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South Carolina Issues Guidance on SALT Cap Workaround

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The South Carolina Department of Revenue has issued draft guidance on its passthrough workaround to the federal cap on the state and local tax deduction.

The DOR issued a draft revenue ruling November 2 on the workaround, which was signed into law in May by Gov. Henry McMaster (R). The workaround allows entities making the election to circumvent the 2017 federal Tax Cuts and Jobs Act's $10,000 limit on the amount of state and local taxes that can be deducted on an individual's federal income tax return.

Under South Carolina's law, partnerships and S corporations — including limited liability companies taxed as partnerships or S corporations — can elect to file and pay taxes on active trade or business income at the entity level at a rate of 3 percent, beginning in tax year 2021.

The four-part, 36-page draft revenue ruling is being circulated for public comments, which are due by November 16.

Raymond Burroughs of Shumaker, Loop & Kendrick LLP told *Tax Notes* that the ruling answers "a lot of technical questions about the workaround which practitioners wanted to know, especially how to treat 2021 active trade or business income so as to qualify for the workaround."

The DOR explained in the draft ruling that the guidance is meant to summarize the IRS's guidance regarding these types of SALT cap workarounds and to address technical and compliance questions about the state's workaround.

Last year, the IRS issued Notice 2020-75, in which it announced plans to issue proposed regulations clarifying that state and local income taxes imposed on and paid by a partnership or an S corporation on its income are allowed as a deduction by the passthrough entity in computing its non-separately stated taxable income or loss for the tax year of payment. The state's draft ruling references the IRS's allowance of such a deduction but notes that "Code Section 12-6-1130(2), however, requires the electing entity to 'add back' the federal deduction for state taxes."

In the first part of the draft guidance, which addresses entity election questions, the department explains that entities that have a loss for the tax year should not make the election. "If . . . the election is made in a tax year the qualified entity had a tax loss, the election will have no effect. As such, the loss would *not* remain at the entity level, but would pass through to the owners, as

if the election had not been made," according to the draft (emphasis in original).

The draft ruling also clarifies that the annual election is made by the entity — the partnership or S corporation — for each tax year (including short tax years) to the DOR and that the "election is *not* reported by the owners to the department" (emphasis in original).

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