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SC Court of Appeals

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

U.S. Bank National Association,

Petitioner,

v.

South Carolina Department of Revenue,

Respondent.

Docket No. 20-ALJ-17-0168-CC

**ORDER ON MOTION FOR
RECONSIDERATION**

This matter came before the South Carolina Administrative Law Court (the “Court” or the “ALC”) pursuant to the request of the Petitioner, U.S. Bank National Association (the “Petitioner” or “U.S. Bank”) for a contested case hearing. Petitioner contested a determination by the South Carolina Department of Revenue (the “Department” or “Respondent”) which assessed Petitioner for bank taxes, penalties, and interest for the periods ending December 31, 2011 through December 31, 2016.

The matter was tried before the Honorable Milton Kimpson on August 17 and 18, 2023. Judge Kimpson issued an amended final order in this matter on June 25, 2024. The procedural history in this case is described in detail in the June 25, 2024 Order and is incorporated herein by reference. Judge Kimpson left the Administrative Law Court on July 1, 2024. On July 5, 2024, U.S. Bank filed a motion to reconsider. This matter was reassigned to the undersigned on July 10, 2024. The Department filed its brief in opposition to the motion on July 22, 2024.

The Court is authorized to apply provisions of the South Carolina Rules of Civil Procedure when appropriate. SCALC Rule 68. The Rules of Civil Procedure provide in pertinent part that:

If at any time after a trial or hearing has been commenced, but before the final order or judgment has been issued, the judge is unable to proceed, a successor judge shall be assigned. The successor judge may proceed upon certifying familiarity with the record and determining that the proceedings may be completed without prejudice to the parties. In a hearing or a trial without a jury, the successor judge shall, at the request of a party, recall any witness whose testimony is material and disputed and who is available to testify without undue burden. A successor judge may also provide for the recall of any witnesses.



Rule 63, SCRCP.

The Court certifies that it has reviewed the record. Additionally, the Court conducted a hearing on the motion on July 30, 2024. Neither party requested that the Court recall any witness or raised any objection to the Court entertaining the pending motion. Accordingly, the Court proceeds to entertain Petitioner's motion.

SCALC Rule 29(D) permits a party to move for reconsideration of a final decision of an administrative law judge in a contested case for any of the grounds for relief set forth in Rule 59, SCRCP. Rule 59(e), SCRCP, in turn authorizes a motion to alter or amend. A Rule 59(e) motion not only serves as a vehicle to request the trial court "alter or amend the judgment," but also as a vehicle to seek "reconsideration" of issues and arguments. *Elam v. S.C. Dep't of Transp.*, 361 S.C. 9, 21–22, 602 S.E.2d 772, 778–79 (2004).

U.S. Bank makes the following arguments with respect to Judge Kimpson's order:

1. The Court misinterpreted the language of the South Carolina Code Sections 12-6-2295(A) and 12-6-30 as treating the income earned from U.S. Bank's mortgage services as income from intangibles used in South Carolina;
2. The Court misinterpreted Code Section 12-6-2295(A)(3) and failed to consider and/or overlooked substantial evidence in the record establishing the portion of U.S. Bank's receipts from mortgage loans "used" in South Carolina.
3. The Court misinterpreted the language of South Carolina Code Section 12-6-2295(A) as treating income earned from U.S. Bank's sale of South Carolina mortgages to government sponsored entities as income from intangibles used in a trade or business to South Carolina.
4. The Court misinterpreted the language of South Carolina Code Sections 12-6-2295(A) and 12-6-30 as treating the income earned from U.S. Bank's credit cardholders as income from intangibles used in South Carolina.
5. The Court misinterpreted Code Section 12-6-2295(A)(3) and failed to consider and/or overlooked substantial evidence in the record establishing the portion of U.S. Bank's receipts from credit cardholders "used" in South Carolina.
6. The Court failed to consider and/or overlooked substantial evidence in the record establishing U.S. Bank's income-producing activities for mortgage interest and credit card interest fees.

7. The Court failed to consider and/or overlooked substantial evidence in the record establishing U.S. Bank's income-producing activities for mortgage servicing.
8. The Court failed to consider and/or overlooked substantial evidence in the record establishing U.S. Bank's income-producing activities for interchange fees.
9. The Court failed to consider and/or overlooked substantial evidence in the record establishing U.S. Bank's income-producing activities for merchant fees.
10. The Court failed to consider and/or overlooked substantial evidence in the record establishing the portion of U.S. Bank's receipts that should be attributed to South Carolina.
11. The Court failed to consider and/or overlooked substantial evidence in the record establishing that the sale of the Visa stock was not allocable to South Carolina.
12. The Court failed to consider U.S. Bank's argument that penalties must be abated when there is substantial authority and/or the taxpayer acted in good faith.

The Court will address each of these arguments.

I. Income From Mortgage Services

Judge Kimpson did not agree with U.S. Bank's argument that its mortgage activities, including mortgage servicing, should be sourced pursuant to section 12-6-2295(A)(5). The court concluded that mortgages should be considered to be intangible property rather than services. Specifically, the court found that mortgages *could* be included within the scope of S.C. Code Section 12-6-2295(A)(3) and that the use of the mortgage continues during the life of the mortgage.

U.S. Bank argues that Judge Kimpson's conclusion that U.S. Bank's mortgage services are the use of intangible property is inconsistent with both S.C. Code Sections 12-6-30 and 12-6-2295(A)(3). U.S. Bank makes two primary points. First, it challenges Judge Kimpson's broader conclusion that mortgages are intangible assets rather than financial services. Second, it challenges the judge's conclusion that income from mortgage services should be considered income from the use of intangible assets. The Court will address both arguments.

