

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

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SC Court of Appeals

APPEAL FROM THE SOUTH CAROLINA ADMINISTRATIVE LAW COURT
Honorable Ralph King Anderson, III, Chief Judge

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

Synovus Bank,

Appellant,

v.

South Carolina Department of Revenue,

Respondent.

RECORD ON APPEAL
VOLUME I

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**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Synovus Bank,	)	Docket No. 17-ALJ-17-0418-CC
	)	
Petitioner,	)	
	)	
vs.	)	ORDER DENYING MOTION FOR RECONSIDERATION
	)	
South Carolina Department of Revenue,	)	
	)	
Respondent.	)	
_____	)	

This case is before the South Carolina Administrative Law Court (Court or ALC) pursuant to a Request for Contested Case filed by Synovus Bank (Petitioner) on November 16, 2017. Petitioner contests the decision of the South Carolina Department of Revenue (Respondent or Department) in which the Department determined Petitioner could not deduct net operating loss (NOL) carryforwards when computing its bank tax liability for tax years 2011 through 2014. The Court issued a Final Order in this matter on April 17, 2020. Following that decision, Petitioner timely filed a Motion for Reconsideration (Motion) on May 12, 2020. Thereafter, the Court withdrew its Final Order to address Petitioner’s Motion.

I generally find that the arguments made in Petitioner’s Motion are without merit or are a reiteration of the arguments made in the hearing into this matter. See CHARLES ALAN WRIGHT & ARTHUR R. MILLER, *FEDERAL PRACTICE AND PROCEDURE* § 2810.1 (2d ed. 1995) (observing that Rule 59(e) motions may be appropriate to preserve an issue raised in a contested case for appellate review or to ask the court to decide an issue which has been raised but not ruled upon, but they “may not be used to relitigate old matters”). Nevertheless, I have amended the Final Order to address points raised by the Department. Furthermore, I briefly address the following issue:

In its response to Petitioner’s Motion for Reconsideration, the Department seems to suggest that there are two means by which agency deference can be invoked. The first is when the agency charged with administering a statute interprets a statute that is a silent or ambiguous. This facet of the agency deference was recently discussed in *Kiawah Development Partners, II v. South Carolina Department of Health & Environmental Control*, 411 S.C. 16, 32–33, 766 S.E.2d 707, 717 (2014) (*Kiawah*). In *Kiawah*, the South Carolina Supreme Court held that if a statute or regulation “is silent or ambiguous with respect to the specific issue,” then the court must give

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deference to the agency's interpretation of the statute or regulation, assuming the interpretation is worthy of deference.¹ The second is when the agency has taken a uniform position for many years such that it can be characterized as a long-standing interpretation of a statute or regulation. For example, in *Charleston County Assessor v. University Ventures, LLC*, the South Carolina Supreme Court noted “[w]e have previously ‘held in many cases that where the construction of the statute has been uniform for many years in administrative practice, and has been acquiesced in by the General Assembly for a long period of time, such construction is entitled to weight, and should not be overruled without cogent reasons.’” 427 S.C. 273, 289, 831 S.E.2d 412, 420 (2019) (quoting *Etiwan Fertilizer Co. v. S.C. Tax Comm’n*, 217 S.C. 354, 359, 60 S.E.2d 682, 684 (1950)); see also *Media Gen. Commc’ns, Inc. v. S.C. Dep’t of Revenue*, 388 S.C. 138, 140, 694 S.E.2d 525, 526 (2010).

However, these holdings must not be treated as separate principles but as part of an overall determination of when it is appropriate to apply the agency deference doctrine. The danger of culling out the “long-standing interpretation” piece of the construction of an ambiguous statute/regulation is illustrated by both extremes of its application. On one hand, ignoring the requirement of a long-standing administrative interpretation would allow an agency to construe its statutes or regulations on a case-by-case basis and seek deference for that mutable interpretation. The fallacy of that viewpoint can be seen in the arguments in *Harry v. South Carolina Department of Health and Environmental Control*, 09-ALJ-07-0255-CC, 2010 WL 8425978 (July 15, 2010). In *Harry*, the Department sought deference for a new interpretation of its regulations by a staff member who had been with the Department for eight months even though the Department had interpreted the regulation contrary to that staff member’s interpretation for over fifteen years. *Id.* Thus, if there is no requirement that the interpretation be long-standing, an agency can simply espouse a view of the law in one case and a different view of the law in the next case and seek deference for both views no matter how short the timeframe. See also *Billy Keyserling, Mayor of the City of Beaufort, the City of Beaufort, Mayor Joseph P. Riley, Jr., Mayor of the City of Charleston, the City of Charleston, Tim Goodwin, Mayor of the City of Folly Beach, the City of Folly*, No. 15-ALJ-07-0319-CC, 2016 WL 1627204, at *6-7 (Apr. 19, 2016). This certainly raises

¹ It is also notable that the issue of long-standing administrative interpretation was never raised before the ALC or the Supreme Court in *Kiawah*. Therefore, there would have been no need for the Supreme Court to directly address the issue.

the potential for equal protection issues. *See Weaver v. South Carolina Coastal Council*, 309 S.C. 368, 423 S.E.2d 340 (1992). On the other hand, if the long-standing interpretation requirement is a separate principle, then an agency that has a long-standing interpretation of a statute/regulation could claim deference even though that interpretation is contrary to the plain meaning of the law.

Accordingly, the Department's suggested interpretation of the agency deference doctrine is untenable. The Supreme Court's holding in *Kiawah* that deference is given to an agency's interpretation of a silent or ambiguous statute "assuming the interpretation is worthy of deference" accounts for the need to consider the entire doctrine before granting deference. *Kiawah*, 411 S.C. at 32–33, 766 S.E.2d at 717.

IT IS THEREFORE ORDERED that Petitioner's Motion for Reconsideration is **DENIED**.

AND IT IS SO ORDERED.

A handwritten signature in black ink, reading "Ralph K. Anderson III". The signature is fluid and cursive, with the "K" and "III" being particularly stylized.

Ralph King Anderson, III
Chief Administrative Law Judge

June 22, 2020
Columbia, South Carolina

CERTIFICATE OF SERVICE

I, Stephanie Michelle Perez, hereby certify that I have 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).



Stephanie Michelle Perez
Judicial Law Clerk

June 22, 2020
Columbia, South Carolina

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Synovus Bank,	)	Docket No. 17-ALJ-17-0418-CC
	)	
Petitioner,	)	
	)	AMENDED FINAL ORDER¹
vs.	)	
	)	
South Carolina Department of Revenue,	)	
	)	
Respondent.	)	
_____	)	

APPEARANCES:

For the Petitioner: Ashley Prickett Cuttino, Esq.; Lewis Smoak, Esq.; and Burnet Maybank, III, Esq.

For the Respondent: Jason P. Luther, Esq.

STATEMENT OF THE CASE

This case is before the South Carolina Administrative Law Court (Court or ALC) pursuant to a Request for Contested Case filed by Synovus Bank (Petitioner) on November 16, 2017. Petitioner contests the decision of the South Carolina Department of Revenue (Respondent or Department) in which the Department determined Petitioner could not deduct net operating loss (NOL) carryforwards² when computing its bank tax liability for tax years 2011 through 2014.

On July 25, 2018, Petitioner and the Department filed Cross-Motions for Summary Judgment. On October 22, 2018, the Court granted the Department's Motion for Summary Judgment, in part, and denied Petitioner's Motion for Summary Judgment. The remaining issue following this Court's order on summary judgement was how to calculate the base of the tax (entire net income) for the purpose of the South Carolina bank tax and whether the Department improperly

¹ The Court withdrew its initial Final Order to address Petitioner's Motion for Reconsideration filed on May 12, 2020. While the Court ultimately determined Petitioner's Motion should be denied, the Court now issues this amended order to address a couple points raised by the Department in its Response to the Motion.

² The term "net operating loss" is defined as "[t]he excess of operating expenses over revenues, the amount of which can be deducted from gross income if other deductions do not exceed gross income." *Net Operating Loss*, BLACK'S LAW DICTIONARY 964 (8th ed. 2004). Further, an NOL "carryforward" or "carryover" is "[a]n income-tax deduction (esp. for a net operating loss) that cannot be taken entirely in a given period but may be taken in a later period." *Carryforward*, BLACK'S LAW DICTIONARY 227 (8th ed. 2004).

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relied on Generally Accepted Accounting Principles (GAAP) for this calculation. Accordingly, a final hearing on this issue was held on October 17, 2019, in Columbia, South Carolina.

Although the Court previously issued an Order on summary judgment resolving many of the issues in this case, because the holdings in the summary judgment order provide an important foundation and context for the remaining issue, the Court has determined it is most efficient to combine the orders into one Final Order.

MATERIAL FACTS NOT IN DISPUTE

In 2010, the National Bank of South Carolina (NBSC) merged with Columbus Bank and Trust Company (CB&T) and was renamed Synovus Bank (Petitioner). CB&T reported net operating losses for 2009; NBSC reported net operating losses for 2009 and 2010; and Petitioner reported net operating losses for 2010. The total South Carolina losses reported by the three banks for 2009 and 2010 was \$391,050,990, as amended. The losses were thereafter increased to a total of \$482,050,990 pursuant to a proposed audit adjustment by the Department.

Following the merger, Petitioner filed South Carolina Bank Tax Returns for tax years 2011–2014. On its original bank tax returns for 2011–2013, Petitioner did not claim any deductions for NOL carryforwards from the 2009 and 2010 losses. However, Petitioner subsequently filed amended returns. On its amended returns for 2011–2013, Petitioner deducted NOL carryforwards, which resulted in Petitioner requesting refunds for tax years 2011–2013. Similarly, on its original bank tax return for 2014, Petitioner also claimed a refund after deducting an NOL carryforward.

The Department initially paid Petitioner its requested refunds for tax years 2013 and 2014. The Department withheld Petitioner’s refund for 2012 due to a procedural problem requiring the refund to be “held for verification.” The Department then conducted an audit of Petitioner’s tax returns for tax years 2011–2014. The Department ultimately issued a Proposed Notice of Adjustment (PNOA) in which it disallowed Petitioner’s claim for NOL carryforwards for 2011–2014 and assessed taxes, penalties, and interest. The Department then issued a revised PNOA updating the interest amount due and deleting the penalties it had originally assessed against Petitioner. On April 6, 2016, the total assessment on the revised PNOA was \$2,076,325. On June 7, 2016, Petitioner filed a written protest regarding both PNOAs. In a letter dated October 17,

2017, the Department issued a determination upholding its decision to disallow the NOL carryforwards. This contested case followed.

FINDINGS OF FACTS

Having observed the witnesses and exhibits presented at the hearing and taking into consideration the burden of proof and the credibility of the witnesses, I make the following findings of fact by a preponderance of the evidence.

Financial Accounting Generally

Financial accounting, also referred to as book accounting, is the method used by companies to prepare their audited financial statements. Specifically, financial accounting is the recording of transactions, assets, and liabilities for financial reporting purposes. Tax accounting is distinct from financial accounting and deals with the determination of taxable income. Because of this distinction, it is important to note that “net income” for financial accounting purposes is not necessarily the same as “net income” for tax accounting purposes. Similarly, a net loss for financial accounting purposes (revenues minus expenses) is not the same as a net operating loss, which is a tax accounting term and is defined in part by the ability to use the net loss as a future tax benefit. In particular, a net operating loss refers to a situation where **taxable deductions** exceeds **taxable income** and results in a loss that can be carried forward (or back) to reduce future (or past) taxes payable.³

GAAP Accounting

GAAP is a financial accounting method.⁴ It is maintained by an independent non-profit organization called the Financial Accounting Standards Board (FASB). Although GAAP may have loosely begun sometime after the Great Depression, the FASB was not created until 1973. The FASB now organizes, publishes, and issues accounting standards under GAAP.

³ Although the issue in this case is whether net operating loss **carryforwards** are allowed, the history of net operating losses show that they may be allowed as both **carryforwards** and **carrybacks**. See, e.g., Revenue Act of 1918, H.R. 12863, 65th Cong. § 204(a) & (b) (1918) (providing net losses accrued between October 31, 1918, and January 1, 1920, were allowed to be carried back and deducted from the net income of the preceding year or, if that was insufficient, to be carried forward and deducted from net income from the successive year) (emphasis added).

⁴ While GAAP is the collection of accounting principles at issue in this case, several other compilations of accounting rules exist, including the international financial reporting standards (IFRS) and “yellow book accounting,” which refers to governmental accounting principles and standards.

GAAP can only be used for accrual-based accounting and not cash-based accounting.⁵ Accordingly, GAAP is not necessarily applicable to South Carolina banks because these banks may use cash-based accounting. S.C. Code Regs. Ann. 117-1500.2 (2012). Nevertheless, the use of GAAP is required for all companies whose ownership is held publicly, such as corporations traded on a stock exchange. More specifically, a publicly traded corporation operating solely in the United States, including a publicly traded bank or bank holding company, must follow GAAP protocols to be compliant with the U.S. Securities and Exchange Commission guidelines. Since Petitioner is a publicly traded company, it is required to use GAAP to prepare its financial statements.

During the early development of GAAP, the American Institute of Public Accountants would periodically issue Bulletins discussing certain accounting practices. In 1944, the American Institute of Public Accountants issued Bulletin No. 23, which, according to Petitioner, is the “earliest record identified that addresses the issue of excess expenses and income taxes for accountants.” ACCOUNTING RESEARCH BULLETIN NO. 23 (Comm. on Accounting Procedure, Am. Institute of Accountants 1944). This Bulletin was issued to address the “[b]asic difficulties [that] arise in connection with income taxes where there are material and extraordinary differences between taxable income upon which they are computed and the income reported in the income statement under generally accepted accounting principles As a result of such transactions the income tax legally payable may not bear a normal relationship to the income shown in the income statement.” *Id.* at 185. In this early Bulletin, the accounting profession was reacting to tax laws that created discrepancies between financial income and taxable income in a given year. Bulletin No. 23 summarizes the treatment of NOL carryforwards as follows:

Where material amounts of losses or unused excess-profits credits of prior years are carried forward into the current tax return, the operating results for the current year should preferably be shown without inclusion of the tax reduction resulting therefrom, i.e., the current provision for income taxes should be computed and shown in the income statement without the benefit of such “carry-forward,” and the

⁵ Cash and accrual-based accounting are differentiated, in part, by when revenue is recognized. For example, in cash-based accounting, the revenue from a sale is recorded when the cash exchanges hand. In contrast, in accrual-based accounting, the revenue from a sale is recorded when the sale occurs regardless of whether cash is exchanged at that point. In other words, in accrual-based accounting, the revenue is recorded when it is accrued rather than when it is received.

amount of the tax reduction should be shown in the income statement as a separate item.

Id. at 184. This section of Bulletin No. 23 shows the profession was particularly reacting to the creation of NOLs because it shows the profession was establishing how to accommodate NOLs in financial statements. It also advised at this time that the income statement should be computed without NOLs.

By 1987, after the FASB had been created, Bulletins were replaced by Statements of Financial Accounting Standards (FAB), and then, in 2009, these standards were codified in the Accounting Standards Codification or “ASC.” Although the standards set forth the principles that accountants follow, they are updated frequently. One of these standards, ASC 740, is a collection of accounting rules that apply to taxes based on income, including franchise taxes based on income. ASC 740, which has been updated over fifty times since 2010, sets forth standards, among other things, for carrying forward deferred tax benefits like NOLs.⁶ Under ASC 740, a company is required to identify and recognize tax impacts (e.g. deductions or credits) on its financial statements. For example, if a company can take an NOL carryforward under the IRC, ASC 740 requires the tax impact of that NOL carryforward to be reflected on the company’s financial statements, namely on its balance sheet.

Under GAAP, four financial statements are required: the income statement, the balance sheet, a statement of cash flows, and a statement of changes in owners’ equity. The income statement shows revenues and gains as well as expenses and losses. The income statement generally covers a one-year period. A bank’s “net income,” also known as its “bottom line,” is the net of the revenues and expenses shown on the income statement. On the other hand, the balance sheet is a statement that shows the assets, liabilities and shareholder’s equity at a point in time.

GAAP also follows the principles of double-entry accounting. Double-entry accounting means that a financial event should have an impact on two financial statements or on two different accounts under the same financial statement. In double-entry accounting there is always a credit and a debit that balance out over two statements or two accounts. When an NOL is recorded in double-entry accounting, it exists as a debit and credit on the balance sheet and may be footnoted

⁶ NOL carryforwards are deferred tax benefits because they allow excess expenses from one tax year to be carried forward to a future year to reduce the future year’s taxable income, thereby creating a future tax benefit from a tax deduction or credit (a deferred tax asset).

on the income statement. A NOL carryforward expense does not affect the income statement in the year that it is taken except to the extent it increases the amount of expense in a given year it is used. In other words, the NOL is not deducted from the income statement as an expense itself; rather, it increases the expenses and thus reduces the taxes paid.

Finally, GAAP does not use the term “book income,” nor does it use the term “entire net income.”

GAAP and the South Carolina Bank Tax

The Department’s longstanding practice is to use financial accounting to calculate the basis of the bank tax instead of relying on federal taxable income.⁷ The Department’s use of “financial accounting” to calculate the basis of the bank tax is interesting since GAAP, financial accounting, and book accounting are generally interchangeable terms. In fact, Mr. von Lehe explained that calculating entire net income using GAAP would **not necessarily** be appropriate because, although GAAP is used to calculate “net income,” it never references “entire net income.” Nevertheless, “entire net income” may be calculated using “book income” which may be determined following the principles of GAAP.

⁷ The parties introduced the testimony of three expert witnesses to explain the financial accounting concepts as they relate to bank tax. Petitioner presented John von Lehe, Esq., who was qualified as an expert in “the application of the South Carolina bank tax to ASC 740 based on the history of the bank tax as a franchise tax based on income.” Mr. von Lehe is a tax attorney and a Certified Public Accountant (CPA). He previously assisted the Department for a number of years in his capacity as an attorney with the South Carolina Attorney General’s office. He has practiced in the tax world as a CPA or tax attorney for over forty years. The Court recognizes that Mr. von Lehe changed his opinion about certain issues between the time of his deposition and the hearing. Previously, he averred that calculating “entire net income” under GAAP would be reasonable. I nevertheless found Mr. von Lehe explained his change of opinion and his testimony was generally credible.

Doug Branch, CPA, also testified on behalf of Petitioner. Mr. Branch is a partner in Price Waterhouse Cooper (PWC), one of the four largest accounting firms in the world. He practices in PWC’s forensic services group and leads the U.S. dispute services practice. Mr. Branch was qualified as an expert in GAAP accounting and the application of ASC 740 to deferred tax assets, including NOLs. The Court found Mr. Branch to be extremely knowledgeable in the area for which he was qualified. However, Mr. Branch has never worked in the area of the South Carolina bank tax and thus his testimony was more pertinent to how GAAP incorporates NOLs.

Additionally, Mr. Beckwith testified on behalf of the Department. Mr. Beckwith is a CPA and worked for Deloitte, a national accounting firm, for almost twenty years. He also worked for an accounting firm in South Carolina for almost ten years. Mr. Beckwith worked in the area of bank tax and was the lead shareholder in that area for his South Carolina firm. He has significant experience preparing South Carolina bank tax returns and described GAAP as subservient to federal and state tax law. I also found him to be generally credible.

Finally, this Court recognizes that the recitation of conflicting testimony is not proper finding of fact. See *Able Commc’ns, Inc. v. S.C. Pub. Serv. Comm’n*, 290 S.C. 409, 351 S.E.2d 151 (1986). However, in this case, an initial recitation of the experts’ testimony is helpful to provide context for the Court’s ultimate findings. In sum, although I found these witnesses to be credible, as reflected by this decision, I did not necessarily accept all of their opinions.

Under GAAP, ASC 740 requires that any deferred tax assets, such as NOL carryforwards, be recognized in a company's financial statements, which include not only the income statement, but also the balance sheet. Accordingly, because the IRC has created NOL carryforwards, ASC 740 requires that NOL carryforwards be recognized on a company's financial statements to be in compliance with GAAP.

It is here that the experts' opinions diverge. Mr. Branch opined that if "the Department adds GAAP to its definition of entire net income, it is inextricably linking the IRC to the South Carolina bank tax." Nevertheless, Mr. Branch also recognized GAAP does not create NOL carryforwards, but rather incorporates them into its methodology because the IRC has created a deduction based on them. Similarly, Mr. Beckwith testified NOL carryforwards were created by tax law. Therefore, when a specific accounting standard under GAAP, like ASC 740, discusses how to reflect NOL carryforwards on a company's financial statements, GAAP is responding to the statutory requirements of the IRC and state tax law. In fact, some states allow NOLs but some states do not.

