001 of the corporation's capital stock and paid-in-surplus, plus $15).

CALCULATION OF INCOME TAXES FOR MULTI-STATE MANUFACTURER C CORPORATION

1. Taxpayer (Txp) calculates its federal income taxes

2. Txp makes certain add-backs (e.g. bonus depreciation) and deductions to federal taxable income

3. Txp subtracts allocations made to other states (e.g. income from the sale of real property in another state.)

This equals net income subject to apportionment.

CALCULATION OF INCOME TAXES FOR MULTI-STATE MANUFACTURER C CORPORATION

4. Txp takes net income subject to apportionment and multiples by apportionment ratio

5. Txp adds back allocations made to South Carolina (e.g. income from sale of property in South Carolina)

This equals total South Carolina net income.

CALCULATION OF INCOME TAXES FOR MULTI-STATE MANUFACTURER C CORPORATION

6. Txp subtracts South Carolina Loss carry forwards

This equals total South Carolina net income subject to tax

7. Txp multiplies this amount by corporate income tax rate of 5%

8. Txp subtracts tax credits (e.g. Job Tax Credit, ITC, etc.)

9. Txp subtracts certain adjustments (e.g. Tax Withholdings) and this equals tax due

INCOME TAXES
ALLOCATION AND APPORTIONMENT OF INCOME

South Carolina Code §12-6-2210 provides for the determination of whether taxable income of a business will be apportioned. A taxpayer whose entire business is transacted or conducted in South Carolina is subject to income tax based on the entire taxable income of the business for the taxable year. A taxpayer that transacts or conducts its business partly within and partly outside of South Carolina is subject to income tax based on the portion of its business carried on in South Carolina. This portion is determined through allocation and apportionment of income. The sum of these amounts is South Carolina taxable income.

INCOME TAXES
ALLOCATION OF INCOME

South Carolina Code §§12-6-2220 and 12-6-2230 provide that certain classes of income, less related expenses, are allocated. Items directly allocated include nonbusiness interest, nonbusiness dividends, nonbusiness rents and royalties from the lease or rental of real estate or tangible personal property, gains and losses from the sale of real property, and nonbusiness gains and losses from sales of intangible property.

INCOME TAXES
APPORTIONMENT OF INCOME

The income remaining after allocation is apportioned in accordance with South Carolina Code §12-6-2240. South Carolina generally requires the use of one of the following apportionment methods:

1. A single factor apportionment method (based on sales) for taxpayers whose principal business in South Carolina is dealing in tangible personal property.
2. A “gross receipts” apportionment method for taxpayers not dealing in tangible personal property. This method is typically used by financial businesses and service businesses. See South Carolina Code §§12-6-2290 and 12-6-2295.

INCOME TAXES
APPORTIONMENT OF INCOME

3. A “special” apportionment method provided in South Carolina Code §12-6-2310 for certain companies, such as railroad companies, telephone companies, pipeline companies, airline companies, and shipping lines.

4. An individualized apportionment method tailored to a particular taxpayer (a) because the standard method for that taxpayer does not fairly represent the extent of the taxpayer’s business in South Carolina, or (b) as an economic incentive allowed the taxpayer.

Income Tax Apportionment for Manufacturers

States typically use one of three forms of apportionment:

1. Three factor formula

$$\frac{\frac{\text{In-State Property}}{\text{Total Property}} + \frac{\text{In-State Payroll}}{\text{Total Payroll}} + \frac{\text{In-State Sales}}{\text{Total Sales}}}{3}$$

2. Double-weighted Sales
   - Sales is counted twice
3. Single Factor (Sales)

$$\frac{\text{Sales Here}}{\text{Sales Everywhere}}$$

Income Tax Apportionment for Manufacturers

- A manufacturer with property and/or payroll in a state generally prefers Single Factor of Sales.
- Manufacturers in small states like South Carolina typically sell very little in the state.

