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SC Court of Appeals

THE STATE OF SOUTH CAROLINA
In the South Carolina Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Honorable Ralph King Anderson, III, Chief Administrative Law Judge

Case No. 2017-ALJ-17-0418-CC
Appellate Case No. 2020-000999

Synovus Bank.. Appellant,

v.

South Carolina Department of Revenue,... Respondent.

SOUTH CAROLINA DEPARTMENT OF REVENUE'S RESPONSE TO FIRST CITIZENS BANK & TRUST COMPANY'S *AMICUS* BRIEF

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May 4, 2023

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INTRODUCTION

As Respondent South Carolina Department of Revenue (Department) noted in its Return in Opposition to the Motion for Leave to File an *Amicus Curiae* Brief of First Citizens Bank & Trust Company (First Citizens), the *amicus* brief does not provide any additional material or analysis that will aid this Court in its consideration of the issues in this appeal. Instead, First Citizens' *amicus* brief merely reiterates versions of the same arguments that Appellant Synovus Bank (Appellant) presented in it briefs over two years ago. Moreover, First Citizens is an adversary party in interest in the litigation (its own dispute with the Department on this identical issue is currently being held in abeyance at the Administrative Law Court). The fact both Appellant and First Citizens are represented by the same law firm is telling and demonstrates that *amicus* is really just a partisan friend of Appellant—not an impartial "friend of the Court."

Moreover, although the *amicus* brief accuses the ALC of using faulty logic, First Citizens' entire argument is built on a premise that assumes the conclusion. A central issue in this appeal is whether "entire net income" is computed using financial accounting or tax accounting. Appellant asserts the latter: that "entire net income" as used in the Bank Tax (Chapter 11 of Title 12) is not based on "book income" but should mean the same thing as "taxable income" in the Corporate Income Tax (Chapter 6 of Title 12). *See* Appellant Initial Br. at 10. First Citizens agrees with Appellant. The *amicus* brief's contribution to this argument focuses on *Crescent Mfg. Co. v. Tax Comm'n*, 129 S.C. 480, 124 S.E.2d 761 (1924), a case that Appellant already addressed in its brief. First Citizens claims *Crescent Mfg.* established "entire net income" to be a "tax accounting term," but it reaches this conclusion based on words and concepts that are completely absent from the case. Nonetheless, First Citizens then claims this is proof of a judicially-approved definition of "entire net income" that must mean the same thing already used in the Corporate Income Tax. *See* Amicus Br. at 15. As discussed below, all of this renders the brief unhelpful in assisting this Court in deciding the appeal.

ARGUMENT

1. First Citizens, like Appellant, ignores the critical principle that NOL deductions are creatures of statute and that the Bank Tax contains no provision that authorizes an NOL deduction.

The fundamental dispute in this case is whether banks are entitled to a tax deduction for net operating losses (NOL). The ALC correctly found NOL carryforward deductions—like any tax deduction—are creatures of statute. *See* Am. Final Order at 35. (R p. 39). It is undisputed that there is no statutory provision in the Bank Tax that expressly authorizes banks to deduct NOL carryforwards. *See* Stip. Facts, ¶ 1 (R. p. 502); Am. Final Order at 11 (R. pp. 15); App. Br. at 6. The ALC rightly concluded that there is no statutory entitlement for Appellant to claim the deduction. *See* Order Granting Part. Summ. J. at 17 (R. p. 105). This finding alone should end the matter.

First Citizens does not directly address this issue in its brief, although it does quietly acknowledge that NOL carryforwards are allowed <u>only</u> by virtue of "statutory authorization." *See* Amicus Brief at 8. Instead, First Citizens resorts to the same strained statutory analysis as Appellant. Their theory: because the Bank Tax does not authorize an NOL deduction, the simple term "entire net income" used in the Bank Tax must be expansively interpreted to incorporate all of the state and federal NOL deductions authorized in the Corporate Income Tax and the Internal Revenue Code (IRC). To bolster this remarkably sweeping approach, the *amicus* brief repeatedly claims First Citizens' (and Appellant's) interpretation of "entire net income" had been judicially decided by the time the Bank Tax was enacted in 1937. *See* Amicus Br. at 9–12.