Entire Net Income

From an accounting perspective, I find the term entire net income means all of a company's gross income minus gross expenses.⁸

The Department's expert, Mr. Beckwith, viewed the purpose of the word "entire" within the term "entire net income" as a recognition that "net income" for banks must include the non-taxable interests that are usually excluded from income tax but not from a franchise tax based on income. Furthermore, in reaching his opinion, Mr. Beckwith relied upon a 1975 Tax Commission decision which sets forth that entire net income should be determined based upon economic income and in Mr. Beckwith's opinion, economic income is equivalent to GAAP and thus, the ASC. Mr. Beckwith also asserted net income is derived solely from the income statement.

Turning to the practical application of the term, Mr. Beckwith explained that, although he is "not sure" he has ever agreed with the way the Department "get[s] to" taxing bank's entire net income, in computing entire net income for purposes of the South Carolina bank tax, he simply

⁸ In setting forth these facts, the Court emphasizes that it considered the experts testimony not as to the legal meaning of entire net income but to the application of that term from an accounting perspective.

follows the Department's instructions that "banks are not allowed the [federal] net operating loss deduction" and adds the deduction back into book income. Therefore, consistent with the bank tax return (Form SC 1101 B), he starts with federal taxable income and removes the federal NOL carryover deductions to reach net income. However, the form that Mr. Beckwith states he follows sets forth that the tax is based on "total net income" instead of "entire net income," thereby introducing yet another term to this quagmire.

Petitioner's experts, however, explained that the phrase "entire net income," without more context, does not mean much to an accountant. In fact, although the term "net income" appears in GAAP, the term "entire net income" does not. Petitioner's expert, Mr. Von Lehe, thus opined entire net income is a broader term than net income in GAAP. Petitioner's experts nevertheless agreed that entire net income means all revenue minus all expenses. But Petitioner's experts view the term entire net income to signal an intent that all financial statements GAAP requires (including where NOL carryforwards are usually reflected the balance sheet) should be considered.

Mr. Branch justified this viewpoint based upon the Department's position that entire net income should be based on GAAP. Indeed, under the principles of GAAP, losses are reflected not just on the income statement but also on the balance sheet. Moreover, Mr. Branch opined that looking at any financial statement in isolation will not produce the full financial picture under GAAP because it would fail to capture all the losses and thus not fulfill the requisite of considering entire net income. In fact, if the excess expense (NOL) from a year is not carried forward, then that excess expense "will just go away" and the loss would not be captured. Therefore, Mr. Branch opined the phrase "entire net income" implies a bank may deduct NOL carryforwards in calculating a South Carolina bank's taxable income.

However, Petitioner's evidentiary theory is dependent upon the Court's determination that GAAP principles govern the calculation of "entire net income." Rather, GAAP principles may be used to calculate "entire net income," but those accounting principles do not create legal tax deductions. For instance, one jurisdiction (federal) may recognize NOLs and another jurisdiction (state) may not. In such a case, the federal NOL carryforward would be recognized and reduce the expense for federal taxes paid on the company's income statement; thus, the federal NOL carryforward would have an impact on the calculation of net income. The company will recognize the NOL carryforwards in its footnotes or on its balance sheet for the federal jurisdiction, but it

will not recognize it for state tax purposes. At issue here is taking an NOL for state income tax purposes.

Book Income

The term “book income” emanates from the historic practice of keeping a ledger in a book to record financial transactions. Book income generally refers to the income kept in such a ledger, but the method for how the books are kept can vary. For instance, cash basis, international financial reporting standards, yellow book governmental standards, and GAAP are all methodologies that can be used to keep a company’s books. Although GAAP is the most prevalent methodology to calculate “net income,” a South Carolina bank can also use cash-based accounting. In addition, net income and book income are not necessarily synonymous. Book income “is more of a term of art” or “slang” that represents the income off the general ledger and could be computed under GAAP principles. Therefore, “book income” is a fluid term that represents gains and losses in a ledger, the calculation of which may vary depending upon the accounting methodology used to maintain that ledger. Nevertheless, because so many companies use GAAP as their accounting methodology, it is not unreasonable to conclude that “book income” is synonymous with financial “net income” under GAAP in many circumstances; however, just because this is a common occurrence does not mean it is the rule.

ISSUES

- 1) Whether a bank can deduct net operating loss carryforwards when calculating its South Carolina bank tax liability.
- 2) How is “entire net income” calculated for the purpose of the South Carolina bank tax?
 - a) Does the term “entire net income” inherently authorize NOL carryforward deductions?
 - b) Is “book income” a reasonable proxy for “entire net income”?
 - c) Is it reasonable for the Department to rely on the GAAP definition of “book income”?⁹

⁹ The Department phrases this issue slightly differently. It states the issue as whether it is reasonable for the Department to “infer that a bank’s entire net income will generally be computed using . . . GAAP.”

CONCLUSIONS OF LAW

Standard of Review

This Court has jurisdiction over this case pursuant to section 12-60-460 of the South Carolina Code (2014) and section 1-23-600 of the South Carolina Code (Supp. 2019).

This is a contested case, and it is heard *de novo*. *Be Mi, Inc. v. S.C. Dep't of Revenue*, 408 S.C. 290, 297, 758 S.E.2d 737, 740 (Ct. App. 2014) (“In reaching a decision in a contested violation matter, the ALC serves as the sole finder of fact in the *de novo* contested case proceeding.”); *Brown v. S.C. Dep't of Health & Envtl. Control*, 348 S.C. 507, 512, 560 S.E.2d 410, 413 (2002) (explaining that a contested case before the ALC is “in the nature of a *de novo* hearing with the presentation of evidence and testimony”). The standard of review is a preponderance of the evidence. S.C. Code Ann. § 1-23-600(A)(5) (Supp. 2019); *see also Anonymous (M-156-90) v. State Bd. of Med. Exam'rs*, 329 S.C. 371, 375-78, 496 S.E.2d 17, 19-20 (1998) (“Absent an allegation of fraud or a statu[t]e or a court rule requiring a higher standard, the standard of proof in administrative hearings is generally a preponderance of the evidence.”). Because Petitioner is challenging a Department determination, Petitioner thus has the burden of proof to show by a preponderance of the evidence that the Department’s determination was incorrect. *Leventis v. Dep't of Health and Envtl. Control*, 340 S.C. 118, 132-33, 530 S.E.2d 643, 651 (Ct. App. 2000) (holding, generally, the complaining party bears the burden of proof).

Statutory Construction

Petitioner argues this Court should find that the applicable tax laws allow banks to carryforward excess NOLs. Petitioner concedes this is an issue of first impression that requires the Court to engage in statutory construction. Petitioner contends NOL carryforwards were extended to banks pursuant to South Carolina’s adoption of tax conformity with the Internal Revenue Code (IRC), which allows corporations to deduct NOL carryforwards. Petitioner also claims that banks should be allowed to deduct NOL carryforwards regardless of whether they are subject to an income tax or a franchise tax. Additionally, Petitioner now claims that even without conformity, the bank tax law should be interpreted to allow NOL carryforwards.

In contrast, the Department argues South Carolina’s adoption of conformity with the IRC did not extend the NOL carryforward deduction to banks because they are treated differently than other corporations. Furthermore, the Department contends that deductions must be specifically

authorized, and the NOL carryforward deduction is only explicitly authorized for calculating corporate income tax based upon “taxable income,” whereas the bank tax is based on “entire net income,” and this term does not inherently authorize NOL carryforwards. Additionally, the Department maintains the bank tax is a franchise tax.

At the heart of this case is a disagreement about whether Petitioner is entitled to a tax deduction. The parties agree that no statute explicitly gives banks the right to deduct NOL carryforwards. Accordingly, it is necessary to engage in statutory interpretation to determine whether the conformity provisions or other elements of the bank tax law have extended the right to deduct NOL carryforwards to banks as Petitioner suggests.

Petitioner claims this is a case in equity and the law should be liberally construed in favor of the taxpayer. While the principle behind NOL carryforwards may be an equitable—redistributing a loss over a number of years—taking an NOL carryforward is a tax deduction. Tax deductions “are a matter of legislative grace and the taxpayer must establish compliance with the statutory conditions imposed.” *Davis Mech. Contractors, Inc. v. Wasson*, 268 S.C. 26, 29, 231 S.E.2d 300, 301 (1977); see *Allied Corp. v. S.C. Tax Comm’n*, 288 S.C. 197, 199, 341 S.E.2d 139, 140–41 (1986) (“It is settled that a deduction is not a matter of right but is one of legislative grace.”); *S. Soya Corp. of Cameron v. Wasson*, 252 S.C. 484, 488, 167 S.E.2d 311, 313 (1969) (“The deduction and benefit is allowed as a matter of legislative grace.”). Furthermore, although ambiguities in tax statutes are generally construed in favor of the taxpayer, this rule “does not apply in the construction of a statute authorizing deductions; rather, the ambiguity will be resolved against the taxpayer.” *Wasson*, 252 S.C. at 489, 167 S.E.2d at 313 (citing 47 C.J.S. Internal Revenue 230). Therefore, Petitioner has the burden to show it is entitled to the NOL carryforward deduction and any ambiguity will be construed in the Department’s favor.

Turning to the general rules of statutory construction, “[t]he cardinal rule of statutory construction is to ascertain and effectuate the intent of the legislature.” *Media Gen. Commc’ns, Inc. v. S.C. Dep’t of Revenue*, 388 S.C. 138, 147, 694 S.E.2d 525, 529 (2010). “The determination of legislative intent is a matter of law.” *Id.* at 148, 694 S.E.2d at 529. “The words of the statute must be given their plain and ordinary meaning without resorting to subtle or forced construction to limit or expand the statute’s operation.” *Berkeley Cty. Sch. Dist. v. S.C. Dep’t of Revenue*, 383 S.C. 334, 345, 679 S.E.2d 913, 919 (2009). Further, “the statute must be read as a whole and

sections which are a part of the same general statutory law must be construed together and each one given effect.” *Sloan v. Hardee*, 371 S.C. 495, 499, 640 S.E.2d 457, 459 (2007). “Where the statute’s language is plain and unambiguous, and conveys a clear and definite meaning, the rules of statutory interpretation are not needed and the court has no right to impose another meaning.” *Hodges v. Rainey*, 341 S.C. 79, 85, 533 S.E.2d 578, 581 (2000). Last, it is important to note that generally “[t]he construction of a statute by the agency charged with its administration will be accorded the most respectful consideration and will not be overruled absent compelling reasons.” *Brown v. S.C. Dep’t of Health & Envtl. Control*, 348 S.C. 507, 515, 560 S.E.2d 410, 414 (2002).

The South Carolina Bank Tax

Petitioner argues the bank tax is an income tax, but even if it is a franchise tax, Petitioner is entitled to an NOL carryforward deduction. Petitioner thus contends that whether the bank tax is an income tax or a franchise tax is not a question this Court need answer. In contrast, the Department argues that the bank tax is a franchise tax and that tax carries implications relevant to this case. Therefore, the Court will address this issue first.

The history of the South Carolina bank tax is fairly simple. In 1937, the General Assembly enacted a tax specifically for banks and excluded banks from the corporate income tax. This new bank tax was a 4.5% tax on the “entire net income” of the bank. The bank tax is codified in Chapter 11 of Title 12 and has remained relatively unchanged since 1937.

Pursuant to Chapter 11, a “bank” or “taxpayer” under this chapter is “any person engaged in a banking business, whether incorporated under the laws of this State, any other state or the United States or whether unincorporated, except cash depositories.” S.C. Code Ann. § 12-11-10 (2014). A tax of 4.5% is levied upon banks, specifically:

A tax is imposed upon every bank engaged in business in the State which shall be levied, collected and paid annually with respect to the **entire net income** of the taxpayer doing a banking business within this State or from the sales or rentals of property within this State, computed at the rate of four and one half per cent of the entire net income of such bank or taxpayer.

S.C. Code Ann. § 12-11-20 (2014).

Although the statutory laws do not specify the nature of the tax on a bank’s income, the bank tax is specifically described in regulation 117-1500 as a “franchise tax.” S.C. Code Regs.

Ann. 117-1500 (2012) (“Chapter 11 of Title 12 imposes a franchise tax on banks.”).¹⁰ Regulation 117-1500.1 further provides that the base of the tax, “entire net income,” includes “income derived from any source whatsoever including interest on obligations of the United States, the United States Government or its possessions or of any state and any political subdivision thereof.” S.C. Code Regs. Ann. 117-1500.1 (2012). Furthermore, Regulation 117-1500.2 provides “[t]he **net income** of the taxpayer as provided for in Section 12-11-20 shall be computed on either a cash or accrual basis,” which suggests that “entire net income” and “net income” may be synonymous. S.C. Code Regs. Ann. 117-1500.2 (2012) (emphasis added).

Including interest on government obligations within the definition of “entire net income” is consistent with a franchise tax. Generally, interest on government obligations or nontaxable securities are, as their name suggests, nontaxable when assessing income tax. However, their worth can be included when assessing a franchise tax because a franchise tax, while it can be measured based upon net income, is not a tax on income, but rather a tax levied for the privilege of doing business within the state. See *Franchise Tax*, Black’s Law Dictionary 1497 (8th ed. 2004) (defining a “franchise tax” as a “tax imposed on the privilege of carrying on a business” that is usually based upon income); 84 C.J.S. *Taxation* § 177 (“The net income of a corporation may be used as a measure of the tax on the privilege of doing business at least with respect to income derived from business done within the state.”); 84 C.J.S. *Taxation* § 223 (“The fact that the tax formula reflects the value of tax-exempt securities does not invalidate it since the tax is not on property but on a privilege or franchise.”). It is also well-settled that government obligations can be included in the calculation of a franchise tax, and this unique aspect of the tax has important implications in this case. *Tradesmens Nat. Bank of Oklahoma City v. Oklahoma Tax Comm’n*, 309 U.S. 560, 563–64 (1940) (“The plain meaning of the amendment [12 U.S.C.A. s. 548] is confirmed by its legislative history showing beyond doubt that Congress intended to authorize a franchise tax measured by net income including interest on tax-immune federal securities.”); *Pac. Co. v. Johnson*, 285 U.S. 480, 490 (1932).

Although regulation 117-1500 describes the bank tax as a franchise tax, Petitioner dismisses this regulation because the regulation was issued in 2003 and is “contrary to the 2005

¹⁰ The tax described in section 12-11-20 is the only tax levied upon banks except for the use tax, deed recording fees, and taxes on real property. S.C. Code Ann. § 12-11-30 (2014).

conformity statute which included the bank tax and [is] an unconstitutional delegation of taxing powers.” Petitioner further argues the bank tax is an income tax because all statutory references to the bank tax refer to an “income tax” and not a “franchise tax.”

Indeed, “[a]s a creature of statute, a regulatory body is possessed of only those powers expressly conferred or necessarily implied for it to effectively fulfill the duties with which it is charged.” *Captain's Quarters Motor Inn, Inc. v. S.C. Coastal Council*, 306 S.C. 488, 490, 413 S.E.2d 13, 14 (1991). Nevertheless, I do not find the Department’s promulgation of regulation 117-1500 resulted in an unconstitutional delegation of power. “While the legislature may not delegate its power to make laws, it may authorize an administrative agency or board to fill up the details by prescribing rules and regulations for the complete operation and enforcement of the law within its expressed general purpose.” *Hampton v. Haley*, 403 S.C. 395, 407–08, 743 S.E.2d 258, 264 (2013) (internal quotation marks and citation omitted).

Here, in 1991, the General Assembly gave the Department the authority to “make rules and promulgate regulations, not inconsistent with law, to aid in the performance of its duties.” S.C. Code Ann. § 12-4-320(1) (2014); Act No. 50, 1991 S.C. Acts ___. Pursuant to this authority, the Department promulgated regulation 117-1500 in 2003, defining the bank tax as a franchise tax. Although, as Petitioner correctly observes, the bank tax is statutorily referred to as an “income tax” on banks or “tax on income of banks,”¹¹ the franchise tax in this instance is also calculated based upon income. Therefore, regulation 117-1500 is not contrary to the plain language of the bank tax statutes. *See* 84 C.J.S. *Taxation* § 177 (“The net income of a corporation may be used as a measure of the tax on the privilege of doing business at least with respect to income derived from business done within the state.”).

Furthermore, from a historical perspective, which is significant since the bank tax has not been substantively amended since 1937, there is no evidence to suggest South Carolina’s bank tax has ever been treated as anything other than a franchise tax since its inception. As far back as 1948, a South Carolina Attorney General Opinion expressed that:

Section 2676 of the Code of 1942 levies a tax upon, or with respect, to the entire net income of banks. This language includes **all income from whatever source derived, even income from nontaxable securities**. This is for the reason that the

¹¹ S.C. State Reg., Vol. 27, Issue 6 (July 27, 2003); § 12-11-10 *et seq.*

bank tax is a **franchise tax** for the privilege of operating, or doing business in this State, the amount thereof being measured by the entire net income.

1947-48 Op. S.C. Att’y Gen. 294 (March 12, 1948) (emphasis added). Similarly, in 1967, South Carolina’s regulations provided that the term “entire net income” included income derived from “any sources whatsoever including interest on obligations of the United States,” which suggests the bank tax was still interpreted as a franchise tax at that time because it included non-taxable obligations. S.C. Regs. BA-R-1: (December 6, 1967).

Additionally, the Department has interpreted the bank tax as a franchise tax for decades as evidence by its opinions and rulings. In 1975, the South Carolina Tax Commission found the bank tax “has been interpreted to be a franchise tax measured by net income.” *RE: BANK TAX*, 1975 WL 23751 (S.C.Tax.Com. Aug. 4, 1975). Similarly, in 1992, the Department issued a revenue ruling noting that “Code Section 12-11-20 provides for a franchise tax based on net income on banks.” S.C. Revenue Ruling No. 92-9, 2 (July 21, 1992).

Thus, there appears to be a long history of interpreting the bank tax as a franchise tax; moreover, a franchise tax based on income. And, for the reasons stated in the next section, this Court does not agree with Petitioner’s contention that regulation 117-1500 was repealed by implication when the tax code was amended in 2005 to, according to Petitioner, broaden the South Carolina’s Tax Code’s conformity with the Internal Revenue Code. Indeed, what speaks loudest is the General Assembly’s silence as to this issue. The General Assembly has had many opportunities to amend the bank tax, both before and after regulation 117-1500 went into effect, and has not done so. This Court finds the General Assembly’s failure to enact legislation to contradict the long-standing interpretation of the bank tax as a franchise tax shows it has acquiesced to this interpretation for several decades. *See Media Gen. Commc’ns, Inc.*, 388 S.C. at 149, 694 S.E.2d at 530–31 (“An agency’s long-standing interpretation of a statute is usually entitled to be given deference and should not be overruled by a reviewing court in the absence of cogent reasons, but the interpretation will not be sustained if it contradicts a statute’s plain language.”); *Etiwan Fertilizer Co. v. S.C. Tax Comm’n*, 217 S.C. 354, 60 S.E.2d 682 (1950) (“[W]here the construction of the statute has been uniform for many years in administrative practice, and has been acquiesced in by the General Assembly for a long period of time, such construction is entitled to weight, and should not be overruled without cogent reasons.”). Because of this history, the Court finds that in promulgating regulation 117-1500 in 2003, the Department was filling in the

details by codifying a long-standing interpretation of the bank tax. *See Hampton*, 403 S.C. at 407–08, 743 S.E.2d at 264. Therefore, pursuant to the applicable and regulations, this Court finds the bank tax is a franchise tax. *See Goodman v. City of Columbia*, 318 S.C. 488, 490, 458 S.E.2d 531, 532 (1995) (“Regulations authorized by the legislature have the force of law.”).

Conformity with the IRC

Next, the Court turns to the issue of whether the legislature intended the bank tax to conform with the IRC such that banks can deduct NOL carryforwards like other corporations when calculating the franchise tax levied upon them.

In its brief, Petitioner argues South Carolina’s adoption of conformity with the IRC through Chapter 6 extended conformity to all of Title 12, including Chapter 11’s bank tax, “as of at least 2005.” Petitioner asks this Court to determine that “through a significant legislative change in the tax conformity statute in 2005, the South Carolina General Assembly granted corporations, including banks, the ability to deduct NOL carryforwards on their South Carolina tax returns and this is true, regardless of whether or not the bank tax is a franchise tax.”

The Department disagrees, arguing that only some provisions of the IRC have been adopted for the purpose of Chapter 11, which otherwise remains a tax scheme for banks that is independent of the IRC. In fact, the Department maintains banks are specifically excluded from the corporate income tax in Chapter 6 under which NOL carryforwards are authorized.

Conformity and Decoupling Provisions

In 1985, the General Assembly enacted the South Carolina Income Tax Federal Conforming Amendments of 1985, which revised the South Carolina Code to conform to the Internal Revenue Code (IRC). However, the General Assembly did not authorize a blanket adoption of the IRC. Rather, the General Assembly also enacted a “decoupling” statute listing specific IRC sections that were not adopted. The “conformity” and “decoupling” provisions are codified in section 12-6-40 and section 12-6-50 of the South Carolina Code (2014), respectively. Both of these statutes are found in Chapter 6, which is the chapter codifying the South Carolina Income Tax Act.