A. Mortgages as Intangibles

In support of its argument that mortgages should be viewed as services¹ rather than intangible assets, U.S. Bank asserts that: (1) mortgages do not fit within the language of S.C. Code

¹ Pursuant to S.C. Code Section 12-2-2295(A)(5) receipts from services are sourced to South Carolina if the entire income-producing activity occurs within South Carolina. If only part of the income-producing activity occurs within South Carolina, receipts are sources to South Carolina only to the extent the income-producing activity occurs within this State. U.S. Bank would benefit from application of this code section because it argues that most or all of the

Section 12-6-2295(A)(3), which defines “intangible property;” and (2) ignores the testimony of witness Frederick Bolstad, who rendered his opinion that a mortgage is a “very specific financial service.”

Section 12-6-2295 is titled “Items included and excluded from terms ‘sales’ and ‘gross receipts’.” It contains a list of items included within the terms “sales” and “gross receipts” if they are not separately allocated. Item 3 on this list is “receipts from the use of intangible property in this State including, but not limited to, royalties from patents, copyrights, trademarks and trade names.” S.C. Code Ann. § 12-6-2295(A)(3) (Supp. 2023). Judge Kimpson concluded that because this section provides that intangibles are not limited to royalties from intellectual property, it was broad enough to include mortgages.

While the Court agrees with U.S. Bank to some extent that the examples of intangible assets listed in Section 12-6-2295(A)(3) may be generally indicative of the type of asset to which this section applies, U.S. Bank’s argument wholly ignores the other statutory sections cited by Judge Kimpson. Section 12-6-30 contains definitions of tangible and intangible property for purposes of Title 12, Chapter 6. It provides that tangible property includes real property and corporeal personal property but “*does not*” include money, bank deposits, shares of stock, bonds, credits, evidences of debt, choses in action, or evidences of an interest in property. S.C. Code Ann. § 12-6-30(11) (2014). It also provides that intangible property is “all property other than tangible property.” S.C. Code Ann. § 12-6-30(12). If a mortgage is a type of “property,” then under these definitions, it must be intangible property.

U.S. Bank also ignores Judge Kimpson’s citation to South Carolina Code Section 12-16-20(4). It defines “intangible personal property” to specifically include mortgages. S.C. Code Ann. § 12-16-20(4) (2014). While this definition is contained in another chapter of Title 12, it nevertheless provides a useful point of reference.

Two other factors also drive this Court’s conclusion. First, mortgages have long been viewed as a species of intangible property. *See, e.g., Berman v. Commissioner of Taxation*, 1972 WL 103 (Minn.Tax 1972); *Epstein v. State Tax Com’n*, 456 N.Y.S.2d 454, 456 (N.Y.Sup.Ct.App.Div. 1982). Second, U.S. Bank itself sells its mortgages to government

income-producing activity from its mortgage “services” occurs outside of South Carolina. As noted *infra*, the Court disagrees with this argument in part.

sponsored entities. This activity indicates that U.S. Bank treats mortgages it originates as a commodity rather than a service.

The Court sees no reason to alter or amend Judge Kimpson's conclusion that mortgages themselves constitute intangibles rather than services.

B. Income from Mortgage Servicing

U.S. Bank challenges Judge Kimpson's conclusion that mortgage services provided by U.S. Bank must be regarded as the use of intangibles. Judge Kimpson ruled that mortgages are used by borrowers to buy or improve residential real estate in South Carolina and that the use of the mortgage continues over the life of the mortgage loan as the borrower repays his debt to the U.S. Bank, including principal, interest, servicing fees and all other fees associated with the life of the mortgage. According to U.S. Bank, the fact that a mortgage is evidenced by a contract does not transform its provision of mortgage services into an intangible.

The Court concludes that receipts from said fees are sufficiently connected with the mortgage itself as to require that receipts from such fees should be sourced to South Carolina with respect to mortgaging service fees for mortgages originated in South Carolina which U.S. Bank did *not* sell to a third-party.²

However, U.S. Bank sells approximately 95% of the residential mortgages it originates in South Carolina to government sponsored entities such as Fannie Mae and Freddie Mac, who are located outside of South Carolina. In the view of the Court, the sale of the mortgage originated in South Carolina to a third-party weakens U.S. Bank's connection to the mortgage. U.S. Bank continues to service the mortgages it sells in this manner but does so pursuant to the contract of sale between U.S. Bank and the mortgage purchaser or a separate contract for services between U.S. Bank and the mortgage purchaser rather than as a term of its original mortgage agreement with the borrower. (Tr: 36: 13 – 41: 11). Mortgage servicing fees earned after a mortgage is sold are therefore a product of a service provided by U.S. Bank to the purchaser of the mortgage.

For apportionment of receipts from a service, section 12-6-2295(A) specifically requires that receipts from services be sourced to South Carolina if the entire income-producing activity is performed in South Carolina, but if some or all of the income-producing activity is performed outside of South Carolina, only the portion attributable to South Carolina may be sourced to South

² It is not clear that U.S Bank receives mortgage service fees for mortgages it originates in South Carolina and retains rather than sells to a third-party.

Carolina. Analyzing the apportionment of mortgage service fees therefore collapses down to two general steps: (1) identify the income producing activities; and (2) determine where those activities took place.