First Citizens' overstates the holding of the cases cited in its *amicus* brief; those cases say nothing about tax deductions—much less NOL carryforwards. Regardless, the Department respectfully submits that even accepting the *amicus* brief's claim that courts had settled on some generic meaning of "entire net income" at the time the Bank Tax was enacted, what ultimately matters is the language of the statute. NOL carryforwards, like every tax deduction, are not common law concepts,

nor are they "judicially determined." NOL carryforward deductions exist only because Congress or the General Assembly have specifically authorized them by statute.

This first principle of statutory construction regarding tax deductions is critical, especially in light of First Citizens' criticism of the ALC's ultimate holding that "entire net income" is based on a bank's book income. The *amicus* brief urges this Court to reject the ALC's conclusion because, it argues, the bank tax statutes never mention "book income" or "financial accounting." According to *amicus*, the absence of these terms is fatal to the ALC's decision, because if the General Assembly had intended those concepts to apply it would have said so explicitly because it knows how to "declare the position in a fashion that is plain, certain, and unequivocal." *See* Amicus Br. at 13–14.

Yet First Citizens is silent about the fact the Bank Tax never mentions NOL carryforward deductions. This is an important omission, because NOL carryforward deductions are a matter of legislative grace and must be construed narrowly against the taxpayer, so the burden is on Appellant (and First Citizens) to prove the Legislature intended for banks to claim an NOL deduction. *See Davis Mech. Contractors, Inc. v. Wasson*, 268 S.C. 26, 29, 231 S.E.2d 300, 301 (1977); *C. W. Matthews Contracting Co. v. S.C. Tax Comm'n*, 267 S.C. 548, 557, 230 S.E.2d 223, 227 (1976) (affirming denial of net operating loss deduction to a corporation because it failed to meet exact requirements of the authorizing statute); *Chronicle Publishers, Inc. v. S.C. Tax Comm'n*, 244 S.C. 192, 194, 136 S.E.2d 261, 262 (1964) (denying deduction for net operating losses). As First Citizens contends, if the General Assembly had intended for banks to claim an NOL carryforward deduction, it could have declared so in a plain, certain, and unequivocal fashion. It did not.

2. The central premise of the *amicus* brief—that by 1937 "entire net income" had a "judicially determined" tax accounting meaning that has nothing to do with book income—is inconsistent with statutory history and is unsupported by a plain reading of *Crescent Mfg.* and similar cases.

The *amicus* brief contends that "entire net income" as used in 1937 (when the General Assembly first enacted the Bank Tax) had a "judicially-determined legal meaning" unrelated to book

income or financial accounting. *See* Amicus Br. at 11. Instead, *amicus* believes *Crescent Mfg.* stands for the proposition that entire net income means "a taxpayer's tax accounting net income" which therefore must include the NOL carryforward deduction in the Corporate Income Tax. *See* Amicus Br. at 11, 14–15 (emphasis added). This argument fails for several reasons.

a. *Crescent Mfg.* interpreted a statute that was completely repealed and replaced over a decade before the Bank Tax was enacted. Under the statutes in place in 1937, the starting point for computing "entire net income" was a taxpayer's book income.

The question in *Crescent Mfg.* was whether a domestic corporation is liable under the state Income Tax Act of 1922 (1922 Act) for net income it derived from business operations outside the State. *Crescent Mfg.*, 129 S.C. at 480, 124 S.E. at 762; 1922 S.C. Acts 896, § 2. Importantly, the 1922 Act was repealed and replaced by the Income Tax Act of 1926 (1926 Act). *See* 1927 S.C. Acts 1, § 1; *Roper v. S.C. Tax Comm'n*, 231 S.C. 587, 597, 99 S.E.2d 377, 382 (1957). To the extent *Crescent Mfg.* offers any historical context, its holding and relevant dicta were mooted by the Legislature's decision to repeal the entire 1922 Act and replace it with a new income tax statute just two years after *Crescent Mfg.* was decided. The amicus brief claims that by 1937 the meaning of "entire net income" had been well-settled since 1924, but it omits the fact the statutory definitions for "entire net income" analyzed in *Crescent Mfg.* no longer existed in 1937.