Section 12-6-40, the “conformity” statute, states in part:

(2)(a) For purposes of this title, “Internal Revenue Code” is deemed to contain all changes necessary for the State to administer its provisions. **Unless a different meaning is required:**

*

*

*

(iv) “Income” includes the modifications required by Article 9¹² of this chapter and allocation and apportionment as provided in Article 17 of this chapter.

Other terms in the Internal Revenue Code must be given the meanings necessary to effectuate this item.

§ 12-6-40 (emphasis added). Therefore, although this section adopts the IRC for the purpose of Title 12, the phrase “unless a different meaning is required” limits the application of “income” in this section. *Id.* Similarly, section 12-6-50 (the decoupling statute), which excludes certain IRC provisions for the purpose of Title 12, provides that the IRC exclusions are generally applicable to “this title and all other titles that provide for taxes administered by the department, **except as otherwise specifically provided.**” § 12-6-50 (emphasis added).¹³

Thus, the limitations and exceptions referred to in sections 12-6-40 and 12-6-50 imply the Court must look beyond these sections when determining their applicability to different parts of Title 12. Moreover, the decoupling statute shows the General Assembly never intended for the bank tax to fully conform with the IRC because it specifically states that “Sections 581, 582, and

¹² The modifications in Article 9 include a deduction for NOLs.

¹³ Although this Court finds that the conformity statute shows the IRC was adopted for the purpose of Title 12 with certain exceptions and limitations, Petitioner relies heavily on an amendment to the decoupling statute in 2005 to support its argument that conformity applies to the entirety of Title 12, apparently without exceptions or limitations. Specifically, Petitioner observes that just prior to 2005, the decoupling statute stated, “for the purposes of this chapter,” but was amended in 2005 to state, “for the purposes of this title and all other titles that provide for taxes administered by the department.” *See* Act No. 145, 2005 S.C. Acts § 8. Petitioner argues that the General Assembly’s decision to replace “chapter” with “title” indicates that not only was the application of the decoupling statute broadened, but the application of the conformity statute was likewise expanded to cover all of Title 12, including the bank tax in Chapter 11. This Court finds such a reading of the 2005 amendment strained and unnecessary to broaden the application of the conformity statute to Title 12 because the conformity statute already applies to Title 12. Moreover, the Court will not infer a change in one statute just because a change was made to another, related statute. *See City of Camden v. Brassell*, 326 S.C. 556, 561, 486 S.E.2d 492, 495 (Ct.App.1997) (“Where the language of the statute is clear and explicit, the court cannot rewrite the statute and inject matters into it which are not in the legislature’s language.”).

Further, the Court disagrees with Petitioner’s assertion that the 2005 amendment of the decoupling statute repealed by implication regulation 117-1500. As discussed in the main body of this order, the General Assembly did not endorse a blanket adoption of conformity; rather, there are limitations and exceptions to conformity, including the decoupling statute itself. The Court finds regulation 117-1500 does not conflict with any of the conformity provisions that have been incorporated into the bank tax. Accordingly, the Court finds regulation 117-1500 has not been repealed by implication.

585 through 596 **relating to the taxation of banking institutions**” are not adopted. S.C. Code Ann. § 12-6-50(9) (2014) (emphasis added). The only section relating to banking institutions that was not decoupled is section 584, which discusses common trust funds and is inapplicable to the general taxation of banks. 26 U.S.C.A. § 584 (West 2018).¹⁴

With these limitations and exceptions in mind, the Court next looks to the overall statutory scheme to ascertain to what extent the bank tax may conform with the IRC. *See Liberty Mut. Ins. Co. v. S.C. Second Injury Fund*, 363 S.C. 612, 622, 611 S.E.2d 297, 302 (Ct. App. 2005) (“Statutes must be read as a whole and sections which are part of the same general statutory scheme must be construed together and given effect, if it can be done by any reasonable construction.”).

Banks Are Not Taxed Like Other Corporations or Entities Under Chapter 6

Looking to the overall statutory scheme in Title 12, it is important to note that almost all individuals and organizations (corporations, partnerships, estates, or trusts) are subject to the income tax described in Chapter 6 (and thus the IRC) except two types of taxpayers: banks and building and loan associations. The bank tax is codified in Chapter 11, and the building and loan association tax is codified in Chapter 13. Although Title 12 and the South Carolina Income Tax Act have been amended several times over the years, including in 2005, the General Assembly never repealed the chapters separately governing banks and building and loan associations to conclusively bring them within the scope of Chapter 6.

Moreover, although banks are generally organized as corporations in South Carolina,¹⁵ the General Assembly distinguished the taxation of incorporated banks from the taxation of other corporations governed by Chapter 6. Section 12-6-550 states:

The following **corporations** are exempt from the tax imposed by **Section 12-6-530** [on corporations] and Section 12-6-540 [on exempt organizations and cooperatives]:

(1) banks as defined in Section 12-11-10;

¹⁴ In addition to section 584, section 583 was not decoupled; however, it was repealed in 1976 and, therefore, is not applicable. 26 U.S.C.A. § 583 (West 2018). Interestingly, section 584 specifically disallows NOL carryforward deductions for a bank’s common trust fund. 26 U.S.C.A. § 584. Petitioner argues that the specific disallowance of NOL carryforwards in this context, but not for banks, shows that NOL carryforwards are not generally disallowed. This Court disagrees with this logic as Petitioner must affirmatively show it is entitled to the deduction. *See Davis Mech. Contractors, Inc.*, 268 S.C. at 29, 231 S.E.2d at 301 (holding tax deductions “are a matter of legislative grace and the taxpayer must establish compliance with the statutory conditions imposed”).

¹⁵ *See* S.C. Code Ann. § 34-3-10(A) (Supp. 2017); S.C. Code Ann. § 34-3-210 (1987).

S.C. Code Ann. § 12-6-550 (2014) (emphasis added). Therefore, although banks are corporations, they are expressly excluded from the corporate income tax under Chapter 6. This is an important distinction because corporations taxed under section 12-6-530 use “taxable income” as their tax base, and the calculation of “taxable income” comprises the NOL carryforward deduction. See S.C. Code Ann. § 12-6-530 (explaining the corporate income tax is based upon taxable income); S.C. Code Ann. § 12-6-1130 (discussing taxable income and NOL carryforwards).

Further, section 12-6-630 provides:

Entities, other than . . . those specifically excluded from income taxation under Section 12-6-550, are taxed as provided in the Internal Revenue Code with the modifications provided in Article 9 of this chapter and subject to allocation and apportionment as provided in Article 17 of this chapter.

S.C. Code Ann. § 12-6-630 (2014). Article 9 includes the NOL carryforward deduction. As discussed above, banks are specifically excluded from income taxation under section 12-6-550; therefore, pursuant to this statute, banks are not an entity taxed as provided in the Internal Revenue Code with the modifications provided in Article 9 (including the NOL carryforward deduction) or Article 17.

The Court must presume the General Assembly had a purpose in excluding banks in sections 12-6-550 and 12-6-630 and in retaining a separate chapter for banks, such as taxing them differently than other corporations and entities. See *Arnold v. Ass'n of Citadel Men*, 337 S.C. 265, 273, 523 S.E.2d 757, 761 (1999) (“There is a basic presumption the General Assembly has knowledge of previous legislation when later statutes are passed on a related subject.”). The remaining question is to what extent are banks treated differently than other corporations and entities. To answer this question, the Court turns to Chapter 11.

Chapter 11 Partially Adopted Chapter 6

Examining Chapter 11, Petitioner claims section 12-11-40 shows the General Assembly’s intent to bring Chapter 11 into conformity with Chapter 6 and the IRC. The Court disagrees. Looking to the plain language of the statute, section 12-11-40 provides:

[f]or the purpose of administration, allocation and apportionment, enforcement, collection, liens, penalties, and other similar provisions, all of the provisions of Chapter 6 of this title that may be appropriate or applicable are adopted and made a part of this chapter for the enforcement and administration of this chapter, including the requirement to make declarations of estimated tax and make estimated tax payments.

S.C. Code Ann. § 12-11-40 (2014) (emphasis added). Dissecting this language, section 12-11-40 does, as emphasized by Petitioner, adopt “all” the provisions of Chapter 6 (and thus the accompanying IRC provisions), but that adoption is circumscribed by the limitation to “appropriate or applicable” provisions for the purposes of “administration, allocation and apportionment.”¹⁶

This Court finds a distinction between adopting certain provisions of Chapter 6 and the accompanying IRC sections for the purposes of allocation and administration versus adopting them for the purpose of calculating the base of the bank tax. This conclusion is supported by a comparison of Chapter 11 (bank tax) and Chapter 13 (building and loan associations tax). It is notable that like Chapter 11, Chapter 13 includes a section adopting Chapter 6 for the purposes of administration and enforcement but, unlike Chapter 11, Chapter 13 also includes a statute defining “net income” to mean “taxable income as determined for a regular corporation in Chapter 6 of this title” after certain deductions and additions. S.C. Code Ann. § 12-13-20 (2014). Therefore, the General Assembly specifically incorporated Chapter 6 for calculating the base of the tax for building and loan associations in Chapter 13, whereas they did not specifically adopt Chapter 6 for calculating the base of the tax for banks in Chapter 11.

Furthermore, the Department has historically interpreted Chapter 11 to be subject to only partial conformity, thus recognizing the limitations and exceptions to conformity in Chapter 6. In 1994, and after the conformity provision of 1985 was passed, the Department issued Information Letter #94-35 advising that section 12-11-40 “applies **certain provisions** of Chapter [6] to banks.” S.C. Dep’t of Revenue, Information Letter #94-35 (December 20, 1994) (emphasis added). One of the provisions from Chapter 6 that applies is apportionment; specifically:

the Department will accept multistate bank returns which are based upon the proportion of the bank’s entire net income that reasonably represents the proportion of the bank’s trade or business carried on within this State in the same manner as required of those corporations subject to the corporate income tax of Chapter [6]

Id. Not only does this information letter indicate that only certain provisions of Chapter 6 apply to the bank tax, but it implies that banks are normally taxed differently than “those corporations

¹⁶ Section 12-11-40 also indicates parts of Chapter 6 may be adopted for the purposes of “enforcement, collection, liens, penalties, and other similar provisions,” however, the Court finds that these purposes, by their plain definitions, would not incorporate the adoption of a provision providing for the deduction of NOL carryforwards and do not warrant discussion at this time.

subject to the corporate income tax of Chapter 6.” *Id.* This Information Letter is also consistent with section 12-11-40 because it incorporates sections of Chapter 6 governing apportionment. See 12-11-40 (“[f]or the purpose of . . . allocation and apportionment . . . all of the provisions of Chapter 6 of this title that may be appropriate or applicable are adopted . . .”).

Just a year later, in 1995, the Department issued a Private Letter Ruling in which it concluded that certain provisions of the IRC describing the reorganization of a business should be extended to the reorganization of a bank. S.C. Dep’t of Revenue, P.L. Ruling #95-10 (Aug. 28, 1995). Essentially, the Department adopted the IRC principle that a reorganization involving a mere change in form, as opposed to a change in substance, should not control for tax purposes. *Id.*; see also *RE: BANK TAX*, I-D-200 (S.C.Tax.Com. Aug. 4, 1975) (adopting IRC section 368 in a bank merger where IRC section 368 stands for the principle that a “mere change in form as opposed to economic change should not be controlling for tax purposes”). The Department specifically limited its ruling to the adoption of the specific IRC section governing the reorganization of the bank and did not adopt the entire IRC for the purpose of assessing the bank tax. S.C. Dep’t of Revenue, P.L. Ruling #95-10 (Aug. 28, 1995). In other words, adopting this specific IRC regulation governing the reorganization aided the Department in administering the bank tax. See § 12-11-40.

Finally, Form 1101 B, the Department’s Bank Tax Return, states: “For the purposes of allocation and apportionment, all of the provisions of Chapter 6, Title 12 that **may be appropriate or applicable** have been adopted for banks.” (emphasis added). The form does not indicate that Chapter 6 is adopted for calculating the base of the bank tax, or that all of Chapter 6 is adopted. The partial adoption of provisions of Chapter 6 in Form 1101 B properly reflects section 12-11-40.

The Department’s historic interpretation that Chapter 11 is subject to only partial conformity is entitled to the most respectful consideration “assuming the interpretation is worthy of deference.” *Kiawah Dev. Partners, II v. S.C. Dep’t of Health & Envtl. Control*, 411 S.C. 16, 33, 766 S.E.2d 707, 717 (2014). Here, the Department has uniformly held this interpretation for an extended period of time. This longstanding acceptance is indeed the fundamental tenet to a

court's deference to an agency's interpretation of law within its regulations.¹⁷ See *Media Gen. Commc'ns, Inc.*, 388 S.C. at 149, 694 S.E.2d at 530–31 (“An agency's long-standing interpretation of a statute is usually entitled to be given deference and should not be overruled by a reviewing court in the absence of cogent reasons, but the interpretation will not be sustained if it contradicts a statute's plain language.”); *Etiwan Fertilizer Co.*, 217 S.C. at 354, 60 S.E.2d at 682 (“[W]here the construction of the statute has been uniform for many years in administrative practice, and has been acquiesced in by the General Assembly for a long period of time, such construction is entitled to weight, and should not be overruled without cogent reasons.”).¹⁸

Conclusion

Four conclusions can be drawn from this analysis. First, the General Assembly did not authorize a blanket adoption of the IRC pursuant to Chapter 6; rather, the General Assembly adopted the IRC with certain exclusions and limitations. Second, the General Assembly intended for banks to be treated differently than other corporations subject to income tax under Chapter 6, as evidenced by sections 12-6-550 and 12-6-630 and the retention of a separate chapter for the bank tax. Third, if the General Assembly had intended for the base of the bank tax to be based on the income tax calculation in Chapter 6 and the IRC, it would have incorporated it by reference like it did for building and loan associates in Chapter 13. Fourth, the General Assembly only intended for certain, selective provisions of Chapter 6 and the IRC to apply to Chapter 11 pursuant to section 12-11-40.

Accordingly, Petitioner cannot rely on conformity as an argument that banks are allowed to deduct NOL carryforwards like other corporations or entities subject to the income tax in

¹⁷ It is notable that in our Supreme Court's recent deference analysis in *Kiawah Dev. Partners, II*, the Supreme Court focused on whether the agency interpretation was rational and not arbitrary and capricious without exploring whether the Department's interpretation was long-standing. *Kiawah Dev. Partners, II*, 411 S.C. at 35, 766 S.E.2d at 719 (holding that the Department's interpretation of regulation 30-11(C)(1) was entitled to deference because the agency's interpretation was not “arbitrary, capricious, nor manifestly contrary to the statute”). Nevertheless, the Supreme Court's lack of consideration of whether the Department's interpretation in *Kiawah Dev. Partners, II* was long-standing should not be interpreted as dismissing that requisite in a deference analysis. Rather, in *Kiawah Dev. Partners, II* the issue of whether the Department's interpretation of regulation 30-11(C)(1) was long-standing was never raised and, therefore, not an issue this court or the Supreme Court ever considered.

¹⁸ The need for uniformity in the agency's interpretation over an extended time frame as set forth in *Etiwan* is profoundly revealed in the facts and legal discussions in *S.C. Coastal Conservation v. S.C. Dep't of Health and Env'tl. Control and Oakridge Landfill, LLC*, Docket No. 14-ALJ-07-0221-CC (August 29, 2014) (order denying motion to dismiss). See also *Harry v. S.C. Dep't of Health and Env'tl. Control*, 09-ALJ-07-0255-CC, 2010 WL 8425978, at *1 (July 15, 2010).

Chapter 6. Petitioner must show that it meets the qualification for the deduction through other means. One way for Petitioner to do this is to show that the bank tax is based upon “taxable income.”

The Bank Tax is Not Based on “Taxable Income”

Whether or not banks are subject to the corporate income tax in Chapter 6 is not necessarily essential to claiming the NOL carryforward deduction. Rather, what is essential is whether banks are taxed, like these other corporations, on “taxable income” as set forth in section 12-6-1130 because it is this section through which Petitioner, in part, seeks a deduction for NOL carryforwards.

The method for calculating corporate income tax imposed under Chapter 6 is found in Article 9 of Chapter 6, which is entitled “Taxable Income Calculation.” “Taxable income” is computed from “gross income” after “making modifications to deductions provided in the Internal Revenue Code as follows.” S.C. Code Ann. § 12-6-1120-1130 (2014 & Supp. 2017) (discussing “gross income” and “taxable income” respectively); *see also* S.C. Code Ann. § 12-6-1110(A) (“For South Carolina income tax purposes, gross income, adjusted gross income, and taxable income as calculated under the Internal Revenue Code are modified as provided in this article and subject to allocation and apportionment as provided in Article 17 of this chapter.”). In other words, “taxable income” is computed by following the provisions of the Internal Revenue Code which specifically sets forth acceptable deductions from a corporation’s gross income.¹⁹

Within Article 9, section 12-6-1130 governs the computation of “taxable income” and contains the provision allowing for the deduction of NOLs. It specifically states that “South Carolina taxable income is computed by making modifications to gross income provided in the Internal Revenue Code as follows,” and one of the modifications that follows is the NOL carryforward. § 12-6-1130. Indeed, the NOL carryforward deduction is found exclusively in this section 12-6-1130(4). However, as explained above, section 12-6-630 sets forth that banks are not

¹⁹ “Gross income,” as calculated pursuant to the applicable IRC section adopted through Chapter 6, excludes nontaxable interest on state and local government bonds. 26 U.S.C.A. § 63 (West 2018); 26 U.S.C.A. § 103 (West 2018). However, since banks are subject to a franchise tax, their tax on “entire net income” includes “income derived from any source whatsoever including interest on obligations of the United States, the United States Government or its possessions or of any state and any political subdivision thereof.” S.C. Code Regs. Ann. 117-1500.1. Though this distinction between “gross income” and “entire net income” clarifies the application of the IRC, it does not explain the computation of a bank’s taxable income, which is discussed later in this order.

included with the entities that are “taxed as provided in the Internal Revenue Code with the modifications provided in Article 9.” Further, Chapter 11 does not specifically incorporate Article 9 like it incorporates the apportionment principles of Article 17. Therefore, banks are not included within those entities whose tax is calculated using the NOL deduction from “gross income” to determine its taxable income. However, the issue of how to calculate the basis of the bank tax—entire net income—remains.

Entire Net Income

The Department has maintained throughout this litigation that “entire net income” is based “book income” or financial net income and not federal taxable income. The Department has also suggested that book income must be calculated pursuant to GAAP. At the hearing in this case, the Department clarified that it now believes book income should generally be equivalent to net income as calculated under GAAP.

Petitioner argues the Department cannot rely on GAAP to define “entire net income” because this would be an unconstitutional delegation of power to the FASB. Petitioner also argues that “book income” as calculated pursuant to GAAP is not a reasonable proxy for entire net income because not all banks are required to use accrual-based accounting and GAAP is used exclusively for accrual-based accounting. Petitioner also contends that if GAAP is used to calculate book income, then it requires NOLs to be recognized. Finally, Petitioner argues that the phrase “entire net income” inherently authorizes NOL carryforward deductions.

Reliance on GAAP to Define “Entire Net Income”

The Court agrees with Petitioners that GAAP should not be used as a wholesale proxy for “entire net income” or “book income.” The FASB is an independent non-profit corporation and GAAP is not a law. The Legislature has never taken any action to conform the bank tax to the ever-changing principles of GAAP. Moreover, the Department has never formally issued guidance on the application of accounting principles/standards to the bank tax. As a result, GAAP, as defined and revised by the FASB, cannot be a binding framework for calculating “entire net income” and any delegation of taxing power to the FASB could constitute a violation of the South Carolina Constitution.

However, if GAAP is properly used as an evaluative tool rather than a binding standard, it does not constitute an unconstitutional delegation of regulatory authority to the FASB.

Accordingly, the use of GAAP's principles in determining a reasonable interpretation of the meaning of "entire net income" is not improper. Yet its use is circumscribed by its application. GAAP does not use the term "entire net income" or "book income." GAAP only uses the term "net income." GAAP is thus a compilation of rules under which net income is computed and which may give insight into the application of "entire net income."

Deference

When a statute or regulation is silent as to a particular issue and an agency's interpretation is worthy of deference, our courts generally defer to an agency's interpretation. *Kiawah Dev. Partners, II v. S.C. Dep't of Health & Envtl. Control*, 411 S.C. 16, 33, 766 S.E.2d 707, 717 (2014). Here, the statutes and regulations are relatively silent as to how to specifically calculate "entire net income." Regulation 117-1500.1 defines "entire net income," but its definition is not very helpful in resolving this issue before the Court. Reg. 117-1500.1 ("[E]ntire net income . . . shall include income derived from any source whatsoever including interest on obligations of the United States, the United States Government or its possessions or of any state and any political subdivision thereof."). However, both parties appear to agree that the Department has historically treated the bank tax as a franchise tax. See *Etiwan Fertilizer Co.*, 217 S.C. at 359, 60 S.E.2d at 684 ("We have held in many cases that where the construction of the statute has been uniform for many years in administrative practice, and has been acquiesced in by the General Assembly for a long period of time, such construction is entitled to weight, and should not be overruled without cogent reasons."). Therefore, this interpretation is entitled to deference.

