



**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.*

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<b>Bill Number:</b>	S. 0627	Amended by House Ways and Means on May 4, 2021
<b>Author:</b>	Bennett	
<b>Subject:</b>	Pass Through Trade and Business Income	
<b>Requestor:</b>	House of Representatives	
<b>RFA Analyst(s):</b>	Jolliff	
<b>Impact Date:</b>	May 10, 2021	

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### **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**

#### **Amended by House Ways and Means on May 4, 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 as amended 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 qualified entities defined as a partnership or 'S' corporation, including a limited liability company taxed as a partnership or 'S' corporation. The qualified entity may make the election annually, and the election only applies to active trade or business income as outlined in §12-6-545. The bill as amended provides technical clarifications and definitions for administration of the section, clarifies the determination of basis for shareholders of a qualified S Corporations, and conforms the language to the definitions and clarifications.

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 a qualified 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

### **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.

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### **Local Expenditure and Local Revenue**

N/A



Frank A. Rainwater, Executive Director