What is relevant to this appeal, and what the *amicus* brief also overlooks, is that the 1926 Act fundamentally changed how a corporation's net income should be computed. Under the 1922 Act, taxable net income for banks and other corporations was calculated as a percentage of their federal income tax, and all of the provisions of the federal income tax act were incorporated by reference. 1927 S.C. Acts 1, § 1; *see Santee Mills v. Query*, 122 S.C. 158, 115 S.E. 202, 205 (1922). But under the 1926 Act, net income was not based on federal law (including any deductions); instead, it was computed based on the corporation's gross income in accordance with the accounting method it employed in keeping its books (i.e. its book income). *See* 1927 S.C. Acts 1, §§ 3, 7–9; Department's

Final Br. at 5, 31–33. So by the time the Legislature enacted the Bank Tax in 1937, the relevant definition of "entire net income" was found in the 1926 Act—not the 1922 Act or *Crescent Mfg.* Importantly, that definition makes book income the basis for computing entire net income.[1] *See* DOR Final Br. at 29–33.

b. *Crescent Mfg.* addressed how "entire net income" is allocated and apportioned, but says nothing about how to compute entire net income.

Not only did *Crescent Mfg.* analyze a statute that was obsolete by 1937, the question presented had nothing to do with whether entire net income was a tax accounting or financial accounting term. To the extent *Crescent Mfg.* is at all relevant to the definition of "entire net income," its relevance was limited to the question of "where the income is derived." In other words, when determining a taxpayer's entire net income (for purposes of the 1922 income tax), did it matter if the income was in South Carolina or elsewhere? The court held that location was irrelevant—entire net income (under the 1922 Act) meant all of a taxpayer's net income "irrespective of *where* the income is earned or the deductions are incurred." *See* Amicus Br. at 11 (emphasis added); *Crescent Mfg.*, 129 S.C. at 480, 124 S.E. at 764.

This is a completely different question from how entire net income is computed, and whether it begins and ends with the corporation's book income (based on the accounting method it employs) or is synonymous with its federal taxable income (based on federal tax rules and the Internal Revenue Code). *Crescent Mfg.* says nothing about what deductions are authorized in calculating a bank's entire net income, much less whether a bank can claim an NOL carryforward deduction.

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[1] It is worth noting that First Citizens cites to section 12-20-50(b) as an example of the Legislature properly relying on "financial accounting" to establish the base for a taxation methodology. This observation is a significant divergence from Appellant's argument that it is an unconstitutional delegation of taxing authority for the State to compute a tax based on financial accounting principles. *See* Appellant Final Br. at 38–41. The ALC rightly concluded there is no unconstitutional delegation of taxing authority, and now even Appellant's fellow bank appears to recognize this argument is without merit. *See* Am. Final Order at 24–25 (R. pp. 28–29).

c. **The other cases cited in the *amicus* brief likewise address only the question of how to apportion income earned both within and without the taxing state, but have nothing to do with establishing a particular method for computing the tax base of a bank's entire net income.**

Similar to *Crescent Mfg.*, the three other cases cited by First Citizens all dealt with the meaning of "entire net income" in the context of the allocation and apportionment of a taxpayer's income when it is derived from sources both within and without the taxing state. *See State v. Weil*, 232 Ala. 578, 168 So. 679 (1936) (analyzing Alabama's income tax act to determine whether only the income derived from a partnership's business operations in Alabama was subject to tax); *Interstate Bond Co. v. State Revenue Comm'n of Ga.*, 50 Ga. App. 744, 179 S.E. 559, 562 (1935) (analyzing whether income earned by a Georgia corporation, whose principal office and place of business was in Atlanta, was subject to the Georgia income tax if that income was derived from business done in other southeastern states); *Hans Rees Sons v. State of N. Carolina ex rel. Maxwell*, 283 U.S. 123, 125, 51 S. Ct. 385, 386 (1931) (noting the controversy related "to the proper allocation of income to the state of North Carolina"). None of these cases speak to the dispositive question of whether the starting point for computing "entire net income" is a bank's book income, or whether the specific statutory modifications and deductions in the Corporate Income Tax and IRC should be imported into the Bank Tax. By claiming these cases establish a settled-meaning of "entire net income" (i.e. a tax accounting term that allows for NOL deductions), the *amicus* brief overstates what the cases actually addressed and held.

Notably, the *Weil* case contains a discussion that is more germane to the issue before this Court. *See Weil*, 168 So. at 685. The Alabama income tax law in 1936—like South Carolina's 1926 Act—only permitted deductions specifically authorized by law. The *Weil* court noted that the 1933 income tax act specifically defined "net income" to mean "gross income" (as defined in section 10 of the Act) less any deductions "allowed by [] this Act." *Id.* (emphasis added). This language is nearly identical to South Carolina's Income Tax Act of 1926, which defined "net income" as gross income "less any exemptions or deductions specifically allowed by the Act." *See* 1927 S.C. Acts 1, §§ 7–9

(emphasis added); *see also* DOR Final Br. at 5. In other words, for an Alabama corporation or bank to claim any kind of deduction—which would include an NOL carryforward deduction—in computing its net income, that deduction would have to be specifically allowed by the Act. The same is true for the South Carolina Bank Tax.