Nevertheless, the Department practice of using financial accounting, or book income, to calculate the basis of the bank tax does not meet the legal parameters of the deference doctrine. Mr. Von Lehe testified he believes the Department's staff has historically used financial accounting, or book income, to calculate the basis of the bank tax. Mr. Beckwith also testified that in his practice of filing bank tax returns in South Carolina for several years, South Carolina accountants have calculated a bank's tax based upon financial net income. While the testimony of these experts indicates that the actions of the Department's staff have led some practitioners to perceive the Department's interpretation of the bank tax as based on book income or financial net income, the fact remains that the Department has not issued any formal guidance on how it

calculates or interprets “entire net income” beyond regulation 117-1500.1.²⁰ Moreover, at the hearing into this matter, the Department modified its interpretation of how to specifically calculate “entire net income” from stating GAAP is a wholesale proxy for “entire net income” or “book income” to asserting that it does not strictly interpret “entire net income” to be calculated pursuant to GAAP. Therefore, the evidence did not show the Department has a long-standing statutory interpretation of how to calculate “entire net income” Indeed, its current interpretation is nascent.

Additionally, the Department’s interpretation must not only be longstanding, it must also be sufficiently known to the legislature such that the legislature can be deemed to have acquiesced to the Department’s interpretation. See *Charleston Cty. Assessor v. Univ. Ventures, LLC*, 427 S.C. 273, 289, 831 S.E.2d 412, 420 (2019) (“We have previously held in many cases that where the construction of the statute has been uniform for many years in administrative practice, and has been acquiesced in by the General Assembly for a long period of time, such construction is entitled to weight, and should not be overruled without cogent reasons.”) (quoting, in part, *Etiwan Fertilizer Co. v. S.C. Tax Comm’n*, 217 S.C. 354, 359, 60 S.E.2d 682, 684 (1950))). Consequently, the Court would expect the interpretation to be (1) recorded in the Department’s policies or procedures to put taxpayers on notice and (2) consistently applied to all applicable taxpayers. The Department’s interpretation does not meet either of these expectations. Here, the Department has no formal ruling or publication interpreting the meaning or calculation of “entire net income.”

Furthermore, for the Department’s position to be entitled to deference, its position ordinarily must be a formal interpretation by the Department and not its staff. *Neal v. Brown*, 383 S.C. 619, 682 S.E.2d 268, 270 (2009) (holding “an agency’s Appellate Panel, not its staff, is typically entitled to deference in interpreting agency regulations”). The Department maintains “entire net income” is also equivalent to “book income” or financial “net income.” Nevertheless, the term “book income” does not appear in any statute, regulation, formal ruling or publication. But what is more concerning is the Department’s further inference that “book income” is based on GAAP was not reflected by the expert testimony. This does not necessarily make the Department’s

²⁰ The bank tax return (Form SC 1101 B) refers to the base of the bank tax as “total net income.” This form also instructs the taxpayer to begin with federal taxable income and then backtrack to financial income or book income. Part of the back tracking specifically requires the taxpayer to eliminate any NOL deductions they may have taken on the federal return. While these instructions could be interpreted to be a public representation of the Department’s interpretation of “entire net income,” it is unclear how long the form used by Synovus has been in use and what relationship **total** net income would have to **entire** net income.

inference unreasonable, but a recent, undocumented interpretation or policy does not entitle the Department to deference.

Does “entire net income” inherently include NOL carryforward deductions?

The parties disagree whether the term “entire net income” inherently incorporates NOLs. At the heart of this debate is the effect and meaning of the word “entire.” Petitioner argues that the word “entire” implies that all income and all expenses must be included in the calculation and the only manner in which all expenses can be deducted by a bank having expenses that exceed income in a year under GAAP is through the use of a NOL carryforward. In other words, Petitioner claims the word “entire” creates the statutory authorization that allows NOL carryovers. Petitioner claims this interpretation is consistent with the legislative intent of the bank tax, the bank regulations, GAAP, and the historical application of the bank tax.²¹ The Department disagrees and takes the position that (1) the primary effect of the word “entire” is meant to capture income from (usually) non-taxable securities²² and (2) although the word “entire” also includes all expenses, it only includes expenses from the taxable year at issue.

History of Income Tax Law

“Entire net income” is not cogently defined for the purpose of the bank tax. However, the legislative history of the term gives insight into its meaning. The General Assembly first enacted an income tax in 1922, when it imposed an income tax on the “net income” of individuals and corporations. See 1922 S.C. Acts No. 502, § 2. Importantly, this South Carolina income tax was

²¹ Interestingly, Petitioner’s argument essentially renders unnecessary its previous argument that NOLs are allowed under the bank tax through conformity with the Internal Revenue Code and the corporate income tax. Indeed, this is the first time Petitioner has put forward this argument in this litigation.

²² The Department also contends the legislative use of “entire” operates to capture all sources of income, including income from non-taxable securities, is reflected by the bank tax regulations and the Attorney General’s opinion in 1948. See Reg. 117-1500.1 (providing the base of the tax, “entire net income,” includes “income derived from any source whatsoever including interest on obligations of the United States, the United States Government or its possessions or of any state and any political subdivision thereof.”); 1947-48 Op. S.C. Att’y Gen. 294 (March 12, 1948) (opining the bank tax is a franchise tax on “all income from whatever source derived, even income from nontaxable securities”); see also 84 C.J.S. *Taxation* § 223 (“The fact that the tax formula reflects the value of tax-exempt securities does not invalidate it since the tax is not on property but on a privilege or franchise.”). On its face, this contention sounds persuasive. However, the term “entire net income” was also historically used for corporations who were not required to declare income from those governmental source as “entire net income.” Nevertheless, the efficacy of this argument can be partially restored because the legislature could have retained the term “entire net income” for banks reasoning that it reflected the breath of income for which banks are taxed. Thus, although the argument has some merit, in light of the other more persuasive legal considerations, I banish this argument to a footnote.

calculated as a percentage of the amount required to be paid as an income tax to the United States government and, therefore, the 1922 Act incorporated by reference “laws made and to be made by Congress and regulations made and to be made thereunder by federal officers.” *Santee Mills v. Query*, 122 S.C. 158, 115 S.E. 202, 205 (1922). In practicality, South Carolina had adopted conformity with the federal income taxes and any additions or deductions for federal income tax purposes indirectly applied in South Carolina.

The federal income tax scheme at this time was established by the Revenue Act of 1918, which levied an income tax on “net income.” Revenue Act of 1918, H.R. 12863, 65th Cong. § 230(a) (1918). This was the first-time net operating losses were introduced into a tax scheme. *The Loss Carryover Deduction and Changes in Corporate Structure*, 66 COLUM. L. REV. 338, 339 (1966) (“Introduced by the Revenue Act of 1918, the net operating loss carryover deduction is intended to mitigate the effects of taxation on an annual basis, which ‘does not adequately recognize the exigencies of business’ and ‘may often result in grave injustice.’”). But although net operating losses were authorized, they were only authorized in limited circumstances. Specifically, only net losses accrued between October 31, 1918, and January 1, 1920, were allowed to be carried back and deducted from the net income of the preceding year or, if that was insufficient, to be carried forward and deducted from net income from the successive year. *Id.* § 204(a) & (b). Additionally, net operating losses were not included in the section of the Act discussing the calculation of “net income,” nor were they discussed as a corporate deduction (business expenses or otherwise); rather, they were addressed as part of the “General Provisions” of the Act. *Id.* § 204(b); § 212(a) & (b); § 214.

Also, of note, the Revenue Act of 1918 at one point uses the phrase “entire net income” as follows:

That whenever parts of a taxpayer’s income are subject to rates for different calendar years, the part subject to the rates for the most recent calendar year shall be placed in the lower brackets of the rate schedule provided in this title, the part subject to the rates for the next preceding calendar year shall be placed in the next higher brackets of the rate schedule applicable to that year, and so on until the **entire net income** has been accounted for. In determining the income, any deductions, exemptions or credits of a kind not plainly and properly chargeable against the income table at rates for a preceding year shall first be applied against the income subject to rates for the most recent calendar year; but any balance thereof shall be applied against the income subject to the rates of the next preceding year or years until fully allowed.

§ 206 (emphasis added). The phrase “entire net income” in this section appears to account for the fact that some businesses kept their books according to a fiscal year that did not align with a calendar-based tax year ending on December 31st of a given year, and, therefore, income taxed at different rates from different tax years had to be combined to create the “entire net income” for the tax year. *See also id.* § 205 (discussing the calculation of taxes across tax years). Also notable at this time, “net income” did not include interest on non-taxable securities under the Act. *See id.* §213(b)(4); § 214(a)(2).

In the successive federal Revenue Acts of 1921, 1924, and 1926, a net loss was only authorized to be carried forward to the succeeding year and next succeeding year (i.e. a company could carry it forward for two years). *See* Revenue Act of 1921, H.R. 8245, 67th Cong., § 204 (1921); Revenue Act of 1924, H.R. 6715, 68th Cong., § 206 (1924); Revenue Act of 1926, H.R. 1, 69th Cong., § 206 (1926). Thus, when NOLs first appeared in the federal tax scheme (and through conformity in South Carolina’s tax scheme), they did not appear as an inherent part of the calculation of “net income” for a taxable year and they were not capable of being carried back or carried forward indefinitely. *See Lancaster Cotton Mills v. S.C. Tax Comm’n*, 132 S.C. 466, 129 S.E. 429, 431-32 (1925) (“[S]ince the state tax commission is governed by the acts of Congress and the rules and regulations made in pursuance thereof . . . it was the duty of the state tax commission to receive and approve such return and to credit against the income for the fiscal year 1921-22 that loss which the Treasury Department of the federal government allowed as a loss, as accrued from January 1, 1921, to June 30, 1921, and that the basis of taxation set up by the state tax department cannot prevail.”).

In 1926, the South Carolina Legislature passed the Income Tax Act of 1926, which repealed the 1922 legislation, disposed of conformity, and did not include any provisions authorizing NOL deductions. *See* 1927 S.C. Acts No. 1, § 42 (“That on the passage of this Act, the Income Tax Act approved the 13th day of March, 1922, as amended, is repealed to take effect January 1st, 1925”); *U. S. Rubber Prod. v. S.C. Tax Comm’n*, 189 S.C. 386, 1 S.E.2d 153, 154 (1939) (“In 1926 the State enacted a complete income tax law (35 St. at Large, p. 1), which had no reference to the Federal Acts.”). The 1926 Act imposed an income tax on corporations, including for-profit banks, as follows:

Every corporation organized under the laws of this State shall pay annually an income tax, with respect to carrying on or doing business equivalent to four percent

of the **entire net income** of such corporation, as herein defined, received by such corporation during the income year

1927 S.C. Act No.1, § 4(a) (emphasis added); *see also id.* § 3 (imposing tax on individuals residing in South Carolina based on the “entire net income” of the individual taxpayer). Although the statute used the phrase “entire net income . . . as herein defined,” the 1926 Act only defined the phrase “net income.” *Id.* § 7 (explaining the “Computation of tax—Net income defined”). “Net income” was defined to mean “the gross income of a taxpayer less the deductions allowed by this Act.” *Id.* The term “gross income” was further defined by the statute to include all manner of “income derived from any source whatever” and to exclude certain items (such as interest upon the obligations of the United States, South Carolina, or any political subdivision thereof). *Id.* § 8. Gross income was to be included in the income year in which it was received unless, “under the methods of accounting permitted under this Act, any such amounts are to be properly accounted for as of a different period.” *Id.* The Act provided certain deductions, but these deductions did not include a net loss or net operating loss. *Id.* § 13. Additionally, a taxpayer was allowed, with the approval of the Tax Commission, to calculate its net income based on their fiscal year instead of the calendar year. *Id.*

Even though only “net income” was defined, the Legislature seemed to use “net income” interchangeably with “entire net income” and “entire income.” *See, e.g., id.* § 15(1) (using “entire income,” “entire net income,” and “net income” interchangeable when discussing the tax on non-residents and foreign corporations). Case law from this time period also suggests that “net income” and “entire net income” were interchangeable. *See U. S. Rubber Prod.*, 189 S.C. at ___, 1 S.E.2d at 154-155 (discussing the application of the 1932 Code and how to determine “net income” for a tax imposed on the “entire net income” of a foreign corporation).

The next substantial change to the income tax was in 1937 when the Legislature separated the bank tax and the corporate income tax: the corporate income tax in Chapter 6 of Title 12, and the bank tax in Chapter 11 of Title 12.^{23,24} This is essentially the same bank tax that is still

²³ In the Code of Laws of South Carolina (1962), the Income Tax Act of 1926 was in Chapter 5 of Title 65, while the Bank Tax was in Chapter 7 of Title 65. Under current law, the South Carolina Income Tax Act is in Chapter 6 of Title 12, while the Bank Tax is in Chapter 11 of Title 12.

²⁴ Also notable during this same time period, the federal tax code stopped recognizing net operating losses for a period of seven years between 1933 and 1939. *See Mut. Assur. Soc. of Virginia Corp. v. Comm'r*, 505 F.2d 128, 136 (4th Cir. 1974) (“The first enactment of a provision permitting the excess of expenses incurred in one tax year over

applicable today. The corporate income tax, in contrast, has been amended several times since 1937.²⁵ Although the bank tax and corporate income tax were separately codified in 1937, they were both based on “entire net income.” See S.C. Code § 65-402 (Supp. 1937) (bank tax); see also S.C. Code Ann. § 2676(2) (1942) (bank tax); S.C. Code § 2440 (1942) (corporate income tax). Again, “entire net income” was not defined for the purpose of the bank tax. See S.C. Code § 65-401 *et. seq.* (Supp. 1937). Also, no deduction for NOLs was authorized for corporations or banks.

In 1955, the bank tax (by this time recognized as a franchise tax)²⁶ and the corporate income tax remained separate and both continued to be imposed on “entire net income.” But a significant change occurred. The corporate income tax was amended to include NOLs as a specific deduction. See S.C. Code Ann. § 65-222 (1952) (corporate income tax); S.C. Code Ann. § 65-402 (1952) (bank tax); S.C. Code Ann. § 65-259 (Supp. 1955) (NOL deduction). In particular, section 65-259 was amended to add an additional deduction for person establishing a new business or industry:

With respect only to taxpayers who have established a new business or industry in South Carolina during the calendar year 1955 and thereafter, in addition to other deductions allowed by this Chapter, there shall be allowed as a deduction from gross income a net operating loss carry over under the following rules:

(A). the net operating loss as herein defined²⁷ for any year ending on or after December 31, 1955, may be carried forward to the next succeeding taxable year and annually thereafter for a total period of three years next succeeding the year of such operating loss, or until such net operating loss has been exhausted or absorbed by the taxable income of a succeeding year. The net operating loss deduction herein allowed shall be allowable only for the first three years of the operation of the said new business or industry in South Carolina.

gross income for such year to be deducted in another tax year came in the Revenue Act of 1918.”); *id.* (“In 1933, the National Industrial Recovery Act abolished all net loss carryovers and carrybacks.”); *id.* at 137 (“In 1939, a net operating loss carryover provision was reintroduced.”). The authorization, prohibition, and re-authorization of NOLs at the federal level indicates NOLs are creatures of statute.

²⁵ For example, in 1985 the Legislature repealed the 1926 Act and made wholesale changes to the entire income tax section of the South Carolina code, including changing the tax base for the corporate income tax from “entire net income” to “taxable income as determined under the [IRC] with the modifications specified.” See Act No. 101, 1985 S.C. Acts 280–314; S.C. Code Ann. § 12-6-580 (2014).

²⁶ See 1947-48 Op. S.C. Att’y Gen. 294 (March 12, 1948) (“[T]he bank tax is a franchise tax for the privilege of operating, or doing business in this State, the amount thereof being measured by the entire net income.”).

²⁷ “Net operating loss” was defined as “the excess of allowable deductions over gross income for the taxable year arising from the operation of such new business of industry.” § 65-259(13)(C).

§ 65-259(13)(A).

By providing that “there shall be **allowed** as a deduction from gross income a net operating loss carry over under the following rules,” the 1955 Act can only be construed to mean that the General Assembly was creating a NOL deduction in 1955 that did not previously exist. And, like federal law prior to 1926 (and thus applicable in South Carolina), the NOL was restricted to a certain time period.

Implied Authorization of NOL Carryforward

Petitioner claims the word “entire” creates a statutory authorization that allows NOL carryovers. Petitioner argues that this interpretation of the calculation of a bank income following tax years subsequent to a NOL is supported by the inherent breadth of the term “entire net income.” In support of that contention, Petitioner asserts that if the legislature intended to limit a bank’s expenses to one year, then the legislature would have simply used the term “net income.”

In considering Petitioner’s contentions, it is important to recognize that Petitioner seeks an interpretation that it is entitled to NOL carryforwards not based upon just the clear meaning of the term “entire net income” but upon an inference resulting from that meaning. As to the meaning of “entire net income,” the Court clearly agrees with the Petitioner that “entire net income” requires consideration of all income and all expenses. In fact, if the word “entire” captures all different sources of income, it must also capture all expenses. Moreover, Petitioner’s argument appeals to the statutory construction principle that every word must have a purpose.

Nevertheless, the fact that the General Assembly specifically amended the corporate income tax on “entire net income” to include a NOL deduction demonstrates the NOL deduction was not inherently part of the meaning of “entire net income” prior to the 1955 amendment. Moreover, the bank tax was also based on “entire net income” at that time and was not similarly amended to include an NOL deduction. The Court can thus only conclude the term “entire net income” did not inherently authorize NOLs to be carried forward to subsequent tax years. If the Legislature intended NOLs carryforwards to apply to banks, the legislature would have similarly amended the bank tax when it allowed NOLs to be deducted as part of the calculation of “entire net income.” The necessity for legislative action to allow NOL carryovers is even more significant in light of the legislative history of treating “entire net income” interchangeably with “net income.”

Even the current form of the statutory and regulatory scheme suggest “entire net income” and “net income” are interchangeable. Compare § 12-11-20 (2014) (providing the bank tax is levied upon “the **entire net income** of the taxpayer doing a banking business within this State”) with S.C. Code Regs. Ann. 117-1500.2 (providing “[t]he **net income** of the taxpayer as provided for in Section 12-11-20 shall be computed on either a cash or accrual basis”). Therefore, the Court cannot conclude that the Legislature would have used “net income” had it intended to constrain the calculation to one year. See 1927 S.C. Act No.1, § 4(a) & § 7 (imposing the income tax on “entire net income” but only defining “net income”); *U. S. Rubber Prod.*, 189 S.C. at ___, 1 S.E.2d at 154-155 (discussing the application of the 1932 Code and how to determine “net income” for a tax imposed on the “entire net income” of a foreign corporation).

I nevertheless recognize the Department’s emphasis upon the fact that “entire net income” can only refer to income, and thus expenses, within one year has a weakness. The income statement would obviously cover one year because the tax laws specifically set the parameters under which the banks are taxed. And, it is obvious that income is routinely taxed in the year that it occurs. In other words, generally in every year that income exceeds expenses, the bank is taxed for that income. Nevertheless, there is a notable distinction between income and expenses. If excess expenses are not carryforward to future tax years, they will be lost. This is an obvious inequity. Indeed, the courts have recognized this inequity. As explained in the Columbia Law Review: “The fundamental proposition underlying the carryover concept is one of tax equity: a taxpayer with a given aggregate income over a period of years whose annual returns vary between profit and loss should not be required to bear a greater tax burden than another taxpayer with the same aggregate income who suffers no annual losses.” *The Loss Carryover Deduction and Changes in Corporate Structure*, 66 Colum. L. Rev. 338, 339 (1966). NOL carryovers allow fluctuations in business cycles to be spread over both good and bad years, especially for the benefit of new businesses that are likely to begin without strong profits. *Id.* at 339-340 (“The carryover deduction finds further justification as a stimulant to investment in new business and risk enterprise.”); see also § 65-259(13)(A) (1955) (authorizing NOLs for new businesses established in or after 1955).

Yet that inequity should not be cured by a court interpreting the term “entire net income” to create legal right to carryforward excess expenses to another tax year. Tax laws are written with

specificity and inferring the creation of a right to carryforward expenses must be based upon more than equity. Interpreting tax laws in that fashion would lead to judicial fiat.