(1) Identifying the Income Producing Activities

Unfortunately, South Carolina law does not define income producing activities.³ The best evidence of what activities must be performed in order to generate income from mortgage services fees provided to GSEs who have purchased a South Carolina mortgage from U.S. Bank would be the contract entered into between U.S. Bank and the GSE. The contract itself would presumably identify what performance U.S. Bank was required to render to earn a fee from the GSE. However, no such contracts were submitted to the Court.

In the absence of the governing contracts, the Court must turn to the testimony presented at the hearing. U.S. Bank’s witness, Mr. Bolstad, identified a number of activities which U.S. Bank asserted were income producing activities. These activities were: (1) working with the borrower to facilitate getting the monthly payment; (2) answering questions should the borrower have a problem; (3) working with the borrower to ensure that the proper amount is held in escrow; (4) paying taxes and mortgage insurance if applicable; (5) collection activities; and (6) foreclosure activities. (Tr. at 38:24 to 41:2).

(2) Determining the Location of Income Producing Activities

U.S. Bank argues that its mortgage servicing activities take place outside of South Carolina for a number of reasons. First, the right to receive a fee for services stems from either the contract of sale or a separate contract for mortgage servicing entered into between U.S. Bank and the GSE, neither of whom are located in South Carolina. This argument is similar to an origin-of-payment argument, one which South Carolina has not adopted.

Second, U.S. Bank argues that its servicing activities occurred outside of South Carolina because the personnel performing the mortgage servicing were located in Owensboro, Kentucky

³ The Multi-state Tax Commission’s definition of income producing activity was developed for section 17 of UDIPTA and provides that: The term “income producing activity” applies to each separate item of income and means the transactions and activity engaged in by the taxpayer in the regular course of its trade or business for the ultimate purpose of producing that item of income. Such activity includes transactions and activities performed on behalf of a taxpayer, such as those conducted on its behalf by an independent contractor. The parties have not, however, argued for use of this definition, and the Court concludes that it is inapplicable because South Carolina is not a UDIPTA/costs of performance state.

during the relevant time period. The Court views this argument as overly simplistic. While each of the income producing activities identified above was performed by an employee located in Kentucky, each of the employees' activities also involved actions taken in South Carolina. Working with the borrower to facilitate getting the monthly payments involves sending the monthly statement, either electronically or by mail, to the borrower, who receives the statement in South Carolina. Answering questions from borrowers involves communication directed to the borrower in South Carolina. Adjusting escrow accounts similarly involving sending either electronic or paper communications to borrowers which are received in South Carolina. Payment of real estate taxes involves sending money to county treasurers in South Carolina. Collection activities involve communications directed to borrowers in South Carolina. Foreclosure activities involve the filing of legal proceedings in South Carolina.⁴

The Court is cognizant that the Department's policy for capturing receipts apportionable to South Carolina need only be a reasonable approximation of U.S. Bank's business activities in South Carolina. *DIRECTV, Inc. & Subsidiaries v. S.C. Dep't of Revenue*, 421 S.C. 59, 77, 804 S.E.2d 633, 642 (Ct. App. 2017) (citing *Duke Energy Corp.*, 415 S.C. at 356, 782 S.E.2d at 592 (“[T]he statutory policy [for the apportionment statutes] is designed to apportion to South Carolina a fraction of the taxpayer's total income *reasonably attributable* to its business activity in this State.”)). Because each of the income activities identified by U.S. Bank has a nexus with South Carolina, and precision is not required of the Department, the Court concludes that U.S. Bank has not met its burden of establishing that Department's apportionment of receipts from mortgage services was incorrect.

The Court therefore sees no reason to alter or amend Judge Kimpson's prior order on this issue.

II. Receipts from mortgage loans “used” in South Carolina

U.S. Bank next argues that even if receipts from mortgage loans were properly classified as income from the use of intangibles, Judge Kimpson erred in concluding that income from use of such intangibles must be sourced to South Carolina. According to U.S. Bank, the court failed to analyze whether receipts from mortgages are “from the use” of intangibles in South Carolina.

⁴ The Court can envision income-producing activities related to mortgage servicing which might occur wholly outside of South Carolina, such as intake of files assigned by GSEs, providing reports to GSEs, and closing of files when a mortgage is satisfied. However, there is no evidence of such activities in this case.

U.S. Bank further asserts that the Court's conclusion that Section 12-6-2295(A)(3) requires a taxpayer to source income from intangible property to the location of the borrower is without legal support.

The Court disagrees with this argument. Judge Kimpson did not fail to conduct an analysis. Judge Kimpson explained that a mortgage is "used" at the location of the real property which it secures, and that the location of the borrower may be properly used as a proxy for the source of the receipts. (Order at p 15-16). The court further explained that its conclusion was premised, at least in part, on the Department's longstanding construction of Section 12-2-2295(A)(3). The court gave deference to this construction as it was a construction of longstanding. *See Etiwan Fertilizer Co. v. S.C. Tax Comm'n*, 217 S.C. 354, 360, 60 S.E.2d 682, 684 (1950). While this Court agrees that language requiring sourcing as described in Judge Kimpson's order is not expressly stated in Section 12-6-2295(A)(3), the Department's longstanding construction of the statute, and the General Assembly's apparent acquiescence to said construction, fills in the gap. U.S. Bank does neither directly address the impact of the Department's construction of the statute nor argues that this construction is in any way arbitrary or capricious.

The Court declines to alter or amend this aspect of Judge Kimpson's order.