Apportioned Income

- South Carolina offers a single factor sales apportionment formula.

Net Income Remaining After Allocation × $\dfrac{\text{Value of Sales Made in SC}}{\text{Value of Sales of the Taxpayer everywhere}}$

- Once the ratio is determined it is then applied to the corporation's total income to determine the amount of income attributed to South Carolina operations.

INCOME TAXES
APPORTIONMENT METHODS

Single Sales Factor Apportionment Method

South Carolina Code §12-6-2252 provides that a taxpayer whose principal business in South Carolina is manufacturing or any form of collecting, buying, assembling or processing goods and materials in this state shall apportion income to South Carolina by multiplying the net income remaining after allocation by the sales factor defined in South Carolina Code §12-6-2280. The single sales factor apportionment method is typically used by manufacturers and retailers having income in South Carolina.

APPORTIONMENT OF INCOME FOR MULTI-STATE MANUFACTURERS

Definition of "Sales" in South Carolina

The term "sales in this State" includes sales of goods, merchandise, or property received by a purchaser in this State. The place where goods are received by the purchaser after all transportation is completed is considered the place which the goods are received by the purchaser. Direct delivery into this State by the taxpayer to a person designated by a purchaser constitutes delivery to the purchaser in this State.

Corporate Income Tax Credits

- In addition to a <u>low corporate income tax rate</u> and a favorable formula for determining the income subject to that rate, South Carolina provides a <u>myriad of credits</u> that in some cases can <u>completely eliminate</u> a company's corporate income tax liability for up to 10, or in some cases 15, years.

Tax Credits
Job Tax Credit

- South Carolina Code § 12-6-3360(C)(1) provides a tax credit against South Carolina income tax, bank tax, or insurance premium tax for a qualifying business creating new jobs in this state.
- Corporations, sole proprietorships, partnerships, S corporations, and limited liability companies are eligible for the credit.
- To qualify for the job tax credit, a business must:
  - Be a certain type of business, and
  - Create and maintain a required minimum number of "new, full time jobs" at the time a new facility or expansion is initially staffed.

Tax Credits
Job Tax Credits

- The following types of businesses qualify for the Jobs Tax Credit.
  - Manufacturing and Processing
  - Warehousing and Distribution
  - Research and Development
  - Agribusiness Operations
  - Qualifying Technology Intensive Facilities
  - Retail Facilities and Service Related Industries in Tier IV counties

Tax Credits
Job Tax Credits

- The following types of businesses qualify for the Jobs Tax Credit cont'd.
  - Tourism
  - Corporate Office
  - Banks
  - Certain Retail and Service Related Businesses

Tax Credits
Job Tax Credit

- The value of the credit (per job, per year) depends on the county's development tier as set forth below:

COUNTY'S DEVELOPMENT TIER	
Tier I	$1,500
Tier II	$2,750
Tier III	$4,250
Tier IV	$8,000

- Multi-County Industrial Park: raises the value of the credits by $1,000 per job, per year.

Tax Credits
Job Tax Credit

- In general, a taxpayer must increase employment by a monthly average of 10 new, full time jobs to qualify for the credit.
- Exceptions include:
  - Tourism facilities that consist of new hotels and motels must create 20 new, full time jobs.
  - A qualifying service-related facility must create 25 to 175 new, full time jobs at a single location based upon average cash compensation.

Tax Credits
Small Business Job Tax Credit

- If the company is a manufacturing, processing, warehousing and distribution, research and development, agribusiness, or qualifies technology intensive facility, or a corporate office that has fewer than 99 employees worldwide, *the company could qualify for the **Small Business Jobs Tax Credit** by creating a monthly average of 2 net new jobs, instead of 10.* The amount of credits is half that of regular JTC's

Tax Credits
Job Tax Credit

- Amount of credit available each year for 5 years, commencing in year after job created.
- Capped at 50% of SC income tax liability.
- 15 year carry-forward.