The issue before this Court is thus not an evaluation of what is fair. The issue is whether the General Assembly clearly authorized carryforward NOLs by the use of the term “entire net income.” Indeed, South Carolina courts have generally recognized that NOL carryovers are “allowed” pursuant to certain statutory rules. See *Wasson*, 252 S.C. at 487, 167 S.E.2d at 312 (“[I]n addition to other deductions allowed by this chapter, there shall be allowed as a deduction from gross income a net operating loss carry-over under the following rules . . .”).²⁸ As the court in *Wasson* further noted, the NOL “deduction and benefit is allowed as a matter of legislative grace” and “[i]n order to take advantage of this statute the respondent was required to meet the conditions of the statute which granted the benefit.” *Id.* at 488, 167 S.E.2d at 313; accord *C. W. Matthews Contracting Co. v. S.C. Tax Comm’n*, 267 S.C. 548, 557, 230 S.E.2d 223, 227 (1976); cf. *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934) (“The statutes pertaining to the determination of taxable income have proceeded generally on the principle that there shall be a computation of gains and losses on the basis of a distinct accounting for each taxable year; and only in exceptional situations, clearly defined, has there been provision for an allowance for losses suffered in an earlier year.”); *Philadelphia Fire & Marine Ins. Co. v. U.S.*, 3 F. Supp. 655, 656 (Ct. Cl. 1933) (“Under our system of taxation each taxable year stands alone and the deduction of the whole or any part of a loss of one taxable year from the net income of another taxable year is wholly within the discretion of Congress and it may constitutionally place any limitation it desires upon such deduction.”). Moreover, both parties’ experts appeared to agree that carrying over NOLs are only the result of statutory authority permitting such carryovers.

Here, Petitioners have put forth no evidence showing that any states, including South Carolina, implicitly allowed NOLs before or after they were introduced by the Revenue Act of 1918. Furthermore, as demonstrated by Regulation 117-1500.3, which discusses a federal income

²⁸ See also *Mut. Assur. Soc. of Virginia Corp. v. Comm’r*, 505 F.2d 128, 136 (4th Cir. 1974) (“The first enactment of a provision **permitting** the excess of expenses incurred in one tax year over gross income for such year to be deducted in another tax year came in the Revenue Act of 1918.”); *id.* (“In 1933, the National Industrial Recovery Act abolished all net loss carryovers and carrybacks.”); *id.* at 137 (“In 1939, a net operating loss carryover provision was reintroduced.”). Notably, in 2017, NOL carryforwards were explicitly allowed indefinitely under federal law, demonstrating that a statute is needed to authorize NOLs even when they are indefinite in nature. See PL 115-97 § 13302 (Dec. 22, 2017). Therefore, statutes authorizing NOLs are not simply there to circumscribe them.

tax deduction for banks, the bank tax is not without an enumerated deduction for taxes paid; yet there is no enumerated deduction for NOLs. S.C. Regs. Ann. 117-1500.3 (2012) (discussing the deduction of taxes paid). The calculation of both income and expenses are made as set forth by the legislature. It is thus improper for Petitioner to infer that expenses should be carried over to another tax year simply because the deduction would be lost if not carried over. NOL carryforwards, as expense deductions, are allowed as set forth by the legislature and thus no equitable right can be inferred.

In sum, the history of the development of NOLs and the 1955 amendment to the corporate income tax to the exclusion of the bank tax shows NOLs are creatures of statute and the term “entire net income” does not inherently authorize NOL carryforwards as part of this State’s tax law. While the basis of the bank tax and corporate tax remained “entire net income” for several decades, the ability to take an NOL deduction has fluctuated and that fluctuation was regulated by statute. Moreover, when an NOL deduction has been allowed, it has been circumscribed by certain time limits for when it can be taken and for how many years it can be taken. These factors demonstrate NOLs are not inherently authorized by the term “entire net income.” Consequently, this Court cannot conclude, in light of statutory history of NOLs, that the term “entire net income” inherently creates a legal right to carryforward excess expenses to another tax year. Even if this conclusion appears to result in a less equitable outcome for banks than for corporations, it is not this Court’s place to judge the wisdom of the Legislature in enacting certain tax policies. *Centex Int’l, Inc. v. S.C. Dep’t of Revenue*, 406 S.C. 132, 151, 750 S.E.2d 65, 75 (2013) (“The result here may appear to be inequitable; however, we are constrained to conclude it is correct under extant law. The wisdom of tax policy is exclusively within the purview of the legislature and may not be supplanted by this Court.”).²⁹

²⁹ Petitioner contends out-of-state banks that merely hold loans in this State are treated like corporations for income tax purposes and, therefore, are allowed to take NOLs unlike in-state banks are not. Petitioner argues this is an inequitable result. Undoubtedly this would appear to be inequitable. However, as Mr. Beckwith explained, if these out-of-state banks do not engage in “banking” as defined by South Carolina law because of their limited operations in this state, then the inequity is at the very least reduced. Moreover, the definition of a bank under the bank tax could include out-of-state banks regardless of what their activities are in this state. Nevertheless, this issue is not before the Court and I therefore make no determination regarding this asserted inequity. Regardless, this situation would be best addressed by a legislative solution.

Use of “Book Income” and/or GAAP to Determine “Entire Net Income”

Statutory or regulatory provisions often describe the calculation of taxable income by defining how gross income is calculated and then subtracting statutorily authorized deductions. However, although taxable income for the purposes of the bank tax is based on “entire net income,” there is no definition or reference to what is gross income or what deductions are authorized (with the exception of regulation 117-1500.3’s reference to a deduction for income taxes paid, which is really just an expense).³⁰ And, as concluded above, “entire net income” does not inherently create a statutory deduction for NOLs. Therefore, the Court must determine how “entire net income” should be calculated in accordance with the tax laws.

The Department contends that the tax on banks is “a franchise tax that uses book income accounting.” That conclusion is founded upon the Department’s determination that the bank tax is based on financial accounting rather than federal income tax accounting.³¹ Relying on this premise, the Department infers that the bank tax “should generally be computed using Generally Accepted Accounting Principles (GAAP).” Petitioner argues, however, that if GAAP accounting is used, then GAAP requires NOL deductions to be reflected on the financial statements and, therefore, to be incorporated into the calculation of “entire net income.”

At the outset, there is no definition for the term “book income” in any statute, regulation, or authoritative policy issued by the Department. Nor does GAAP define “book income.” Thus, there is no mandate in the tax laws that “entire net income” be determined by “book income” in accordance with the principles of GAAP. Nevertheless, using “book income” may be a proper

³⁰ Petitioner complains the Department allows banks to take other federal credits and deductions, including the deduction in IRC § 162 (Ordinary and Necessary Business Expenses) without specific statutory authority. However, the deduction for ordinary and necessary business expenses in IRC § 162 would be implicitly included in any calculation of “net income” because it reflects expenses during the year. Therefore, explicit statutory authority would not be needed to allow banks to deduct any expenses during the year to arrive at net income.

³¹ The Department asserts its position is supported by a Tax Commission opinion in 1975 that noted there are “special rules in this State applicable to the taxation of banks.” The Tax Commission further noted that

the bank tax “has **always been construed to be a franchise tax** measured by the bank’s entire net income. The phrase “entire net income” has been construed to mean “all income from whatever source derived, less all expenses incurred”. See BA–OAG–1 (March 12, 1948). **The special base of this tax is, therefore, economic income rather than taxable income.**

Re: Bank Tax, 1975 WL 23740, at *1 (S.C. Tax. Comm. January 24, 1975) (emphasis added). Accordingly, the 1975 Tax Commission decision suggests is that “entire net income” is based on economic or financial income. Notably, financial accounting and book accounting are interchangeable terms and thus, the decision could equally be viewed as stating the tax is calculated according to a bank’s books.

means for calculating taxable income for the purposes of the bank tax. As explained by the experts, “book income” is a financial accounting term that refers, very generally, to the revenues and expenses listed in a ledger, which may vary depending upon the accounting methodology used to “keep the books.” Furthermore, if a company uses GAAP to keep its books, it is reasonable to conclude the company’s “book income” will be equivalent to its “net income” under GAAP because both are defined by subtracting expenses from revenues and would be based on the same accounting methodology. And here, Petitioner uses GAAP accounting to keep its books and, therefore, its book income is derived by using the principles of GAAP. Therefore, since Petitioner’s “book” income” is equivalent to its net income on its income statement under GAAP and, it is reasonable to infer that book income is equivalent of net income pursuant to GAAP in this situation.

Petitioner nevertheless argues that without looking at all the financial statements together, the full financial picture of the company will not be apparent. However, Petitioner provides no theory about how to mesh the four financial statements together to come up with “entire net income.” Rather, Petitioner contends that GAAP’s recording of NOLs upon the balance sheet supports its theory to use NOL carryforwards to reflect “entire net income.” It is also interesting that Petitioner has emphasized GAAP should not be a binding standard, yet for purposes of this contention, Petitioner now asserts NOL carryforwards must be approved because GAAP validates that use.

In evaluating this contention, the Court first looks to the general principles of accounting. The intent of the balance sheet is to give a picture of the health of a company at a particular moment in time for the purpose of informing investors, etc., of the company’s over-all financial health. It does this by listing assets minus liabilities equals equity. It is not a reflection of the annual income and expenses of a company, which are the metrics important to an annual income tax.³² It is the income statement that reflects the metrics important to an annual income tax—mainly, the revenues and expenses of a business within the its fiscal year or the calendar year, depending upon

³² Petitioner makes a blanket statement in its proposed order that using net income from its income statement is inconsistent with prior interpretations of the bank tax because “[p]rior interpretation of the Bank Tax allow for a deduction for all expenses without limitation to one year and other deductions are allowed to be taken in multiple years (even though thither deductions have no impact on the income statement).” This statement is so generic without concrete examples that it is not useful to the Court.

how it keeps its books. Thus, the weight an NOL carryforward carries as a tax asset upon the balance sheet is only as significant as the authority by which it is established as an equitable tax asset. In this instance, as addressed above, that authority is based upon an insufficient inference. Additionally, although Mr. Branch and Mr. Beckwith indicated GAAP requires NOLs to be documented in the financial statements, they also testified NOLs do not impact the calculation of “net income” on the income statement.³³ Rather, NOLs may be reflected in footnotes on the income statement or they may be reflected on the balance sheet.

Moreover, while it is true that GAAP requires NOL carryforwards to be reflected in a company’s financial statements, that does not mean GAAP controls what the taxing jurisdiction recognizes as the basis for its tax. It would thus be a mistake to infer that a taxing jurisdiction that does not allow NOL carryforwards would cause a company to be out of compliance with GAAP. If a jurisdiction does not recognize NOL carryforwards for tax purposes, then the NOL would not be a tax impact and GAAP would not require it to be recognized as a carryforward expense. A company who keeps its books according to GAAP will continue to note any NOL carryforwards it may have in the footnotes of its income statements or on its balance sheets; it merely will not get to deduct the NOL from its taxable income in jurisdictions that do not recognize NOL carryforwards. In other words, the Court does not find that GAAP’s requirement to record NOLs supersedes South Carolina’s income tax laws to authorize NOLs under the authority of GAAP. In fact, the provisions dealing with NOLs were developed in response to the creation of NOLs via federal and state tax law, not the other way around. *See* Bulletin No. 23, *supra*. And, indeed, both Mr. Beckwith and Mr. Branch agreed that GAAP is subservient to federal and state tax law.

Conclusion

The term “entire net income” reflects a breadth of income and expenses that requires **all revenues** and **all expenses** be included in the calculation of a bank’s taxable income. Yet despite that breadth, NOL carryforwards are not inherently included by the use of that term. Rather, the legislative history, the testimony of the experts, and the history of GAAP and accounting principles establishes that NOL carryovers are statutory creations of tax law in particular jurisdictions and

³³ An exception to this statement is found in the calculation and use of NOLs for federal income taxes. Since the IRC authorizes NOL carryforwards, then a company taking an NOL on a subsequent tax return will have a lesser taxable income than it would have had without using the NOL.

thus should be reflected in a company's financial statements as they are authorized in the jurisdiction. Moreover, the word "entire" may have been retained to reflect that certain sources of income that are usually not taxed are included within the calculation of banks' net income. In fact, interpreting "entire net income" to incorporate this income from non-taxable securities is consistent with the long-standing interpretation of the bank tax as a franchise tax. Therefore, since NOL carryforwards are not clearly authorized by South Carolina law, the expenses are limited to the fiscal/calendar year at issue. In this case, because Petitioner keeps its books according to GAAP, Petitioner's "book income" is equivalent to its "net income" as calculated pursuant to GAAP.³⁴

CONCLUSION

Petitioner's strongest argument in this case is an equitable one: that banks should be able to benefit from NOL carryforwards just like other corporations, especially when they suffer severe loss as in the financial crisis of 2008, which is when the losses in this case stem from. However, simply because an outcome is more equitable does not mean this Court can ignore the law or usurp the authority of the Legislature. *Centex Int'l, Inc.*, 406 S.C. at 151, 750 S.E.2d at 75 ("The result here may appear to be inequitable; however, we are constrained to conclude it is correct under extant law. The wisdom of tax policy is exclusively within the purview of the legislature and may not be supplanted by this Court."). NOL carryforwards are statutorily authorized deductions; not ordinary annual expenses. As such, NOL carryforwards are allowed as a matter of legislative grace and Petitioner was required to show it squarely met the requirements to take them. *See Davis Mech. Contractors, Inc.*, 268 S.C. at 29, 231 S.E.2d at 301 (holding tax deductions "are a matter of legislative grace and the taxpayer must establish compliance with the statutory conditions imposed"). Thus, a carryforward deduction cannot simply be inferred from an expansive right to take all expenses.

Here, Petitioner failed to show that the Legislature has authorized banks to take those carryforward expenses. Indeed, even if the Legislature's intent was ambiguous, this Court is still required to decide in the Department's favor. *S. Soya Corp. of Cameron*, 252 S.C. at 489, 167 S.E.2d at 313 (holding although ambiguities in tax statutes are generally construed in favor of the

³⁴ To the extent the Department asserts that "book income" means GAAP is the required accounting methodology to be used, the Court finds this is to be incorrect. "Book income" represents the revenues minus losses based upon whatever accounting method is used, which may be GAAP.

taxpayer, this rule “does not apply in the construction of a statute authorizing deductions; rather, the ambiguity will be resolved against the taxpayer”). Therefore, for all the reasons stated above:

ORDER

IT IS HEREBY ORDERED that Petitioner’s deductions of net operating loss carryforwards for tax years 2011 through 2014 are **DENIED**.

AND IT IS SO ORDERED.

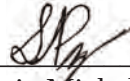


Ralph King Anderson, III
Chief Administrative Law Judge

June 22, 2020
Columbia, South Carolina

CERTIFICATE OF SERVICE

I, Stephanie Michelle Perez, hereby certify that I have 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).



Stephanie Michelle Perez
Judicial Law Clerk

June 22, 2020
Columbia, South Carolina

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Synovus Bank,	)	Docket No. 17-ALJ-17-0418-CC
	)	
Petitioner,	)	
	)	ORDER
vs.	)	
	)	
South Carolina Department of Revenue,	)	
	)	
Respondent.	)	
_____	)	

A hearing was held in this matter on October 17, 2019, at the Administrative Law Court (ALC or Court). This Court issued a Final Order and Decision on April 17, 2020. Thereafter, on May 12, 2020¹, Petitioner filed a Motion for Reconsideration. The South Carolina Department of Revenue (Department) filed a Response to the Motion for Reconsideration on May 19, 2020. Therefore,

IT IS HEREBY ORDERED that the Final Order and Decision is hereby rescinded pending a decision upon the parties' pleadings.

AND IT IS SO ORDERED.



Ralph King Anderson, III
Chief Administrative Law Judge

May 20, 2020
Columbia, South Carolina

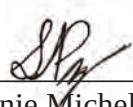
¹ Petitioner requested a two-week extension by email on April 24, 2020 due to the COVID-19 pandemic, which the Department consented to. Thus, the extension was granted by the Court and the Motion for Reconsideration was filed timely.

FILED

May 20, 2020
SC ADMIN. LAW COURT

CERTIFICATE OF SERVICE

I, Stephanie Michelle Perez, hereby certify that I have 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).



Stephanie Michelle Perez
Judicial Law Clerk

May 20, 2020
Columbia, South Carolina

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Synovus Bank,	)	DOCKET NO. 17-ALJ-17-0418-CC
	)	
Petitioner,	)	
	)	FINAL ORDER
vs.	)	
	)	
South Carolina Department of Revenue,	)	
	)	
Respondent.	)	
_____	)	

APPEARANCES:

For the Petitioner: Ashley Prickett Cuttino, Esq.; Lewis Smoak, Esq.; and Burnet Maybank, III, Esq.

For the Respondent: Jason P. Luther, Esq.

STATEMENT OF THE CASE

This case is before the South Carolina Administrative Law Court (Court or ALC) pursuant to a Request for Contested Case filed by Synovus Bank (Petitioner) on November 16, 2017. Petitioner contests the decision of the South Carolina Department of Revenue (Respondent or Department) in which the Department determined Petitioner could not deduct net operating loss (NOL) carryforwards¹ when computing its bank tax liability for tax years 2011 through 2014.

On July 25, 2018, Petitioner and the Department filed Cross-Motions for Summary Judgment. On October 22, 2018, the Court granted the Department's Motion for Summary Judgment, in part, and denied Petitioner's Motion for Summary Judgment. The remaining issue following this Court's order on summary judgement was how to calculate the base of the tax (entire net income) for the purpose of the South Carolina bank tax and whether the Department improperly relied on Generally Accepted Accounting Principles (GAAP) for this calculation. Accordingly, a final hearing on this issue was held on October 17, 2019, in Columbia, South Carolina.

¹ The term "net operating loss" is defined as "[t]he excess of operating expenses over revenues, the amount of which can be deducted from gross income if other deductions do not exceed gross income." *Net Operating Loss*, BLACK'S LAW DICTIONARY 964 (8th ed. 2004). Further, an NOL "carryforward" or "carryover" is "[a]n income-tax deduction (esp. for a net operating loss) that cannot be taken entirely in a given period but may be taken in a later period." *Carryforward*, BLACK'S LAW DICTIONARY 227 (8th ed. 2004).

FILED

April 17, 2020

SC ADMIN. LAW COURT

Although the Court previously issued an Order on summary judgment resolving many of the issues in this case, because the holdings in the summary judgment order provide an important foundation and context for the remaining issue, the Court has determined it is most efficient to combine the orders into one Final Order.

MATERIAL FACTS NOT IN DISPUTE

In 2010, the National Bank of South Carolina (NBSC) merged with Columbus Bank and Trust Company (CB&T) and was renamed Synovus Bank (Petitioner). CB&T reported net operating losses for 2009; NBSC reported net operating losses for 2009 and 2010; and Petitioner reported net operating losses for 2010. The total South Carolina losses reported by the three banks for 2009 and 2010 was \$391,050,990, as amended. The losses were thereafter increased to a total of \$482,050,990 pursuant to a proposed audit adjustment by the Department.

Following the merger, Petitioner filed South Carolina Bank Tax Returns for tax years 2011–2014. On its original bank tax returns for 2011–2013, Petitioner did not claim any deductions for NOL carryforwards from the 2009 and 2010 losses. However, Petitioner subsequently filed amended returns. On its amended returns for 2011–2013, Petitioner deducted NOL carryforwards, which resulted in Petitioner requesting refunds for tax years 2011–2013. Similarly, on its original bank tax return for 2014, Petitioner also claimed a refund after deducting an NOL carryforward.

The Department initially paid Petitioner its requested refunds for tax years 2013 and 2014. The Department withheld Petitioner’s refund for 2012 due to a procedural problem requiring the refund to be “held for verification.” The Department then conducted an audit of Petitioner’s tax returns for tax years 2011–2014. The Department ultimately issued a Proposed Notice of Adjustment (PNOA) in which it disallowed Petitioner’s claim for NOL carryforwards for 2011–2014 and assessed taxes, penalties, and interest. The Department then issued a revised PNOA updating the interest amount due and deleting the penalties it had originally assessed against Petitioner. On April 6, 2016, the total assessment on the revised PNOA was \$2,076,325. On June 7, 2016, Petitioner filed a written protest regarding both PNOAs. In a letter dated October 17, 2017, the Department issued a determination upholding its decision to disallow the NOL carryforwards. This contested case followed.

FINDINGS OF FACTS

Having observed the witnesses and exhibits presented at the hearing and taking into consideration the burden of proof and the credibility of the witnesses, I make the following findings of fact by a preponderance of the evidence.

Financial Accounting Generally

Financial accounting, also referred to as book accounting, is the method used by companies to prepare their audited financial statements. Specifically, financial accounting is the recording of transactions, assets, and liabilities for financial reporting purposes. Tax accounting is distinct from financial accounting and deals with the determination of taxable income. Because of this distinction, it is important to note that “net income” for financial accounting purposes is not necessarily the same as “net income” for tax accounting purposes. Similarly, a net loss for financial accounting purposes (revenues minus expenses) is not the same as a net operating loss, which is a tax accounting term and is defined in part by the ability to use the net loss as a future tax benefit. In particular, a net operating loss refers to a situation where **taxable deductions** exceeds **taxable income** and results in a loss that can be carried forward (or back) to reduce future (or past) taxes payable.²

GAAP Accounting

GAAP is a financial accounting method.³ It is maintained by an independent non-profit organization called the Financial Accounting Standards Board (FASB). Although GAAP may have loosely begun sometime after the Great Depression, the FASB was not created until 1973. The FASB now organizes, publishes, and issues accounting standards under GAAP.