III. Income from the sale of South Carolina mortgages

U.S. Bank argues Judge Kimpson erred by sourcing receipts from U.S Bank's sale of mortgages to government sponsored entities to the location of the underlying borrower. U.S. Bank relies on South Carolina Code Section 12-6-2295(A)(1), which it contends requires sourcing of receipts from the sale of "property," tangible or intangible, which is maintained for sale of in the ordinary course of the taxpayer's trade or business to the location of the customer purchasing the property rather than the location of the underlying borrower. U.S. Bank contends that the testimony of Mr. Bolstad (Tr. 37:7-13) establishes that U.S. Bank's sale of mortgages was done in the ordinary course of business.

Judge Kimpson concluded that Section 12-6-2295(A)(1) was not applicable because another subsection dealt more specifically with intangible property. The subsection includes the following within the definition of sales and gross receipts:

(4) net gain from the sale of property used in the trade or business. For purposes of this subsection, property used in the trade or business means property subject to the allowance for depreciation, real property used in the trade or business, and *intangible property used in the trade or business* which is:

(a) not property of a kind that properly would be includible in inventory of the business if on hand at the close of the taxable year; or

(b) held by the business primarily for sale to customers in the ordinary course of the trade or business.

S.C. Code Ann. § 12-6-2295(A)(4) (emphasis added).

The Court has already concluded that Judge Kimpson was correct in ruling that mortgages are a form of intangible property. To qualify under subsection A(4) then, the mortgages must either: (1) not be property of a kind ordinarily includible in business inventory; or (2) be held by the business primarily for sale to customers in the ordinary course of the trade or business. Black's Law Dictionary defines "inventory" as "[r]aw materials or goods in stock <the dealership held a sale to clear out its October inventory" INVENTORY, Black's Law Dictionary (12th ed. 2024). Intangible mortgages do not fit within this definition. As a result, the first of the two conditions is satisfied. The Court therefore agrees with Judge Kimpson that Section 12-6-2295(A)(4) is the applicable section.

For purposes of clarification, subsection (A)(4) only sources the "net gain" from the sale of South Carolina mortgages to South Carolina. The use of the term "net gain" in this subsection is in contraindication to all other subsections of Section 12-6-2295(A), which require sourcing of "receipts."

IV. Income earned from credit card holders as intangible property

U.S. Bank argues that Judge Kimpson erred in treating income from credit card holders in South Carolina as an intangible rather than as a service. It asserts that all of its credit card activities, including issuing, underwriting, authentication and billing and collection activities take place outside of South Carolina. It notes that two of its witnesses classified credit cards as a service.

The term "service" is not defined in applicable statutes. Where a word is not defined in a statute, appellate courts have looked to the usual dictionary meaning to supply its meaning. *Lee v. Thermal Eng'g Corp.*, 352 S.C. 81, 91–92, 572 S.E.2d 298, 303 (Ct. App. 2002). Black's Law Dictionary defines a "service" as:

Labor performed in the interest or under the direction of others; specif., the performance of some useful act or series of acts for the benefit of another, usu. for a fee <goods and services>. • In this sense, *service* denotes an intangible commodity in the form of human effort, such as labor, skill, or advice.

SERVICE, Black's Law Dictionary (12th ed. 2024) (emphasis in original). Webster's Dictionary contains a number of definitions for service as a noun. The most applicable of which is "useful labor that does not produce a tangible commodity—usually used in plural, charge for professional *services*." Merriam-Webster Online Dictionary (service); *see also TK Power, Inc. v. Textron, Inc.*, 433 F. Supp. 2d 1058, 1062 (N.D. Cal. 2006) (a contract for services involves the purchase of labor and the "knowledge, skill, and ability" of the contracting party). The provision of a mere open line of credit, *i.e.*, a loan to South Carolina residents does not, in the Court's view, fit within the common and ordinary meaning of the word service. *See Boubelik v. Liberty State Bank*, 553 N.W.2d 393, 403 (Minn. 1996) (bank loans do not fall within the meaning of "services" under consumer statute); *cf. Hitz v First Interstate Bank*, 44 Cal.Rptr.2d 890, 897 (Cal.App.1st.Dist. 1995).⁵ As a result, the Court agrees with Judge Kimpson's classification of income from interest, late fees, and annual fees as intangibles.⁶

⁵ The Court disagrees with the conclusion reached in *Hitz* that late and overlimit fees are generated by services. In the Court's view, these income streams are more closely related to the provision of credit than any additional service offered by U.S. Bank. Nevertheless, *Hitz* provides a useful discussion of the dual aspect of credit cards which includes both the provision of credit *and* the provision of certain services.

⁶ Credit card agreements may include the provision of services in addition to the extension of credit. The court in *Hitz* explained the dual nature of a credit card, stating that a credit card encompasses:

convenience services in addition to extension of credit.

A textbook on commercial banking explains these two discrete functions: "The popularity of credit cards is due to the many advantages they offer as a means of payment. These advantages have created two general distinct patterns of credit card use among cardholders—convenience and revolving credit. Many cardholders pay their outstanding balances in full each month; consequently, they incur no monthly finance charge. In fact, nearly half of the cardholders can be classified as convenience users. The remaining cardholders use credit cards as a source of credit and infrequently pay their entire outstanding monthly balance. Both of these uses have distinct advantages over cash, checks, and other means of payment. *Convenience use minimizes the need to carry cash, allows the user to defer payment for goods and services for a short time, and establishes a favorable payment record that is important in credit evaluations. Revolving credit users realize the same advantages plus one other, namely, they increase their ability to purchase goods and services and in so doing avoid the red tape involved in obtaining a personal loan. Moreover, the credit card holder has considerable flexibility in the timing and amount of debt repayment.*" . . .