3. Even if *Crescent Mfg.* addressed the concept of "tax accounting" generally, it did so only in the generic sense, but the *amicus* brief wrongly construes the case as adopting a very specific, technical meaning of "tax accounting" that is completely absent from the court's analysis.

Throughout its *amicus* brief, First Citizens repeats the refrain that *Crescent Mfg.* (and the other cases) established a judicially-determined definition of "entire net income" that means "all of a taxpayer's tax accounting income and all of a taxpayer's tax accounting deductions." *See* Amicus Br. at 10–11. Not once is the term "tax accounting"—or even just "accounting"—used in any of those cases. None of the decisions ever refer to "tax accounting deductions." In *Crescent Mfg.*, other than twice mentioning "entire net income" in passing, the opinion never addresses whether "entire net income" means tax accounting or book income/financial accounting. And, as discussed above, other than concluding "entire net income" includes income derived from out-of-state operations, the cases are entirely silent about how to compute "entire net income" with respect to the issues germane to this appeal.

To further confuse matters, the *amicus* brief conflates technical definitions with generic concepts and then incorrectly declares the courts have judicially adopted those technical definitions. As demonstrated in the record in this case, there is a distinction between these relevant terms; understanding that distinction reveals the flaw in the *amicus* brief's analysis of *Crescent Mfg.*

- **Financial accounting** is the method by which companies keep their books and record their transactions, assets, and liabilities, primarily for preparing their audited financial statements. *See* Am. Final Order at 3 (R. p. 7); Hr'g Tr. at 124 (R. p. 233).

- **Tax accounting** is the process of determining the tax basis of assets and the adjustments to income and expenses from a balance sheet to calculate taxable income and deductible

expenses. *See* Hr'g Tr. at 129–30 (R. p. 238–39). Stated differently, tax accounting is the method of adjusting a taxpayer's income (as determined through financial accounting) into a taxpayer's taxable income (based on explicit state or federal tax laws and regulations). *See* Amended Final Order at 3 (R. pp. 50); Hr'g Tr. 129–30 (R. pp. 239–40).

- **Taxable income** refers to the income amount that is subject to tax after all credits, deductions, exemptions, and other statutory modifications have been applied under either federal or state income tax laws. Taxable income is a term of art in the Corporate Income Tax, and is computed after certain statutory modifications to federal taxable income (which itself is a term of art). *See* Am. Final Order at 23–24 (R. pp. 27–28); S.C. Code Ann. § 12-6-530, -580; 26 U.S.C § 63.

Understanding these definitions is important to identify the error in First Citizens' argument. In its most basic, generic sense "taxable income" refers to the income base upon which a tax is applied, i.e. the income that is taxable. Similarly, "tax accounting" is simply the method used to determine what that taxable income base is. All three concepts are interrelated: every tax on income begins with the taxpayer's book income (financial accounting) as the measure of the tax base that, after performing the book-to-tax computations of applying statutory deductions and modifications (tax accounting), becomes the taxpayer's "taxable income."[2]

Thus, the closest *Crescent Mfg.* gets to addressing "tax accounting" is that its holding identifies one category of income—derived from out of state operations—that should be included in computing the entire net income (i.e. the taxable income base) of the corporate taxpayer. This overall method, generally speaking, could be considered a "tax accounting" computation.

But note the *amicus* brief's sleight of hand. As described above, although "tax accounting" and "taxable income" are generic concepts, they are also defined terms of art in certain circumstances.

[2] For example, in order to calculate a taxpayer's *federal* taxable income, a taxpayer starts with its book income (i.e. their financial income, typically determined using GAAP), then make adjustments based on federal law and regulations to determine a final income amount upon which the tax is imposed. *See* Hr'g Tr. at 130–31 (R. pp. 239–40). To compute the Corporate Income Tax in South Carolina, a taxpayer begins with its federal taxable income; thus, even the Corporate Income Tax relies on book income as the ultimate starting point for calculating its taxable income in South Carolina. *See* Hr'g Tr. 219 (R. p. 328).