GAAP can only be used for accrual-based accounting and not cash-based accounting.⁴ Accordingly, GAAP is not necessarily applicable to South Carolina banks because these banks

² Although the issue in this case is whether net operating loss **carryforwards** are allowed, the history of net operating losses show that they may be allowed as both **carryforwards** and **carrybacks**. See, e.g., Revenue Act of 1918, H.R. 12863, 65th Cong. § 204(a) & (b) (1918) (providing net losses accrued between October 31, 1918, and January 1, 1920, were allowed to be carried back and deducted from the net income of the preceding year or, if that was insufficient, to be carried forward and deducted from net income from the successive year) (emphasis added).

³ While GAAP is the collection of accounting principles at issue in this case, several other compilations of accounting rules exist, including the international financial reporting standards (IFRS) and “yellow book accounting,” which refers to governmental accounting principles and standards.

⁴ Cash and accrual-based accounting are differentiated, in part, by when revenue is recognized. For example, in cash-based accounting, the revenue from a sale is recorded when the cash exchanges hand. In contrast, in accrual-

may use cash-based accounting. S.C. Code Regs. Ann. 117-1500.2 (2012). Nevertheless, the use of GAAP is required for all companies whose ownership is held publicly, such as corporations traded on a stock exchange. More specifically, a publicly traded corporation operating solely in the United States, including a publicly traded bank or bank holding company, must follow GAAP protocols to be compliant with the U.S. Securities and Exchange Commission guidelines. Since Petitioner is a publicly traded company, it is required to use GAAP to prepare its financial statements.

During the early development of GAAP, the American Institute of Public Accountants would periodically issue Bulletins discussing certain accounting practices. In 1944, the American Institute of Public Accountants issued Bulletin No. 23, which, according to Petitioner, is the “earliest record identified that addresses the issue of excess expenses and income taxes for accountants.” ACCOUNTING RESEARCH BULLETIN NO. 23 (Comm. on Accounting Procedure, Am. Institute of Accountants 1944). This Bulletin was issued to address the “[b]asic difficulties [that] arise in connection with income taxes where there are material and extraordinary differences between taxable income upon which they are computed and the income reported in the income statement under generally accepted accounting principles As a result of such transactions the income tax legally payable may not bear a normal relationship to the income shown in the income statement.” *Id.* at 185. In this early Bulletin, the accounting profession was reacting to tax laws that created discrepancies between financial income and taxable income in a given year. Bulletin No. 23 summarizes the treatment of NOL carryforwards as follows:

Where material amounts of losses or unused excess-profits credits of prior years are carried forward into the current tax return, the operating results for the current year should preferably be shown without inclusion of the tax reduction resulting therefrom, i.e., the current provision for income taxes should be computed and shown in the income statement without the benefit of such “carry-forward,” and the amount of the tax reduction should be shown in the income statement as a separate item.

Id. at 184. This section of Bulletin No. 23 shows the profession was particularly reacting to the creation of NOLs because it shows the profession was establishing how to accommodate NOLs in

based accounting, the revenue from a sale is recorded when the sale occurs regardless of whether cash is exchanged at that point. In other words, in accrual-based accounting, the revenue is recorded when it is accrued rather than when it is received.

financial statements. It also advised at this time that the income statement should be computed without NOLs.

By 1987, after the FASB had been created, Bulletins were replaced by Statements of Financial Accounting Standards (FAB), and then, in 2009, these standards were codified in the Accounting Standards Codification or “ASC.” Although the standards set forth the principles that accountants follow, they are updated frequently. One of these standards, ASC 740, is a collection of accounting rules that apply to taxes based on income, including franchise taxes based on income. ASC 740, which has been updated over fifty times since 2010, sets forth standards, among other things, for carrying forward deferred tax benefits like NOLs.⁵ Under ASC 740, a company is required to identify and recognize tax impacts (e.g. deductions or credits) on its financial statements. For example, if a company can take an NOL carryforward under the IRC, ASC 740 requires the tax impact of that NOL carryforward to be reflected on the company’s financial statements, namely on its balance sheet.

Under GAAP, four financial statements are required: the income statement, the balance sheet, a statement of cash flows, and a statement of changes in owners’ equity. The income statement shows revenues and gains as well as expenses and losses. The income statement generally covers a one-year period. A bank’s “net income,” also known as its “bottom line,” is the net of the revenues and expenses shown on the income statement. On the other hand, the balance sheet is a statement that shows the assets, liabilities and shareholder’s equity at a point in time.

GAAP also follows the principles of double-entry accounting. Double-entry accounting means that a financial event should have an impact on two financial statements or on two different accounts under the same financial statement. In double-entry accounting there is always a credit and a debit that balance out over two statements or two accounts. When an NOL is recorded in double-entry accounting, it exists as a debit and credit on the balance sheet and may be footnoted on the income statement. A NOL carryforward expense does not affect the income statement in the year that it is taken except to the extent it increases the amount of expense in a given year it is

⁵ NOL carryforwards are deferred tax benefits because they allow excess expenses from one tax year to be carried forward to a future year to reduce the future year’s taxable income, thereby creating a future tax benefit from a tax deduction or credit (a deferred tax asset).

used. In other words, the NOL is not deducted from the income statement as an expense itself; rather, it increases the expenses and thus reduces the taxes paid.

Finally, GAAP does not use the term “book income,” nor does it use the term “entire net income.”

GAAP and the South Carolina Bank Tax

The Department’s longstanding practice is to use financial accounting to calculate the basis of the bank tax instead of relying on federal taxable income.⁶ The Department’s use of “financial accounting” to calculate the basis of the bank tax is interesting since GAAP, financial accounting, and book accounting are generally interchangeable terms. In fact, Mr. von Lehe explained that calculating entire net income using GAAP would **not necessarily** be appropriate because, although GAAP is used to calculate “net income,” it never references “entire net income.” Nevertheless, “entire net income” may be calculated using “book income” which may be determined following the principles of GAAP.

Under GAAP, ASC 740 requires that any deferred tax assets, such as NOL carryforwards, be recognized in a company’s financial statements, which include not only the income statement,

⁶ The parties introduced the testimony of three expert witnesses to explain the financial accounting concepts as they relate to bank tax. Petitioner presented John von Lehe, Esq., who was qualified as an expert in “the application of the South Carolina bank tax to ASC 740 based on the history of the bank tax as a franchise tax based on income.” Mr. von Lehe is a tax attorney and a Certified Public Accountant (CPA). He previously assisted the Department for a number of years in his capacity as an attorney with the South Carolina Attorney General’s office. He has practiced in the tax world as a CPA or tax attorney for over forty years. The Court recognizes that Mr. von Lehe changed his opinion about certain issues between the time of his deposition and the hearing. Previously, he averred that calculating “entire net income” under GAAP would be reasonable. I nevertheless found Mr. von Lehe explained his change of opinion and his testimony was generally credible.

Doug Branch, CPA, also testified on behalf of Petitioner. Mr. Branch is a partner in Price Waterhouse Cooper (PWC), one of the four largest accounting firms in the world. He practices in PWC’s forensic services group and leads the U.S. dispute services practice. Mr. Branch was qualified as an expert in GAAP accounting and the application of ASC 740 to deferred tax assets, including NOLs. The Court found Mr. Branch to be extremely knowledgeable in the area for which he was qualified. However, Mr. Branch has never worked in the area of the South Carolina bank tax and thus his testimony was more pertinent to how GAAP incorporates NOLs.

Additionally, Mr. Beckwith testified on behalf of the Department. Mr. Beckwith is a CPA and worked for Deloitte, a national accounting firm, for almost twenty years. He also worked for an accounting firm in South Carolina for almost ten years. Mr. Beckwith worked in the area of bank tax and was the lead shareholder in that area for his South Carolina firm. He has significant experience preparing South Carolina bank tax returns and described GAAP as subservient to federal and state tax law. I also found him to be generally credible.

Finally, this Court recognizes that the recitation of conflicting testimony is not proper finding of fact. See *Able Commc’ns, Inc. v. S.C. Pub. Serv. Comm’n*, 290 S.C. 409, 351 S.E.2d 151 (1986). However, in this case, an initial recitation of the experts’ testimony is helpful to provide context for the Court’s ultimate findings. In sum, although I found these witnesses to be credible, as reflected by this decision, I did not necessarily accept all of their opinions.

but also the balance sheet. Accordingly, because the IRC has created NOL carryforwards, ASC 740 requires that NOL carryforwards be recognized on a company's financial statements to be in compliance with GAAP.

It is here that the experts' opinions diverge. Mr. Branch opined that if "the Department adds GAAP to its definition of entire net income, it is inextricably linking the IRC to the South Carolina bank tax." Nevertheless, Mr. Branch also recognized GAAP does not create NOL carryforwards, but rather incorporates them into its methodology because the IRC has created a deduction based on them. Similarly, Mr. Beckwith testified NOL carryforwards were created by tax law. Therefore, when a specific accounting standard under GAAP, like ASC 740, discusses how to reflect NOL carryforwards on a company's financial statements, GAAP is responding to the statutory requirements of the IRC and state tax law. In fact, some states allow NOLs but some states do not.

Entire Net Income

From an accounting perspective, I find the term entire net income means all of a company's gross income minus gross expenses.⁷

The Department's expert, Mr. Beckwith, viewed the purpose of the word "entire" within the term "entire net income" as a recognition that "net income" for banks must include the non-taxable interests that are usually excluded from income tax but not from a franchise tax based on income. Furthermore, in reaching his opinion, Mr. Beckwith relied upon a 1975 Tax Commission decision which sets forth that entire net income should be determined based upon economic income and in Mr. Beckwith's opinion, economic income is equivalent to GAAP and thus, the ASC. Mr. Beckwith also asserted net income is derived solely from the income statement.

Turning to the practical application of the term, Mr. Beckwith explained that, although he is "not sure" he has ever agreed with the way the Department "get[s] to" taxing bank's entire net income, in computing entire net income for purposes of the South Carolina bank tax, he simply follows the Department's instructions that "banks are not allowed the [federal] net operating loss deduction" and adds the deduction back into book income. Therefore, consistent with the bank

⁷ In setting forth these facts, the Court emphasizes that it considered the experts testimony not as to the legal meaning of entire net income but to the application of that term from an accounting perspective.

tax return (Form SC 1101 B), he starts with federal taxable income and removes the federal NOL carryover deductions to reach net income. However, the form that Mr. Beckwith states he follows sets forth that the tax is based on “total net income” instead of “entire net income,” thereby introducing yet another term to this quagmire.

Petitioner’s experts, however, explained that the phrase “entire net income,” without more context, does not mean much to an accountant. In fact, although the term “net income” appears in GAAP, the term “entire net income” does not. Petitioner’s expert, Mr. Von Lehe, thus opined entire net income is a broader term than net income in GAAP. Petitioner’s experts nevertheless agreed that entire net income means all revenue minus all expenses. But Petitioner’s experts view the term entire net income to signal an intent that all financial statements GAAP requires (including where NOL carryforwards are usually reflected the balance sheet) should be considered.

Mr. Branch justified this viewpoint based upon the Department’s position that entire net income should be based on GAAP. Indeed, under the principles of GAAP, losses are reflected not just on the income statement but also on the balance sheet. Moreover, Mr. Branch opined that looking at any financial statement in isolation will not produce the full financial picture under GAAP because it would fail to capture all the losses and thus not fulfill the requisite of considering entire net income. In fact, if the excess expense (NOL) from a year is not carried forward, then that excess expense “will just go away” and the loss would not be captured. Therefore, Mr. Branch opined the phrase “entire net income” implies a bank may deduct NOL carryforwards in calculating a South Carolina bank’s taxable income.

However, Petitioner’s evidentiary theory is dependent upon the Court’s determination that GAAP principles govern the calculation of “entire net income.” Rather, GAAP principles may be used to calculate “entire net income,” but those accounting principles do not create legal tax deductions. For instance, one jurisdiction (federal) may recognize NOLs and another jurisdiction (state) may not. In such a case, the federal NOL carryforward would be recognized and reduce the expense for federal taxes paid on the company’s income statement; thus, the federal NOL carryforward would have an impact on the calculation of net income. The company will recognize the NOL carryforwards in its footnotes or on its balance sheet for the federal jurisdiction, but it will not recognize it for state tax purposes. At issue here is taking an NOL for state income tax purposes.

Book Income

The term “book income” emanates from the historic practice of keeping a ledger in a book to record financial transactions. Book income generally refers to the income kept in such a ledger, but the method for how the books are kept can vary. For instance, cash basis, international financial reporting standards, yellow book governmental standards, and GAAP are all methodologies that can be used to keep a company’s books. Although GAAP is the most prevalent methodology to calculate “net income,” a South Carolina bank can also use cash-based accounting. In addition, net income and book income are not necessarily synonymous. Book income “is more of a term of art” or “slang” that represents the income off the general ledger and could be computed under GAAP principles. Therefore, “book income” is a fluid term that represents gains and losses in a ledger, the calculation of which may vary depending upon the accounting methodology used to maintain that ledger. Nevertheless, because so many companies use GAAP as their accounting methodology, it is not unreasonable to conclude that “book income” is synonymous with financial “net income” under GAAP in many circumstances; however, just because this is a common occurrence does not mean it is the rule.

ISSUES

- 1) Whether a bank can deduct net operating loss carryforwards when calculating its South Carolina bank tax liability.
- 2) How is “entire net income” calculated for the purpose of the South Carolina bank tax?
 - a) Does the term “entire net income” inherently authorize NOL carryforward deductions?
 - b) Is “book income” a reasonable proxy for “entire net income”?
 - c) Is it reasonable for the Department to rely on the GAAP definition of “book income”?⁸

⁸ The Department phrases this issue slightly differently. It states the issue as whether it is reasonable for the Department to “infer that a bank’s entire net income will generally be computed using . . . GAAP.”

CONCLUSIONS OF LAW

Standard of Review

This Court has jurisdiction over this case pursuant to section 12-60-460 of the South Carolina Code (2014) and section 1-23-600 of the South Carolina Code (Supp. 2019).

This is a contested case, and it is heard *de novo*. *Be Mi, Inc. v. S.C. Dep't of Revenue*, 408 S.C. 290, 297, 758 S.E.2d 737, 740 (Ct. App. 2014) (“In reaching a decision in a contested violation matter, the ALC serves as the sole finder of fact in the *de novo* contested case proceeding.”); *Brown v. S.C. Dep't of Health & Envtl. Control*, 348 S.C. 507, 512, 560 S.E.2d 410, 413 (2002) (explaining that a contested case before the ALC is “in the nature of a *de novo* hearing with the presentation of evidence and testimony”). The standard of review is a preponderance of the evidence. S.C. Code Ann. § 1-23-600(A)(5) (Supp. 2019); *see also Anonymous (M-156-90) v. State Bd. of Med. Exam'rs*, 329 S.C. 371, 375-78, 496 S.E.2d 17, 19-20 (1998) (“Absent an allegation of fraud or a statu[t]e or a court rule requiring a higher standard, the standard of proof in administrative hearings is generally a preponderance of the evidence.”). Because Petitioner is challenging a Department determination, Petitioner thus has the burden of proof to show by a preponderance of the evidence that the Department’s determination was incorrect. *Leventis v. Dep't of Health and Envtl. Control*, 340 S.C. 118, 132-33, 530 S.E.2d 643, 651 (Ct. App. 2000) (holding, generally, the complaining party bears the burden of proof).

Statutory Construction

Petitioner argues this Court should find that the applicable tax laws allow banks to carryforward excess NOLs. Petitioner concedes this is an issue of first impression that requires the Court to engage in statutory construction. Petitioner contends NOL carryforwards were extended to banks pursuant to South Carolina’s adoption of tax conformity with the Internal Revenue Code (IRC), which allows corporations to deduct NOL carryforwards. Petitioner also claims that banks should be allowed to deduct NOL carryforwards regardless of whether they are subject to an income tax or a franchise tax. Additionally, Petitioner now claims that even without conformity, the bank tax law should be interpreted to allow NOL carryforwards.

In contrast, the Department argues South Carolina’s adoption of conformity with the IRC did not extend the NOL carryforward deduction to banks because they are treated differently than other corporations. Furthermore, the Department contends that deductions must be specifically

authorized, and the NOL carryforward deduction is only explicitly authorized for calculating corporate income tax based upon “taxable income,” whereas the bank tax is based on “entire net income,” and this term does not inherently authorize NOL carryforwards. Additionally, the Department maintains the bank tax is a franchise tax.

At the heart of this case is a disagreement about whether Petitioner is entitled to a tax deduction. The parties agree that no statute explicitly gives banks the right to deduct NOL carryforwards. Accordingly, it is necessary to engage in statutory interpretation to determine whether the conformity provisions or other elements of the bank tax law have extended the right to deduct NOL carryforwards to banks as Petitioner suggests.

Petitioner claims this is a case in equity and the law should be liberally construed in favor of the taxpayer. While the principle behind NOL carryforwards may be an equitable—redistributing a loss over a number of years—taking an NOL carryforward is a tax deduction. Tax deductions “are a matter of legislative grace and the taxpayer must establish compliance with the statutory conditions imposed.” *Davis Mech. Contractors, Inc. v. Wasson*, 268 S.C. 26, 29, 231 S.E.2d 300, 301 (1977); see *Allied Corp. v. S.C. Tax Comm’n*, 288 S.C. 197, 199, 341 S.E.2d 139, 140–41 (1986) (“It is settled that a deduction is not a matter of right but is one of legislative grace.”); *S. Soya Corp. of Cameron v. Wasson*, 252 S.C. 484, 488, 167 S.E.2d 311, 313 (1969) (“The deduction and benefit is allowed as a matter of legislative grace.”). Furthermore, although ambiguities in tax statutes are generally construed in favor of the taxpayer, this rule “does not apply in the construction of a statute authorizing deductions; rather, the ambiguity will be resolved against the taxpayer.” *Wasson*, 252 S.C. at 489, 167 S.E.2d at 313 (citing 47 C.J.S. Internal Revenue 230). Therefore, Petitioner has the burden to show it is entitled to the NOL carryforward deduction and any ambiguity will be construed in the Department’s favor.

Turning to the general rules of statutory construction, “[t]he cardinal rule of statutory construction is to ascertain and effectuate the intent of the legislature.” *Media Gen. Commc’ns, Inc. v. S.C. Dep’t of Revenue*, 388 S.C. 138, 147, 694 S.E.2d 525, 529 (2010). “The determination of legislative intent is a matter of law.” *Id.* at 148, 694 S.E.2d at 529. “The words of the statute must be given their plain and ordinary meaning without resorting to subtle or forced construction to limit or expand the statute’s operation.” *Berkeley Cty. Sch. Dist. v. S.C. Dep’t of Revenue*, 383 S.C. 334, 345, 679 S.E.2d 913, 919 (2009). Further, “the statute must be read as a whole and

sections which are a part of the same general statutory law must be construed together and each one given effect.” *Sloan v. Hardee*, 371 S.C. 495, 499, 640 S.E.2d 457, 459 (2007). “Where the statute’s language is plain and unambiguous, and conveys a clear and definite meaning, the rules of statutory interpretation are not needed and the court has no right to impose another meaning.” *Hodges v. Rainey*, 341 S.C. 79, 85, 533 S.E.2d 578, 581 (2000). Last, it is important to note that generally “[t]he construction of a statute by the agency charged with its administration will be accorded the most respectful consideration and will not be overruled absent compelling reasons.” *Brown v. S.C. Dep’t of Health & Envtl. Control*, 348 S.C. 507, 515, 560 S.E.2d 410, 414 (2002).

The South Carolina Bank Tax

Petitioner argues the bank tax is an income tax, but even if it is a franchise tax, Petitioner is entitled to an NOL carryforward deduction. Petitioner thus contends that whether the bank tax is an income tax or a franchise tax is not a question this Court need answer. In contrast, the Department argues that the bank tax is a franchise tax and that tax carries implications relevant to this case. Therefore, the Court will address this issue first.

The history of the South Carolina bank tax is fairly simple. In 1937, the General Assembly enacted a tax specifically for banks and excluded banks from the corporate income tax. This new bank tax was a 4.5% tax on the “entire net income” of the bank. The bank tax is codified in Chapter 11 of Title 12 and has remained relatively unchanged since 1937.

Pursuant to Chapter 11, a “bank” or “taxpayer” under this chapter is “any person engaged in a banking business, whether incorporated under the laws of this State, any other state or the United States or whether unincorporated, except cash depositories.” S.C. Code Ann. § 12-11-10 (2014). A tax of 4.5% is levied upon banks, specifically:

A tax is imposed upon every bank engaged in business in the State which shall be levied, collected and paid annually with respect to the entire net income of the taxpayer doing a banking business within this State or from the sales or rentals of property within this State, computed at the rate of four and one half per cent of the entire net income of such bank or taxpayer.