The convenience feature of credit cards is surely a "service" within the meaning of Civil Code section 1671, subdivision (c), wholly apart from the credit feature. Observers of the banking industry view the convenience feature as such; the publications quoted above both include references to "credit card services." A credit card user enjoys various benefits *other than borrowing*—primarily cashless and checkless purchasing—regardless of whether the credit feature is used. Indeed, convenience use without borrowing is the "reason that some banks levy a flat charge on the use of the card." Thus, some users even *pay* for these two features separately: their annual charge for the card is attributable to the convenience feature, while they pay for use of the credit feature through finance charges.

V. Apportionment of receipts from credit card intangibles used in South Carolina

U.S. Bank argues that even if receipts from credit cards are viewed as intangibles, Judge Kimpson failed to analyze whether U.S. Bank's receipts from credit cards are generated from the "use" of those credit cards in South Carolina, as required by S.C. Code Section 12-6-2295(A)(3). U.S. Bank asserts that Judge Kimpson's statement that because "South Carolina cardholders use their credit cards to buy goods and services and then repay U.S. Bank the balances owed," the receipt are from the "use" of intangible property in the South Carolina is without analytical support. It further argues that Judge Kimpson's conclusion is inconsistent with S.C. Code Section 12-6-2295(A)(3) because this section makes no mention of the location of the borrower. Finally, it contends that there is extensive evidence in the record regarding use of credit cards by U.S. Banks outside of South Carolina; namely, processing and approval of credit card transactions.

After review of Judge Kimpson's order, the Court perceives no error of fact or law which requires amendment of the order. The Court disagrees with U.S. Bank's position that Judge Kimpson's statement regarding use of credit cards in South Carolina is unsupported by an analysis. The statement itself is the analysis.⁷

U.S. Bank is correct that Section 12-6-2295(A)(3) does not specifically mention using the location of the borrower as a proxy. Use of the location of the borrower, or more particularly, the billing address of the card holder, as a proxy for the location of the use of the credit card – at least with respect to receipts such as interest, late fees, and annual fees appears common in other jurisdictions. *E.g.*, Colorado Private Letter Ruling, 2009 WL 6916903, at *3; Conn. Gen. Stat. § 12-218(j) (credit card fees apportioned based on billing address of cardholder); Ind. Code § 6-5.5-4-8 (apportioned to billing address of cardholder). These rules were established based upon the language of state statutes which have no apparent South Carolina counterpart which limits their import to some degree in connection with the determination of South Carolina law before the Court.

Accordingly, to the extent that U.S. Bank generated receipts from services provided to South Carolina credit card holders over and above the extension of credit produce income, receipts from these services could potentially be sourced differently pursuant to South Carolina Code Section 22-6-2295(A)(5). Such services could for example include travel planning and ticket brokering. However, no evidence of receipts from such services was presented in this case.

⁷ Judge Kimpson's Order reads, p. 24: "As South Carolina cardholders use their credit cards to buy goods and services and then repay U.S. Bank the balances owed on their credit card accounts, or even to pay annual fees to maintain access to those accounts, the borrowers are creating "receipts from the use of intangible property in this State" within the meaning of subsection 12-6-2295(A)(3)."

But even if these authorities are not directly applicable, the Court nevertheless agrees with Judge Kimpson's use of the borrower's address as a proxy for the location of the use of the credit card as it pertains to receipts for interest and late fees, and annual fees is appropriate. It is self-evident that a credit card is "used" at the location where a credit card transaction occurs. For an individual residing in South Carolina, it is reasonable to expect that the vast majority of "uses" of the credit card will occur in South Carolina.

Finally, the Court rejects the argument that contends there is extensive evidence in the record regarding use of credit cards by U.S. Bank outside of South Carolina; namely, processing and approval of credit card transactions. U.S. Bank does not "use" credit cards it issues to cardholders. The activities undertaken by U.S. Bank to facilitate the use of a credit card by a cardholder are not "uses" of the card in the same manner as are attempts by a cardholder to purchase an item or obtain a cash advance with a credit card.

VI. Income-producing activities for mortgage interest and credit card interest.

U.S. Bank argues that Judge Kimpson failed to consider and/or overlooked substantial evidence in the record establishing U.S. Bank's income-producing activities for mortgage interest and credit card interest fees. It points to testimony from its witnesses which establishes that a number of activities associated with credit cards occur outside of South Carolina and contends that these activities are income-producing activities for purposes of apportionment of receipts. The Court has reviewed the record and Judge Kimpson's order, and, to some extent, discussed this issue above. The Court sees no error of law or factual mistake which would warrant altering or amending Judge Kimpson's order on this issue.

VII. Income-producing activities for mortgage servicing

U.S. Bank argue that Judge Kimpson failed to consider and/or overlooked substantial evidence in the record establishing U.S. Bank's income-producing activities for mortgage servicing. This issue has been addressed by the Court above.

VIII. Income-producing activities for interchange fees

Judge Kimpson concluded that income-producing activity for an interchange fee occurs at the location of the merchant at which a credit card is used, stating that interchange fees were generated from an income-producing activity in South Carolina to the extent that U.S. Bank's merchants are located in South Carolina. U.S. Bank argues that Judge Kimpson failed to consider

and/or overlooked substantial evidence in the record establishing U.S. Bank's income-producing activities for interchange fees occurred outside of the State of South Carolina.

In the Court's view, this issue reduces primarily to a single question: What are the activities which actually produce interchange fee income? Once the income-producing activities have been properly identified, the evidence easily admits of the location of the activity. U.S. Bank argues that income-producing activities with respect to interchange fees include both approval and processing of credit card transactions initiated at a South Carolina merchant, and that these activities occur outside of South Carolina. The Department argues that, for the purposes of interchange fees, the income-producing activity is the swipe of a credit card by a credit cardholder in South Carolina.