Tax Credits
Investment Tax Credit

- South Carolina Code § 12-14-60 allows manufacturers locating or expanding in South Carolina a one-time credit against a company's corporate income tax of up to 2.5% of a company's investment in new production equipment.
- The actual value of the credit depends on the applicable recovery period for property under the Internal Revenue Code.
- The following table illustrates the credit value for the various years outlined in the code.

RECOVERY PERIOD	CREDIT VALUE
3 years	.5%
5 years	1%
7 years	1.5%
10 years	2%
15 years or more	2.5%

Tax Credits
Research & Development Tax Credit

- In order to reward companies for increasing research and development in a taxable year, South Carolina Code § 12-6-3415 provides a credit equal to 5% of the taxpayer's qualified research expenses as defined in Section 41 of the Internal Revenue Code.
- The credit taken in any one taxable year may not exceed 50% of the company's remaining tax liability after all other credits have been applied.
- Any unused portion of the credit can be carried forward for 10 years from the date of the qualified expenditure.

Tax Credits
Port Tax Credit

- The SC Port Tax Credit was amended by H.3557 in 2013.
- There are now 3 ways to qualify for the tax credit.
  - (1) Existing business which increase their imports/exports through a SC port; and
  - (2) Two alternatives for new warehouse and distribution facilities.

Tax Credits
Port Volume Increase Tax Credit

- South Carolina Code § 12-6-3375, as amended by H.3557 (2013), provides an income tax credit or withholding tax credit to manufacturers, distributors, freight forwarders, freight handling, goods processing, cross docking and transloading that use South Carolina port facilities and increase base port cargo volume by 5% over base-year totals.
- To qualify, a company must have 75 net tons of non-containerized cargo,10 loaded TEUs or 385 cubic meters transported through a South Carolina port for their base year.
- The base year port cargo volume will be re-calculated every year after the initial base year.

Tax Credits
Port Volume Increase Tax Credit

- The South Carolina Coordinating Council for Economic Development has the sole discretion in determining eligibility for the credit and the amount of credit that a company may receive.
- The total amount of tax credits allowed to all qualifying companies is limited to $8 million per calendar year, which may be awarded as credits against withholding taxes or against income taxes.

Tax Credits
Port New Warehouse Tax Credit

Alternative 1

- In addition, South Carolina provides a possible tax credit of up to $1 million to distributors that locate a new warehouse or distribution facility in South Carolina and invest at least $40 million, create at least 100 new jobs at that site, and have a minimum of 500,000 TEUs or containerized equivalent.
- The base cargo requirements do not apply to this credit.
- Withholding tax credit may be carried forward 20 succeeding taxable quarters.
- Pro-rata clawback.

Tax Credits
Port New Warehouse Tax Credit

Alternative 2

The Act also allows the CCED to award a Port Volume tax credit to a taxpayer which does not currently have a distribution center so long as the taxpayer:

1. Employs at least 250 jobs statewide;
2. Completes construction of the facility within 5 years of the tax credit award; and
3. Has a base year TEU of 500,000 or non-containerized equivalent.
4. Pro rata clawback.

Tax Credits
USE OF TAX CREDITS BY PASS THROUGH ENTITIES

- Pass Through Entity Specifically Qualifying for Credit

South Carolina Code §12-6-3310(B) contains special provisions concerning the use of income tax credits by pass through entities. Unless specifically prohibited, an S corporation, limited liability company taxed as a partnership, or partnership that qualifies for a credit pursuant to Article 25 of Chapter 6, Title 12 may pass through the credit earned to each shareholder of the S corporation, member of the limited liability company, or partner of the partnership.

Tax Credits
USE OF TAX CREDITS
BY PASS THROUGH ENTITIES (CONT.)

NOTE: The statutory language of a particular tax credit controls whether a credit generated by an entity may be used by a partner, shareholder, or member.

Great majority pass through.