S.C. Code Ann. § 12-11-20 (2014).

Although the statutory laws do not specify the nature of the tax on a bank’s income, the bank tax is specifically described in regulation 117-1500 as a “franchise tax.” S.C. Code Regs.

Ann. 117-1500 (2012) (“Chapter 11 of Title 12 imposes a franchise tax on banks.”).⁹ Regulation 117-1500.1 further provides that the base of the tax, “entire net income,” includes “income derived from any source whatsoever including interest on obligations of the United States, the United States Government or its possessions or of any state and any political subdivision thereof.” S.C. Code Regs. Ann. 117-1500.1 (2012).

Including interest on government obligations within the definition of “entire net income” is consistent with a franchise tax. Generally, interest on government obligations or nontaxable securities are, as their name suggests, nontaxable when assessing income tax. However, their worth can be included when assessing a franchise tax because a franchise tax, while it can be measured based upon net income, is not a tax on income, but rather a tax levied for the privilege of doing business within the state. See *Franchise Tax*, Black’s Law Dictionary 1497 (8th ed. 2004) (defining a “franchise tax” as a “tax imposed on the privilege of carrying on a business” that is usually based upon income); 84 C.J.S. *Taxation* § 177 (“The net income of a corporation may be used as a measure of the tax on the privilege of doing business at least with respect to income derived from business done within the state.”); 84 C.J.S. *Taxation* § 223 (“The fact that the tax formula reflects the value of tax-exempt securities does not invalidate it since the tax is not on property but on a privilege or franchise.”). It is also well-settled that government obligations can be included in the calculation of a franchise tax, and this unique aspect of the tax has important implications in this case. *Tradesmens Nat. Bank of Oklahoma City v. Oklahoma Tax Comm’n*, 309 U.S. 560, 563–64 (1940) (“The plain meaning of the amendment [12 U.S.C.A. s. 548] is confirmed by its legislative history showing beyond doubt that Congress intended to authorize a franchise tax measured by net income including interest on tax-immune federal securities.”); *Pac. Co. v. Johnson*, 285 U.S. 480, 490 (1932).

Although regulation 117-1500 describes the bank tax as a franchise tax, Petitioner dismisses this regulation because the regulation was issued in 2003 and is “contrary to the 2005 conformity statute which included the bank tax and [is] an unconstitutional delegation of taxing powers.” Petitioner further argues the bank tax is an income tax because all statutory references to the bank tax refer to an “income tax” and not a “franchise tax.”

⁹ The tax described in section 12-11-20 is the only tax levied upon banks except for the use tax, deed recording fees, and taxes on real property. S.C. Code Ann. § 12-11-30 (2014).

Indeed, “[a]s a creature of statute, a regulatory body is possessed of only those powers expressly conferred or necessarily implied for it to effectively fulfill the duties with which it is charged.” *Captain's Quarters Motor Inn, Inc. v. S.C. Coastal Council*, 306 S.C. 488, 490, 413 S.E.2d 13, 14 (1991). Nevertheless, I do not find the Department’s promulgation of regulation 117-1500 resulted in an unconstitutional delegation of power. “While the legislature may not delegate its power to make laws, it may authorize an administrative agency or board to fill up the details by prescribing rules and regulations for the complete operation and enforcement of the law within its expressed general purpose.” *Hampton v. Haley*, 403 S.C. 395, 407–08, 743 S.E.2d 258, 264 (2013) (internal quotation marks and citation omitted).

Here, in 1991, the General Assembly gave the Department the authority to “make rules and promulgate regulations, not inconsistent with law, to aid in the performance of its duties.” S.C. Code Ann. § 12-4-320(1) (2014); Act No. 50, 1991 S.C. Acts ___. Pursuant to this authority, the Department promulgated regulation 117-1500 in 2003, defining the bank tax as a franchise tax. Although, as Petitioner correctly observes, the bank tax is statutorily referred to as an “income tax” on banks or “tax on income of banks,”¹⁰ the franchise tax in this instance is also calculated based upon income. Therefore, regulation 117-1500 is not contrary to the plain language of the bank tax statutes. See 84 C.J.S. *Taxation* § 177 (“The net income of a corporation may be used as a measure of the tax on the privilege of doing business at least with respect to income derived from business done within the state.”).

Furthermore, from a historical perspective, which is significant since the bank tax has not been substantively amended since 1937, there is no evidence to suggest South Carolina’s bank tax has ever been treated as anything other than a franchise tax since its inception. As far back as 1948, a South Carolina Attorney General Opinion expressed that:

Section 2676 of the Code of 1942 levies a tax upon, or with respect, to the entire net income of banks. This language includes **all income from whatever source derived, even income from nontaxable securities**. This is for the reason that the bank tax is a **franchise tax** for the privilege of operating, or doing business in this State, the amount thereof being measured by the entire net income.

1947-48 Op. S.C. Att’y Gen. 294 (March 12, 1948) (emphasis added). Similarly, in 1967, South Carolina’s regulations provided that the term “entire net income” included income derived from

¹⁰ S.C. State Reg., Vol. 27, Issue 6 (July 27, 2003); § 12-11-10 *et seq.*

“any sources whatsoever including interest on obligations of the United States,” which suggests the bank tax was still interpreted as a franchise tax at that time because it included non-taxable obligations. S.C. Regs. BA-R-1: (December 6, 1967).

Additionally, the Department has interpreted the bank tax as a franchise tax for decades as evidence by its opinions and rulings. In 1975, the South Carolina Tax Commission found the bank tax “has been interpreted to be a franchise tax measured by net income.” *RE: BANK TAX*, 1975 WL 23751 (S.C.Tax.Com. Aug. 4, 1975). Similarly, in 1992, the Department issued a revenue ruling noting that “Code Section 12-11-20 provides for a franchise tax based on net income on banks.” S.C. Revenue Ruling No. 92-9, 2 (July 21, 1992).

Thus, there appears to be a long history of interpreting the bank tax as a franchise tax; moreover, a franchise tax based on income. And, for the reasons stated in the next section, this Court does not agree with Petitioner’s contention that regulation 117-1500 was repealed by implication when the tax code was amended in 2005 to, according to Petitioner, broaden the South Carolina’s Tax Code’s conformity with the Internal Revenue Code. Indeed, what speaks loudest is the General Assembly’s silence as to this issue. The General Assembly has had many opportunities to amend the bank tax, both before and after regulation 117-1500 went into effect, and has not done so. This Court finds the General Assembly’s failure to enact legislation to contradict the long-standing interpretation of the bank tax as a franchise tax shows it has acquiesced to this interpretation for several decades. *See Media Gen. Commc’ns, Inc.*, 388 S.C. at 149, 694 S.E.2d at 530–31 (“An agency’s long-standing interpretation of a statute is usually entitled to be given deference and should not be overruled by a reviewing court in the absence of cogent reasons, but the interpretation will not be sustained if it contradicts a statute’s plain language.”); *Etiwan Fertilizer Co. v. S.C. Tax Comm’n*, 217 S.C. 354, 60 S.E.2d 682 (1950) (“[W]here the construction of the statute has been uniform for many years in administrative practice, and has been acquiesced in by the General Assembly for a long period of time, such construction is entitled to weight, and should not be overruled without cogent reasons.”). Because of this history, the Court finds that in promulgating regulation 117-1500 in 2003, the Department was filling in the details by codifying a long-standing interpretation of the bank tax. *See Hampton*, 403 S.C. at 407–08, 743 S.E.2d at 264. Therefore, pursuant to the applicable and regulations, this Court finds the

bank tax is a franchise tax. *See Goodman v. City of Columbia*, 318 S.C. 488, 490, 458 S.E.2d 531, 532 (1995) (“Regulations authorized by the legislature have the force of law.”).

Conformity with the IRC

Next, the Court turns to the issue of whether the legislature intended the bank tax to conform with the IRC such that banks can deduct NOL carryforwards like other corporations when calculating the franchise tax levied upon them.

In its brief, Petitioner argues South Carolina’s adoption of conformity with the IRC through Chapter 6 extended conformity to all of Title 12, including Chapter 11’s bank tax, “as of at least 2005.” Petitioner asks this Court to determine that “through a significant legislative change in the tax conformity statute in 2005, the South Carolina General Assembly granted corporations, including banks, the ability to deduct NOL carryforwards on their South Carolina tax returns and this is true, regardless of whether or not the bank tax is a franchise tax.”

The Department disagrees, arguing that only some provisions of the IRC have been adopted for the purpose of Chapter 11, which otherwise remains a tax scheme for banks that is independent of the IRC. In fact, the Department maintains banks are specifically excluded from the corporate income tax in Chapter 6 under which NOL carryforwards are authorized.

Conformity and Decoupling Provisions

In 1985, the General Assembly enacted the South Carolina Income Tax Federal Conforming Amendments of 1985, which revised the South Carolina Code to conform to the Internal Revenue Code (IRC). However, the General Assembly did not authorize a blanket adoption of the IRC. Rather, the General Assembly also enacted a “decoupling” statute listing specific IRC sections that were not adopted. The “conformity” and “decoupling” provisions are codified in section 12-6-40 and section 12-6-50 of the South Carolina Code (2014), respectively. Both of these statutes are found in Chapter 6, which is the chapter codifying the South Carolina Income Tax Act.

Section 12-6-40, the “conformity” statute, states in part:

(2)(a) For purposes of this title, “Internal Revenue Code” is deemed to contain all changes necessary for the State to administer its provisions. **Unless a different meaning is required:**

* * *

(iv) “Income” includes the modifications required by Article 9¹¹ of this chapter and allocation and apportionment as provided in Article 17 of this chapter.

Other terms in the Internal Revenue Code must be given the meanings necessary to effectuate this item.

§ 12-6-40 (emphasis added). Therefore, although this section adopts the IRC for the purpose of Title 12, the phrase “unless a different meaning is required” limits the application of “income” in this section. *Id.* Similarly, section 12-6-50 (the decoupling statute), which excludes certain IRC provisions for the purpose of Title 12, provides that the IRC exclusions are generally applicable to “this title and all other titles that provide for taxes administered by the department, **except as otherwise specifically provided.**” § 12-6-50 (emphasis added).¹²

Thus, the limitations and exceptions referred to in sections 12-6-40 and 12-6-50 imply the Court must look beyond these sections when determining their applicability to different parts of Title 12. Moreover, the decoupling statute shows the General Assembly never intended for the bank tax to fully conform with the IRC because it specifically states that “Sections 581, 582, and 585 through 596 **relating to the taxation of banking institutions**” are not adopted. S.C. Code Ann. § 12-6-50(9) (2014) (emphasis added). The only section relating to banking institutions that

¹¹ The modifications in Article 9 include a deduction for NOLs.

¹² Although this Court finds that the conformity statute shows the IRC was adopted for the purpose of Title 12 with certain exceptions and limitations, Petitioner relies heavily on an amendment to the decoupling statute in 2005 to support its argument that conformity applies to the entirety of Title 12, apparently without exceptions or limitations. Specifically, Petitioner observes that just prior to 2005, the decoupling statute stated, “for the purposes of this chapter,” but was amended in 2005 to state, “for the purposes of this title and all other titles that provide for taxes administered by the department.” See Act No. 145, 2005 S.C. Acts § 8. Petitioner argues that the General Assembly’s decision to replace “chapter” with “title” indicates that not only was the application of the decoupling statute broadened, but the application of the conformity statute was likewise expanded to cover all of Title 12, including the bank tax in Chapter 11. This Court finds such a reading of the 2005 amendment strained and unnecessary to broaden the application of the conformity statute to Title 12 because the conformity statute already applies to Title 12. Moreover, the Court will not infer a change in one statute just because a change was made to another, related statute. See *City of Camden v. Brassell*, 326 S.C. 556, 561, 486 S.E.2d 492, 495 (Ct.App.1997) (“Where the language of the statute is clear and explicit, the court cannot rewrite the statute and inject matters into it which are not in the legislature’s language.”).

Further, the Court disagrees with Petitioner’s assertion that the 2005 amendment of the decoupling statute repealed by implication regulation 117-1500. As discussed in the main body of this order, the General Assembly did not endorse a blanket adoption of conformity; rather, there are limitations and exceptions to conformity, including the decoupling statute itself. The Court finds regulation 117-1500 does not conflict with any of the conformity provisions that have been incorporated into the bank tax. Accordingly, the Court finds regulation 117-1500 has not been repealed by implication.

was not decoupled is section 584, which discusses common trust funds and is inapplicable to the general taxation of banks. 26 U.S.C.A. § 584 (West 2018).¹³

With these limitations and exceptions in mind, the Court next looks to the overall statutory scheme to ascertain to what extent the bank tax may conform with the IRC. *See Liberty Mut. Ins. Co. v. S.C. Second Injury Fund*, 363 S.C. 612, 622, 611 S.E.2d 297, 302 (Ct. App. 2005) (“Statutes must be read as a whole and sections which are part of the same general statutory scheme must be construed together and given effect, if it can be done by any reasonable construction.”).

Banks Are Not Taxed Like Other Corporations or Entities Under Chapter 6

Looking to the overall statutory scheme in Title 12, it is important to note that almost all individuals and organizations (corporations, partnerships, estates, or trusts) are subject to the income tax described in Chapter 6 (and thus the IRC) except two types of taxpayers: banks and building and loan associations. The bank tax is codified in Chapter 11, and the building and loan association tax is codified in Chapter 13. Although Title 12 and the South Carolina Income Tax Act have been amended several times over the years, including in 2005, the General Assembly never repealed the chapters separately governing banks and building and loan associations to conclusively bring them within the scope of Chapter 6.

Moreover, although banks are generally organized as corporations in South Carolina,¹⁴ the General Assembly distinguished the taxation of incorporated banks from the taxation of other corporations governed by Chapter 6. Section 12-6-550 states:

The following **corporations** are exempt from the tax imposed by **Section 12-6-530** [on corporations] and Section 12-6-540 [on exempt organizations and cooperatives]:

(1) banks as defined in Section 12-11-10;

S.C. Code Ann. § 12-6-550 (2014) (emphasis added). Therefore, although banks are corporations, they are expressly excluded from the corporate income tax under Chapter 6. This is an important

¹³ In addition to section 584, section 583 was not decoupled; however, it was repealed in 1976 and, therefore, is not applicable. 26 U.S.C.A. § 583 (West 2018). Interestingly, section 584 specifically disallows NOL carryforward deductions for a bank’s common trust fund. 26 U.S.C.A. § 584. Petitioner argues that the specific disallowance of NOL carryforwards in this context, but not for banks, shows that NOL carryforwards are not generally disallowed. This Court disagrees with this logic as Petitioner must affirmatively show it is entitled to the deduction. *See Davis Mech. Contractors, Inc.*, 268 S.C. at 29, 231 S.E.2d at 301 (holding tax deductions “are a matter of legislative grace and the taxpayer must establish compliance with the statutory conditions imposed”).

¹⁴ *See* S.C. Code Ann. § 34-3-10(A) (Supp. 2017); S.C. Code Ann. § 34-3-210 (1987).

distinction because corporations taxed under section 12-6-530 use “taxable income” as their tax base, and the calculation of “taxable income” comprises the NOL carryforward deduction. See S.C. Code Ann. § 12-6-530 (explaining the corporate income tax is based upon taxable income); S.C. Code Ann. § 12-6-1130 (discussing taxable income and NOL carryforwards).

Further, section 12-6-630 provides:

Entities, other than . . . those specifically excluded from income taxation under Section 12-6-550, are taxed as provided in the Internal Revenue Code with the modifications provided in Article 9 of this chapter and subject to allocation and apportionment as provided in Article 17 of this chapter.

S.C. Code Ann. § 12-6-630 (2014). Article 9 includes the NOL carryforward deduction. As discussed above, banks are specifically excluded from income taxation under section 12-6-550; therefore, pursuant to this statute, banks are not an entity taxed as provided in the Internal Revenue Code with the modifications provided in Article 9 (including the NOL carryforward deduction) or Article 17.

The Court must presume the General Assembly had a purpose in excluding banks in sections 12-6-550 and 12-6-630 and in retaining a separate chapter for banks, such as taxing them differently than other corporations and entities. See *Arnold v. Ass'n of Citadel Men*, 337 S.C. 265, 273, 523 S.E.2d 757, 761 (1999) (“There is a basic presumption the General Assembly has knowledge of previous legislation when later statutes are passed on a related subject.”). The remaining question is to what extent are banks treated differently than other corporations and entities. To answer this question, the Court turns to Chapter 11.

Chapter 11 Partially Adopted Chapter 6

Examining Chapter 11, Petitioner claims section 12-11-40 shows the General Assembly’s intent to bring Chapter 11 into conformity with Chapter 6 and the IRC. The Court disagrees. Looking to the plain language of the statute, section 12-11-40 provides:

[f]or the purpose of administration, allocation and apportionment, enforcement, collection, liens, penalties, and other similar provisions, all of the provisions of Chapter 6 of this title that may be appropriate or applicable are adopted and made a part of this chapter for the enforcement and administration of this chapter, including the requirement to make declarations of estimated tax and make estimated tax payments.

S.C. Code Ann. § 12-11-40 (2014) (emphasis added). Dissecting this language, section 12-11-40 does, as emphasized by Petitioner, adopt “all” the provisions of Chapter 6 (and thus the

accompanying IRC provisions), but that adoption is circumscribed by the limitation to “appropriate or applicable” provisions for the purposes of “administration, allocation and apportionment.”¹⁵

This Court finds a distinction between adopting certain provisions of Chapter 6 and the accompanying IRC sections for the purposes of allocation and administration versus adopting them for the purpose of calculating the base of the bank tax. This conclusion is supported by a comparison of Chapter 11 (bank tax) and Chapter 13 (building and loan associations tax). It is notable that like Chapter 11, Chapter 13 includes a section adopting Chapter 6 for the purposes of administration and enforcement but, unlike Chapter 11, Chapter 13 also includes a statute defining “net income” to mean “taxable income as determined for a regular corporation in Chapter 6 of this title” after certain deductions and additions. S.C. Code Ann. § 12-13-20 (2014). Therefore, the General Assembly specifically incorporated Chapter 6 for calculating the base of the tax for building and loan associations in Chapter 13, whereas they did not specifically adopt Chapter 6 for calculating the base of the tax for banks in Chapter 11.

Furthermore, the Department has historically interpreted Chapter 11 to be subject to only partial conformity, thus recognizing the limitations and exceptions to conformity in Chapter 6. In 1994, and after the conformity provision of 1985 was passed, the Department issued Information Letter #94-35 advising that section 12-11-40 “applies **certain provisions** of Chapter [6] to banks.” S.C. Dep’t of Revenue, Information Letter #94-35 (December 20, 1994) (emphasis added). One of the provisions from Chapter 6 that applies is apportionment; specifically:

the Department will accept multistate bank returns which are based upon the proportion of the bank’s entire net income that reasonably represents the proportion of the bank’s trade or business carried on within this State in the same manner as required of those corporations subject to the corporate income tax of Chapter [6]

Id. Not only does this information letter indicate that only certain provisions of Chapter 6 apply to the bank tax, but it implies that banks are normally taxed differently than “those corporations subject to the corporate income tax of Chapter 6.” *Id.* This Information Letter is also consistent with section 12-11-40 because it incorporates sections of Chapter 6 governing apportionment. *See*

¹⁵ Section 12-11-40 also indicates parts of Chapter 6 may be adopted for the purposes of “enforcement, collection, liens, penalties, and other similar provisions,” however, the Court finds that these purposes, by their plain definitions, would not incorporate the adoption of a provision providing for the deduction of NOL carryforwards and do not warrant discussion at this time.

12-11-40 (“[f]or the purpose of . . . allocation and apportionment . . . all of the provisions of Chapter 6 of this title that may be appropriate or applicable are adopted . . .”).

Just a year later, in 1995, the Department issued a Private Letter Ruling in which it concluded that certain provisions of the IRC describing the reorganization of a business should be extended to the reorganization of a bank. S.C. Dep’t of Revenue, P.L. Ruling #95-10 (Aug. 28, 1995). Essentially, the Department adopted the IRC principle that a reorganization involving a mere change in form, as opposed to a change in substance, should not control for tax purposes. *Id.*; see also *RE: BANK TAX*, I-D-200 (S.C.Tax.Com. Aug. 4, 1975) (adopting IRC section 368 in a bank merger where IRC section 368 stands for the principle that a “mere change in form as opposed to economic change should not be controlling for tax purposes”). The Department specifically limited its ruling to the adoption of the specific IRC section governing the reorganization of the bank and did not adopt the entire IRC for the purpose of assessing the bank tax. S.C. Dep’t of Revenue, P.L. Ruling #95-10 (Aug. 28, 1995). In other words, adopting this specific IRC regulation governing the reorganization aided the Department in administering the bank tax. See § 12-11-40.