To the extent U.S. Bank's activities with respect to interchange fees can be viewed as merely preparatory activities, *DIRECT TV* directs that these activities should not be viewed as income-producing activities. The Court therefore does not view activities such as contracting with merchants or credit card networks or obtaining or allocating funding as income-producing activities.

The question of whether activities such as credit approval and transmission of an approval to a point of sale should be considered income-producing activities is closer. These activities occur *after* a credit card has been swiped. The Court chooses to draw the line between non-income-producing activities and income-producing activities based upon whether or not an activity can be performed without generating income. If it can, it is not an income generating activity. If it cannot, then the activity is an income-generating activity.

Here, the Court, on balance, does not consider the approval activities relied upon by U.S. Bank to be income-producing activities. U.S. Bank has not submitted any authority for the proposition that such activities should be considered income-producing activities and the Court's own research has revealed none. Additionally, the activities which are the focus of U.S. Bank's argument can be performed without generating income. For example, if a credit cardholder initiates a transaction at a point of sale, and it is approved, but the cardholder refuses to sign the credit card receipt agreeing to repay the advance, no income is generated.⁸

The Court has reviewed the record and sees no error of law or factual mistake which would warrant altering or amending Judge Kimpson's order on this issue.

⁸ Additionally and alternatively, these activities may be viewed as occurring in South Carolina. For example, the approval message for a transaction initiated in South Carolina is transmitted to and received in South Carolina.

IX. Income-producing activities for merchant fees

U.S. Bank challenges Judge Kimpson’s finding that merchant fees were earned from services from income-producing activity to the “extent U.S. Bank’s merchants are located in South Carolina.” Specifically, it argues that Judge Kimpson failed to consider and/or overlooked substantial evidence in the record establishing that U.S. Bank earned merchant fees from sending transaction approval messages and settling those transactions with merchants. The Court’s analysis with respect to interchange fees above applies with equal force here. The Court sees no error warranting an amendment of Judge Kimpson’s order on this issue.

X. Receipts attributable to South Carolina

U.S. Bank argues Judge Kimpson overlooked or failed to consider evidence establishing the portion of U.S. Bank’s receipts which should be attributed to South Carolina. It relies upon South Carolina Code Section 12-6-2295(A)(5) which provides for apportionment to South Carolina only to the extent that the income-producing activity occurred in South Carolina.

It also contends that Judge Kimpson erred in applying *DIRECTV v. S.C. Dept. of Rev.*, 421 S.C. 59, 75, 804 S.E.2d 633, 641(Ct.App. 2017) to determine that income-producing activity with respect to services provided by U.S. Bank occurred in South Carolina. U.S. Bank contends that there is more than a single income-producing activity and that two-thirds of the income-producing activity, including the actual lending of money, took place outside of South Carolina. U.S. Bank also argues that, with respect to merchant and interchange fees, Judge Kimpson’s factual findings support its expert’s testimony that the income-producing activities associated with these fees occur outside of South Carolina.

These arguments are in large part addressed above. The Court has reviewed the evidence and the submissions of the parties and sees no reason to alter or amend Judge Kimpson’s ruling.

XI. Visa Stock

Gains from the sale of stock, an intangible, are excluded from apportioned income when the stock is not connected with the business of the taxpayer and not held for sale to customers in the normal course of business. S.C. Code Ann. § 12-6-2220(5) (2014). Gains from the sale of an intangible are included in receipts which may be apportioned to South Carolina when the property sold is used in the taxpayer’s trade or business. S.C. Code Ann. § 12-6-2295(A)(4). Accordingly, whether gains from the sale of Visa stock are included in receipts which may be apportioned to South Carolina turns on the connection between the Visa stock and U.S. Bank’s trade or business.

The test of allocation or apportionment of gains on stock sales is not whether the sale of the stock is connected to the business. Instead, the test is whether the stock is connected to the business. *M. Lowenstein Corp. v. S.C. Tax Comm'n*, 298 S.C. 93, 100, 378 S.E.2d 272, 276 (Ct. App. 1989). “[T]he answer to the question of whether income is allocated or apportioned depends, not upon whether the income in dispute is connected with the business of the taxpayer, but rather upon whether the property producing the income is connected with the business.” *Id.* at 101 and 276 (“The director of taxes for Lowenstein testified that the bonds were issued ‘because the company needed the funds to put into their operations.’ Lowenstein offered no other reason for the bond issue. Thus, the bonds in question were connected with Lowenstein's business.”). In *Lowenstein*, our court of appeals determined that bonds issued by a corporation were connected with the corporation’s business because the corporation issued the bonds to “put funds into their operations.” *Id.* at 100 - 101. 378 S.E.2d at 276.

Here, the Department argues that the Visa stock is connected with U.S. Bank’s business for two reasons: (1) U.S. Bank issues Visa credit cards and does business with Visa; and (2) the Form 10-K annual report filed by U.S. Bank’s parent corporation, U.S. Bancorp., contains the following statement:

The Company also has derivative contracts that are created through its operations, including commitments to originate MLHFS and swap agreements related to the sale of a portion of its Class B common shares of Visa Inc.

(U.S.S.E.C. Form 10-K 2014).⁹ U.S. Bank challenges these rationales and bore the burden of establishing that the Department’s reasoning was incorrect. *DIRECTV, Inc. & Subsidiaries v. S.C. Dep't of Revenue*, 421 S.C. 59, 80, 804 S.E.2d 633, 644 (Ct. App. 2017).