First Citizens declares that "entire net income" (as used in *Crescent Mfg.*) is a tax accounting term because the court was deciding what to include in "entire net income." But then First Citizens ascribes to that generic concept of tax accounting a specific, technical meaning; namely, that the case "sets the tax accounting meaning of 'entire net income'" that must refer to "taxable income" as defined in Chapter 6 of Title 12, including all of the corporate tax deductions contained in Chapter 6 and the Internal Revenue Code. *See* Amicus Br. at 14–15. This is a huge logical leap, especially where the term "tax accounting" or "taxable income" never appear in the decision and the court never discusses the specific set of rules (i.e. the statutory deductions in the Corporate Income Tax) that First Citizens claims are part and parcel with tax accounting. There is nothing in *Crescent Mfg.* that suggests the Supreme Court contemplated its decision to establish the definitions First Citizens claims.

CONCLUSION

First Citizens urges this Court to adopt its "corrected chain of logic" that supports reversing the ALC and granting Appellant—and by extension, First Citizens—an NOL deduction. But this chain of logic has its own flaws and fallacies. It assumes the *Crescent Mfg.* interpretation of "entire net income" in 1924 was still relevant in 1937, even though the statutory definition of "entire net income" had been repealed and replaced in 1926. It assumes *Crescent Mfg.* implicitly addresses the generic concept of "tax accounting" and "taxable income," but then that the *Crescent Mfg.* court meant for this to judicially establish a technical definition of those terms even though both terms are entirely absent from the case. It assumes that when the General Assembly enacted the Bank Tax in 1937, it intended to authorize a deduction that was not included in the Bank Tax but would eventually be included in the Corporate Income Tax (which banks are not subject to) some two decades later. As discussed above, these assumptions do not withstand scrutiny, and they certainly cannot overcome the legal presumption that deductions must be expressly authorized by statute, that any claimed deduction is narrowly construed against the taxpayer, and that Appellant (and First Citizens) have the burden to

prove they are entitled to an NOL deduction. For the reasons set forth above, this Court should reject the arguments in First Citizens' *amicus* brief as irrelevant and unpersuasive for purposes of this appeal.

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APPEAL FROM THE ADMINISTRATIVE LAW COURT
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Case No. 2017-ALJ-17-0418-CC
Appellate Case No. 2020-000999

Synovus Bank.. Appellant,

v.

South Carolina Department of Revenue,.. Respondent.

PROOF OF SERVICE

I certify that I have served the South Carolina Department of Revenue's Response to First Citizens Bank & Trust Company's *Amicus* Brief via electronic mail at the electronic address provided in the Attorney Information System, on May 4, 2023, at the following address(es):

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Subject: Synovus Bank v. SCDOR, Appellate Case No. 2020-00099
Attachments: 2023.05.04 SCDOR's Response to First Citizen's Amicus Brief.pdf

Good afternoon,

Attached please find the South Carolina Department of Revenue's Response to First Citizens Bank & Trust Company's Amicus Brief, which I hereby serve upon you in the above-referenced matter. I am electronically filing the same with the Court of Appeals this afternoon.

If you have any questions please do not hesitate to give me a call.

Have a great afternoon!

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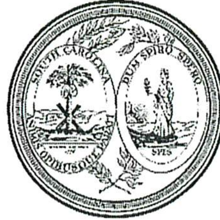

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Re: Synovus Bank v. South Carolina Department of Revenue
Appellate Case No.: 2020-000999

Dear Ms. Kitchings:

Attached for filing please find the South Carolina Department of Revenue's Response to First Citizens Bank & Trust Company's *Amicus* Brief in the above-referenced matter. In accordance with Rule 262(a)(3) of the South Carolina Appellate Court Rules and Supreme Court Order 2021-08-25-02 section (b), the attached filing is being made to the email address of the Court of Appeals. As also permitted by the Court, no other copies, whether paper or electronic, are being provided, although I am happy to do so at the Court's request.

By copy of this letter I am serving counsel for Appellant and counsel for the *amicus* via email as permitted by Supreme Court Order 2021-08-25-02 section (d)(1).

If you have any questions or need anything further from me please do not hesitate to contact me at 803-898-5785 or Jason.Luther@dor.sc.gov.

With my regards, I am

Sincerely,

Jason P. Luther, Esquire
Chief Legal Officer

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