Judge Kimpson concluded that U.S. bank had successfully rebutted any connection between the Visa stock and U.S. Bank’s trade or business based upon the fact that U.S. Bank does business with Visa. U.S. Bank submitted evidence that it receives no favorable treatment from Visa because it holds the Class B stock. However, Judge Kimpson did not believe that U.S. Bank had disproved the Department’s assertion regarding the derivative swaps related to the sale of a

⁹ In its opposition to U.S. Bank’s motion, the Department argues that this statement discussing the creation of derivative contracts indicates that the Visa stock helped fund U.S. Bank’s operations in the same way that the corporate bonds at issue in *Lowenstein* helped fund the corporation. This argument does not appear to have been previously made and relies on assumptions about the purpose of the derivative contracts and the use to which they have been put for which there is no support in the record.

portion of the Visa stock. As a result, Judge Kimpson ruled that the gain from the sale of the Visa stock should be apportionable.

U.S. Bank now argues that Judge Kimpson overlooked evidence in the record relating to the Visa stock. In particular, U.S. Bank asserts that Judge Kimpson failed to consider: (1) Mr. Owen's testimony that U.S. Bank receives no preferential treatment from Visa; (2) Mr. Wylie's testimony regarding the brands of credit cards offered by U.S. bank; and (3) evidence relating to how U.S. Bank became the owner of the Visa stock. U.S. Bank also criticizes the testimony of Mr. Sharpe, who testified as an expert on behalf of the Department, because, according to U.S. Bank, Mr. Sharpe misunderstood basic facts related to U.S. Bank's ownership of the stock. It cites to a portion of the trial transcript in which Mr. Sharpe admits that his statement that Visa issued the stock to U.S. Bank was incorrect and that Visa actually issued the stock to U.S. Bank's parent corporation, U.S. Bancorp. (Tr. At 162:23-165:3). At the hearing on the motion to reconsider, U.S. Bank also relied heavily on the Form 10-K, which it believed rebutted the Department's argument.

After a careful review of the transcript and a detailed examination of the Form 10-K, the Court concludes that the greater weight of the evidence indicates that the Visa stock was not connected to the trade or business of U.S. Bank. The evidence is clear that Visa did not issue the stock to U.S. bank, but rather to U.S. Bank's parent company, U.S. Bancorp. The evidence is also clear that that U.S. Bank did not purchase the stock from its parent. The stock was instead transferred to U.S. Bank by U.S. Bancorp because U.S. Bancorp, as a holding company, was not legally permitted to own the stock. Additionally, ownership of the stock by U.S. Bank did not entitle U.S. Bank to preferential treatment from Visa.

The Department's only remaining position with respect to the Visa stock is based upon the statement contained in the Form 10-K quoted above, and a single question posed by the Department to its expert at trial, who confirmed that the Form 10-K indicates that derivative swap agreements associated with the Visa stock were created. The statement relied upon by the Department is equivocal at best. For convenience, the Court quotes the sentence again below:

The Company also has derivative contracts that are created through its operations, including commitments to originate MLHFS and swap agreements related to the sale of a portion of its Class B common shares of Visa Inc.

(U.S.S.E.C. Form 10-K). Notably, the statement indicates that the “Company” created swap agreements through its operations. The term “Company” is a defined term in the Form 10-K. At times, it refers solely to U.S. Bancorp., the author of the Form 10-K. At other times, it refers to “U.S. Bancorp. and its subsidiaries.” It is impossible to know from the context surrounding this statement whether the term “Company” in the quoted sentence refers to U.S. Bancorp., U.S. Bank, or some other subsidiary of U.S. Bancorp.¹⁰

Additionally, the swaps were also related to the “sale” of a portion of the shares of Visa stock rather than the Visa stock itself. This fact is significant. The purpose of the swaps was to minimize risk associated with the sale of the stock, rather than to minimize risk associated with U.S. Bank’s general business operations. This fact also negates the possibility that U.S. Bank uses the stock as collateral of some kind to finance its general business operations.

Finally, the Form 10-K contains additional information related to the Visa stock. Immediately below the quoted sentence, the 10-K directs readers to refer to Note 23 for information on the Visa restructuring and related card association litigation. Note 23 in turn states that:

Visa Restructuring and Card Association Litigation The Company’s payment services business issues and acquires credit and debit card transactions through the Visa U.S.A. Inc. card association or its affiliates (collectively “Visa”). In 2007, Visa completed a restructuring and issued shares of Visa Inc. common stock to its financial institution members in contemplation of its initial public offering (“IPO”) completed in the first quarter of 2008 (the “Visa Reorganization”). As a part of the Visa Reorganization, the Company received its proportionate number of shares of Visa Inc. common stock, which were subsequently converted to Class B shares of Visa Inc. (“Class B shares”). Visa U.S.A. Inc. (“Visa U.S.A.”) and MasterCard International (collectively, the “Card Associations”) are defendants in antitrust lawsuits challenging the practices of the Card Associations (the “Visa Litigation”). Visa U.S.A. member banks have a contingent obligation to indemnify Visa Inc. under the Visa U.S.A. bylaws (which were modified at the time of the restructuring in October 2007) for potential losses arising from the Visa Litigation. The indemnification by the Visa U.S.A. member banks has no specific maximum amount. Using proceeds from its IPO and through reductions to the conversion ratio

¹⁰ The Court realizes that it is unlikely that the reference to the Company is a reference to a subsidiary of U.S. Bancorp other than U.S. Bank. However, it is equally possible that the term refers to U.S. Bancorp as it does to U.S. Bank. As discussed *infra*, U.S. Bancorp had a reason to mitigate the price risk associated with the conversion of the Visa stock to Class A shares and its subsequent sale.

applicable to the Class B shares held by Visa U.S.A. member banks, Visa Inc. has funded an escrow account for the benefit of member financial institutions to fund their indemnification obligations associated with the Visa Litigation. The receivable related to the escrow account is classified in other liabilities as a direct offset to the related Visa Litigation contingent liability. On October 19, 2012, Visa signed a settlement agreement to resolve class action claims associated with the multi-district interchange litigation, the largest of the remaining Visa Litigation matters. The settlement has been approved by the court, but has been challenged by some class members and is being appealed. In addition, a number of class members opted out of the settlement and have filed actions against the Card Associations. At December 31, 2014, the carrying amount of the Company's liability related to the Visa Litigation matters, net of its share of the escrow fundings, was \$19 million. During 2014, the Company sold 3.8 million of its Class B shares. These sales do not impact the Company's liability for the Visa Litigation matters or the receivable related to the escrow account. The remaining 8.9 million Class B shares held by the Company will be eligible for conversion to Class A shares of Visa Inc., and thereby become marketable, upon final settlement of the Visa Litigation. These shares are excluded from the Company's financial instruments disclosures included in Note 22.¹¹

(Form 10-K).

This information clarifies matters surrounding the Visa stock. It appears that Visa issued stock to U.S. Bancorp., the current iteration of one of Visa's founding members as part of Visa's corporate reorganization. The stock could not immediately be sold due to complications arising from the class action litigation pending against Visa. U.S. Bancorp then transferred the stock to U.S. Bank. In 2014, 3.8 million shares were sold. Derivative swaps were created to minimize risk associated with this sale. Both U.S. Bancorp and U.S. Bank would benefit from such swaps because the swaps would reduce the risk that the asset would lose value due to fluctuations in the stock market before the shares could be converted to Class A stock and sold. As of 2014, U.S.

¹¹ This section of the Form 10-K illustrates the potential confusion regarding the identity of the "Company" as referred to in the document. In one instance, the 10-K report states that "[a]s a part of the Visa Reorganization, the Company received its proportionate number of shares of Visa Inc. common stock." Based upon the evidence before the Court, it is undisputed that this reference to the Company is a reference to U.S. Bancorp. At another point in the same Note, the 10-K provides that "[d]uring 2014, the Company sold 3.8 million of its Class B shares." This reference to the Company can only be understood as a reference to U.S. Bank, as it was the entity which held the stock, and the only entity which could therefore sell the stock.

Bank still held another 8.9 million shares, because complications from the litigation prevented the sale of those shares at that time.

While the issue is a close one, the Court concludes that a preponderance of the evidence indicates that U.S. Bank's possession of the Visa stock was a unique circumstance caused by the affairs of its parent company and for the benefit of its parent. Accordingly, the Court concludes that the Visa stock is not connected to the trade or business of U.S. Bank and cannot be apportioned.

The Court hereby alters and amends Judge Kimpson's order in this respect.

XII. Penalties

Judge Kimpson abated underpayment fees for receipts from interchange and merchant fees and for the sale of the Visa stock. U.S. Bank argues that Judge Kimpson overlooked or failed to consider evidence which would have supported abatement of fees for other revenue streams. The Department contends that U.S. Bank is a sophisticated party and that its own expert testified that some portion of the receipts in question should have been sourced to South Carolina. The Court agrees and sees no reason to alter or amend this aspect of Judge Kimpson's order.

ORDER

IT IS THEREFORE ORDERED that U.S. Bank's motion to alter or amend is GRANTED IN PART. Specifically, receipts from the sale of the Visa stock should not be apportioned to South Carolina. U.S. Bank's Motion is DENIED in all other respects.

IT IS FURTHER ORDERED that the Department's assessment is modified to conform to the following:¹²

Tax: \$2,827,928.00

Interest: \$1,559,725.86¹³

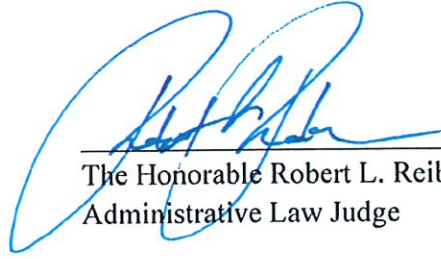
Penalty: \$582,864.29

Total: \$4,970,518.15

¹² Following the hearing, the parties jointly calculated the amount of the applicable tax, interest and penalties when the Visa Stock is not apportioned and supplied these figures to the Court. The Court has incorporated the parties' calculations into this Order. The Court notes that the parties' cooperation in agreeing to and providing these figures to the Court should not be viewed as a waiver of any right or issue a party may wish to assert or challenge in a subsequent appeal, should there be one.

¹³ Interest is calculated through September 16, 2024 per the parties' agreement.

AND IT IS SO ORDERED.



The Honorable Robert L. Reibold
Administrative Law Judge

August 19, 2024
Columbia, South Carolina

CERTIFICATE OF SERVICE

I, Van Whitehead, hereby certify that I have on this date served this order upon all parties to this cause by depositing a copy hereof in the United States mail, postage paid, or by electronic mail, to the address provided by the party(ies) and/or their attorney(s).



Van Whitehead
Judicial Law Clerk

August 19, 2024
Columbia, South Carolina