Finally, Form 1101 B, the Department’s Bank Tax Return, states: “For the purposes of allocation and apportionment, all of the provisions of Chapter 6, Title 12 that **may be appropriate or applicable** have been adopted for banks.” (emphasis added). The form does not indicate that Chapter 6 is adopted for calculating the base of the bank tax, or that all of Chapter 6 is adopted. The partial adoption of provisions of Chapter 6 in Form 1101 B properly reflects section 12-11-40.

The Department’s historic interpretation that Chapter 11 is subject to only partial conformity is entitled to the most respectful consideration “assuming the interpretation is worthy of deference.” *Kiawah Dev. Partners, II v. S.C. Dep’t of Health & Envtl. Control*, 411 S.C. 16, 33, 766 S.E.2d 707, 717 (2014). Here, the Department has uniformly held this interpretation for an extended period of time. This longstanding acceptance is indeed the fundamental tenet to a court’s deference to an agency’s interpretation of law within its regulations.¹⁶ See *Media Gen.*

¹⁶ It is notable that in our Supreme Court’s recent deference analysis in *Kiawah Dev. Partners, II*, the Supreme Court focused on whether the agency interpretation was rational and not arbitrary and capricious without exploring whether the Department’s interpretation was long-standing. *Kiawah Dev. Partners, II*, 411 S.C. at 35, 766 S.E.2d at 719 (holding that the Department’s interpretation of regulation 30-11(C)(1) was entitled to deference because the agency’s

Commc'ns, Inc., 388 S.C. at 149, 694 S.E.2d at 530–31 (“An agency's long-standing interpretation of a statute is usually entitled to be given deference and should not be overruled by a reviewing court in the absence of cogent reasons, but the interpretation will not be sustained if it contradicts a statute's plain language.”); *Etiwan Fertilizer Co.*, 217 S.C. at 354, 60 S.E.2d at 682 (“[W]here the construction of the statute has been uniform for many years in administrative practice, and has been acquiesced in by the General Assembly for a long period of time, such construction is entitled to weight, and should not be overruled without cogent reasons.”).¹⁷

Conclusion

Four conclusions can be drawn from this analysis. First, the General Assembly did not authorize a blanket adoption of the IRC pursuant to Chapter 6; rather, the General Assembly adopted the IRC with certain exclusions and limitations. Second, the General Assembly intended for banks to be treated differently than other corporations subject to income tax under Chapter 6, as evidenced by sections 12-6-550 and 12-6-630 and the retention of a separate chapter for the bank tax. Third, if the General Assembly had intended for the base of the bank tax to be based on the income tax calculation in Chapter 6 and the IRC, it would have incorporated it by reference like it did for building and loan associates in Chapter 13. Fourth, the General Assembly only intended for certain, selective provisions of Chapter 6 and the IRC to apply to Chapter 11 pursuant to section 12-11-40.

Accordingly, Petitioner cannot rely on conformity as an argument that banks are allowed to deduct NOL carryforwards like other corporations or entities subject to the income tax in Chapter 6. Petitioner must show that it meets the qualification for the deduction through other

interpretation was not “arbitrary, capricious, nor manifestly contrary to the statute”). Nevertheless, the Supreme Court’s lack of consideration of whether the Department’s interpretation in *Kiawah Dev. Partners, II* was long-standing should not be interpreted as dismissing that requisite in a deference analysis. Rather, in *Kiawah Dev. Partners, II* the issue of whether the Department’s interpretation of regulation 30-11(C)(1) was long-standing was never raised and, therefore, not an issue this court or the Supreme Court ever considered.

¹⁷ The need for uniformity in the agency’s interpretation over an extended time frame as set forth in *Etiwan* is profoundly revealed in the facts and legal discussions in *S.C. Coastal Conservation v. S.C. Dep’t of Health and Env’tl. Control and Oakridge Landfill, LLC*, Docket No. 14-ALJ-07-0221-CC (August 29, 2014) (order denying motion to dismiss). See also *Harry v. S.C. Dep’t of Health and Env’tl. Control*, 09-ALJ-07-0255-CC, 2010 WL 8425978, at *1 (July 15, 2010).

means. One way for Petitioner to do this is to show that the bank tax is based upon “taxable income.”

The Bank Tax is Not Based on “Taxable Income”

Whether or not banks are subject to the corporate income tax in Chapter 6 is not necessarily essential to claiming the NOL carryforward deduction. Rather, what is essential is whether banks are taxed, like these other corporations, on “taxable income” as set forth in section 12-6-1130 because it is this section through which Petitioner, in part, seeks a deduction for NOL carryforwards.

The method for calculating corporate income tax imposed under Chapter 6 is found in Article 9 of Chapter 6, which is entitled “Taxable Income Calculation.” “Taxable income” is computed from “gross income” after “making modifications to deductions provided in the Internal Revenue Code as follows.” S.C. Code Ann. § 12-6-1120-1130 (2014 & Supp. 2017) (discussing “gross income” and “taxable income” respectively); *see also* S.C. Code Ann. § 12-6-1110(A) (“For South Carolina income tax purposes, gross income, adjusted gross income, and taxable income as calculated under the Internal Revenue Code are modified as provided in this article and subject to allocation and apportionment as provided in Article 17 of this chapter.”). In other words, “taxable income” is computed by following the provisions of the Internal Revenue Code which specifically sets forth acceptable deductions from a corporation’s gross income.¹⁸

Within Article 9, section 12-6-1130 governs the computation of “taxable income” and contains the provision allowing for the deduction of NOLs. It specifically states that “South Carolina taxable income is computed by making modifications to gross income provided in the Internal Revenue Code as follows,” and one of the modifications that follows is the NOL carryforward. § 12-6-1130. Indeed, the NOL carryforward deduction is found exclusively in this section 12-6-1130(4). However, as explained above, section 12-6-630 sets forth that banks are not included with the entities that are “taxed as provided in the Internal Revenue Code with the

¹⁸ “Gross income,” as calculated pursuant to the applicable IRC section adopted through Chapter 6, excludes nontaxable interest on state and local government bonds. 26 U.S.C.A. § 63 (West 2018); 26 U.S.C.A. § 103 (West 2018). However, since banks are subject to a franchise tax, their tax on “entire net income” includes “income derived from any source whatsoever including interest on obligations of the United States, the United States Government or its possessions or of any state and any political subdivision thereof.” S.C. Code Regs. Ann. 117-1500.1. Though this distinction between “gross income” and “entire net income” clarifies the application of the IRC, it does not explain the computation of a bank’s taxable income, which is discussed later in this order.

modifications provided in Article 9.” Further, Chapter 11 does not specifically incorporate Article 9 like it incorporates the apportionment principles of Article 17. Therefore, banks are not included within those entities whose tax is calculated using the NOL deduction from “gross income” to determine its taxable income. However, the issue of how to calculate the basis of the bank tax—entire net income—remains.

Entire Net Income

The Department has maintained throughout this litigation that “entire net income” is based “book income” or financial net income and not federal taxable income. The Department has also suggested that book income must be calculated pursuant to GAAP. At the hearing in this case, the Department clarified that it now believes book income should generally be equivalent to net income as calculated under GAAP.

Petitioner argues the Department cannot rely on GAAP to define “entire net income” because this would be an unconstitutional delegation of power to the FASB. Petitioner also argues that “book income” as calculated pursuant to GAAP is not a reasonable proxy for entire net income because not all banks are required to use accrual-based accounting and GAAP is used exclusively for accrual-based accounting. Petitioner also contends that if GAAP is used to calculate book income, then it requires NOLs to be recognized. Finally, Petitioner argues that the phrase “entire net income” inherently authorizes NOL carryforward deductions.

Reliance on GAAP to Define “Entire Net Income”

The Court agrees with Petitioners that GAAP should not be used as a wholesale proxy for “entire net income” or “book income.” The FASB is an independent non-profit corporation and GAAP is not a law. The Legislature has never taken any action to conform the bank tax to the ever-changing principles of GAAP. Moreover, the Department has never formally issued guidance on the application of accounting principles/standards to the bank tax. As a result, GAAP, as defined and revised by the FASB, cannot be a binding framework for calculating “entire net income” and any delegation of taxing power to the FASB could constitute a violation of the South Carolina Constitution.

However, if GAAP is properly used as an evaluative tool rather than a binding standard, it does not constitute an unconstitutional delegation of regulatory authority to the FASB. Accordingly, the use of GAAP’s principles in determining a reasonable interpretation of the

meaning of “entire net income” is not improper. Yet its use is circumscribed by its application. GAAP does not use the term “entire net income” or “book income.” GAAP only uses the term “net income.” GAAP is thus a compilation of rules under which net income is computed and which may give insight into the application of “entire net income.”

Deference

When a statute or regulation is silent as to a particular issue and an agency’s interpretation is worthy of deference, our courts generally defer to an agency’s interpretation. *Kiawah Dev. Partners, II v. S.C. Dep’t of Health & Envtl. Control*, 411 S.C. 16, 33, 766 S.E.2d 707, 717 (2014). Here, the statutes and regulations are relatively silent as to how to specifically calculate “entire net income.” Regulation 117-1500.1 defines “entire net income,” but its definition is not very helpful in resolving this issue before the Court. Reg. 117-1500.1 (“[E]ntire net income . . . shall include income derived from any source whatsoever including interest on obligations of the United States, the United States Government or its possessions or of any state and any political subdivision thereof.”). However, both parties appear to agree that the Department has historically treated the bank tax as a franchise tax. See *Etiwan Fertilizer Co.*, 217 S.C. at 359, 60 S.E.2d at 684 (“We have held in many cases that where the construction of the statute has been uniform for many years in administrative practice, and has been acquiesced in by the General Assembly for a long period of time, such construction is entitled to weight, and should not be overruled without cogent reasons.”). Therefore, this interpretation is entitled to deference.

Nevertheless, the Department practice of using financial accounting, or book income, to calculate the basis of the bank tax does not meet the legal parameters of the deference doctrine. Mr. Von Lehe testified he believes the Department’s staff has historically used financial accounting, or book income, to calculate the basis of the bank tax. Mr. Beckwith also testified that in his practice of filing bank tax returns in South Carolina for several years, South Carolina accountants have calculated a bank’s tax based upon financial net income. While the testimony of these experts indicates that the actions of the Department’s staff have led some practitioners to perceive the Department’s interpretation of the bank tax as based on book income or financial net income, the fact remains that the Department has not issued any formal guidance on how it

calculates or interprets “entire net income” beyond regulation 117-1500.1.¹⁹ Moreover, at the hearing into this matter, the Department modified its interpretation of how to specifically calculate “entire net income” from stating GAAP is a wholesale proxy for “entire net income” or “book income” to asserting that it does not strictly interpret “entire net income” to be calculated pursuant to GAAP. Therefore, the evidence did not show the Department has a long-standing statutory interpretation of how to calculate “entire net income” Indeed, its current interpretation is nascent.

Additionally, the Department’s interpretation must not only be longstanding, it must also be sufficiently known to the legislature such that the legislature can be deemed to have acquiesced to the Department’s interpretation. See *Charleston Cty. Assessor v. Univ. Ventures, LLC*, 427 S.C. 273, 289, 831 S.E.2d 412, 420 (2019) (“We have previously held in many cases that where the construction of the statute has been uniform for many years in administrative practice, and has been acquiesced in by the General Assembly for a long period of time, such construction is entitled to weight, and should not be overruled without cogent reasons.”) (quoting, in part, *Etiwan Fertilizer Co. v. S.C. Tax Comm’n*, 217 S.C. 354, 359, 60 S.E.2d 682, 684 (1950))). Consequently, the Court would expect the interpretation to be (1) recorded in the Department’s policies or procedures to put taxpayers on notice and (2) consistently applied to all applicable taxpayers. The Department’s interpretation does not meet either of these expectations. Here, the Department has no formal ruling or publication interpreting the meaning or calculation of “entire net income.”

Furthermore, for the Department’s position to be entitled to deference, its position ordinarily must be a formal interpretation by the Department and not its staff. *Neal v. Brown*, 383 S.C. 619, 682 S.E.2d 268, 270 (2009) (holding “an agency’s Appellate Panel, not its staff, is typically entitled to deference in interpreting agency regulations”). The Department maintains “entire net income” is also equivalent to “book income” or financial “net income.” Nevertheless, the term “book income” does not appear in any statute, regulation, formal ruling or publication. But what is more concerning is the Department’s further inference that “book income” is based on GAAP was not reflected by the expert testimony. This does not necessarily make the Department’s

¹⁹ The bank tax return (Form SC 1101 B) refers to the base of the bank tax as “total net income.” This form also instructs the taxpayer to begin with federal taxable income and then backtrack to financial income or book income. Part of the back tracking specifically requires the taxpayer to eliminate any NOL deductions they may have taken on the federal return. While these instructions could be interpreted to be a public representation of the Department’s interpretation of “entire net income,” it is unclear how long the form used by Synovus has been in use and what relationship **total** net income would have to **entire** net income.

inference unreasonable, but a recent, undocumented interpretation or policy does not entitle the Department to deference.

Does “entire net income” inherently include NOL carryforward deductions?

The parties disagree whether the term “entire net income” inherently incorporates NOLs. At the heart of this debate is the effect and meaning of the word “entire.” Petitioner argues that the word “entire” implies that all income and all expenses must be included in the calculation and the only manner in which all expenses can be deducted by a bank having expenses that exceed income in a year under GAAP is through the use of a NOL carryforward. In other words, Petitioner claims the word “entire” creates the statutory authorization that allows NOL carryovers. Petitioner claims this interpretation is consistent with the legislative intent of the bank tax, the bank regulations, GAAP, and the historical application of the bank tax.²⁰ The Department disagrees and takes the position that (1) the primary effect of the word “entire” is meant to capture income from (usually) non-taxable securities²¹ and (2) although the word “entire” also includes all expenses, it only includes expenses from the taxable year at issue.

History of Income Tax Law

“Entire net income” is not cogently defined for the purpose of the bank tax. However, the legislative history of the term gives insight into its meaning. The General Assembly first enacted an income tax in 1922, when it imposed an income tax on the “net income” of individuals and corporations. See 1922 S.C. Acts No. 502, § 2. Importantly, this South Carolina income tax was

²⁰ Interestingly, Petitioner’s argument essentially renders unnecessary its previous argument that NOLs are allowed under the bank tax through conformity with the Internal Revenue Code and the corporate income tax. Indeed, this is the first time Petitioner has put forward this argument in this litigation.

²¹ The Department also contends the legislative use of “entire” operates to capture all sources of income, including income from non-taxable securities, is reflected by the bank tax regulations and the Attorney General’s opinion in 1948. See Reg. 117-1500.1 (providing the base of the tax, “entire net income,” includes “income derived from any source whatsoever including interest on obligations of the United States, the United States Government or its possessions or of any state and any political subdivision thereof.”); 1947-48 Op. S.C. Att’y Gen. 294 (March 12, 1948) (opining the bank tax is a franchise tax on “all income from whatever source derived, even income from nontaxable securities”); see also 84 C.J.S. *Taxation* § 223 (“The fact that the tax formula reflects the value of tax-exempt securities does not invalidate it since the tax is not on property but on a privilege or franchise.”). On its face, this contention sounds persuasive. However, the term “entire net income” was also historically used for corporations who were not required to declare income from those governmental source as “entire net income.” Nevertheless, the efficacy of this argument can be partially restored because the legislature could have retained the term “entire net income” for banks reasoning that it reflected the breath of income for which banks are taxed. Thus, although the argument has some merit, in light of the other more persuasive legal considerations, I banish this argument to a footnote.

calculated as a percentage of the amount required to be paid as an income tax to the United States government and, therefore, the 1922 Act incorporated by reference “laws made and to be made by Congress and regulations made and to be made thereunder by federal officers.” *Santee Mills v. Query*, 122 S.C. 158, 115 S.E. 202, 205 (1922). In practicality, South Carolina had adopted conformity with the federal income taxes and any additions or deductions for federal income tax purposes indirectly applied in South Carolina.

The federal income tax scheme at this time was established by the Revenue Act of 1918, which levied an income tax on “net income.” Revenue Act of 1918, H.R. 12863, 65th Cong. § 230(a) (1918). This was the first-time net operating losses were introduced into a tax scheme. *The Loss Carryover Deduction and Changes in Corporate Structure*, 66 COLUM. L. REV. 338, 339 (1966) (“Introduced by the Revenue Act of 1918, the net operating loss carryover deduction is intended to mitigate the effects of taxation on an annual basis, which ‘does not adequately recognize the exigencies of business’ and ‘may often result in grave injustice.’”). But although net operating losses were authorized, they were only authorized in limited circumstances. Specifically, only net losses accrued between October 31, 1918, and January 1, 1920, were allowed to be carried back and deducted from the net income of the preceding year or, if that was insufficient, to be carried forward and deducted from net income from the successive year. *Id.* § 204(a) & (b). Additionally, net operating losses were not included in the section of the Act discussing the calculation of “net income,” nor were they discussed as a corporate deduction (business expenses or otherwise); rather, they were addressed as part of the “General Provisions” of the Act. *Id.* § 204(b); § 212(a) & (b); § 214.

Also, of note, the Revenue Act of 1918 at one point uses the phrase “entire net income” as follows:

That whenever parts of a taxpayer’s income are subject to rates for different calendar years, the part subject to the rates for the most recent calendar year shall be placed in the lower brackets of the rate schedule provided in this title, the part subject to the rates for the next preceding calendar year shall be placed in the next higher brackets of the rate schedule applicable to that year, and so on until the **entire net income** has been accounted for. In determining the income, any deductions, exemptions or credits of a kind not plainly and properly chargeable against the income table at rates for a preceding year shall first be applied against the income subject to rates for the most recent calendar year; but any balance thereof shall be applied against the income subject to the rates of the next preceding year or years until fully allowed.

§ 206 (emphasis added). The phrase “entire net income” in this section appears to account for the fact that some businesses kept their books according to a fiscal year that did not align with a calendar-based tax year ending on December 31st of a given year, and, therefore, income taxed at different rates from different tax years had to be combined to create the “entire net income” for the tax year. *See also id.* § 205 (discussing the calculation of taxes across tax years). Also notable at this time, “net income” did not include interest on non-taxable securities under the Act. *See id.* §213(b)(4); § 214(a)(2).

In the successive federal Revenue Acts of 1921, 1924, and 1926, a net loss was only authorized to be carried forward to the succeeding year and next succeeding year (i.e. a company could carry it forward for two years). *See* Revenue Act of 1921, H.R. 8245, 67th Cong., § 204 (1921); Revenue Act of 1924, H.R. 6715, 68th Cong., § 206 (1924); Revenue Act of 1926, H.R. 1, 69th Cong., § 206 (1926). Thus, when NOLs first appeared in the federal tax scheme (and through conformity in South Carolina’s tax scheme), they did not appear as an inherent part of the calculation of “net income” for a taxable year and they were not capable of being carried back or carried forward indefinitely. *See Lancaster Cotton Mills v. S.C. Tax Comm’n*, 132 S.C. 466, 129 S.E. 429, 431-32 (1925) (“[S]ince the state tax commission is governed by the acts of Congress and the rules and regulations made in pursuance thereof . . . it was the duty of the state tax commission to receive and approve such return and to credit against the income for the fiscal year 1921-22 that loss which the Treasury Department of the federal government allowed as a loss, as accrued from January 1, 1921, to June 30, 1921, and that the basis of taxation set up by the state tax department cannot prevail.”).

In 1926, the South Carolina Legislature passed the Income Tax Act of 1926, which repealed the 1922 legislation, disposed of conformity, and did not include any provisions authorizing NOL deductions. *See* 1927 S.C. Acts No. 1, § 42 (“That on the passage of this Act, the Income Tax Act approved the 13th day of March, 1922, as amended, is repealed to take effect January 1st, 1925”); *U. S. Rubber Prod. v. S.C. Tax Comm’n*, 189 S.C. 386, 1 S.E.2d 153, 154 (1939) (“In 1926 the State enacted a complete income tax law (35 St. at Large, p. 1), which had no reference to the Federal Acts.”). The 1926 Act imposed an income tax on corporations, including for-profit banks, as follows:

Every corporation organized under the laws of this State shall pay annually an income tax, with respect to carrying on or doing business equivalent to four percent

of the **entire net income** of such corporation, as herein defined, received by such corporation during the income year

1927 S.C. Act No.1, § 4(a) (emphasis added); *see also id.* § 3 (imposing tax on individuals residing in South Carolina based on the “entire net income” of the individual taxpayer). Although the statute used the phrase “entire net income . . . as herein defined,” the 1926 Act only defined the phrase “net income.” *Id.* § 7 (explaining the “Computation of tax—Net income defined”). “Net income” was defined to mean “the gross income of a taxpayer less the deductions allowed by this Act.” *Id.* The term “gross income” was further defined by the statute to include all manner of “income derived from any source whatever” and to exclude certain items (such as interest upon the obligations of the United States, South Carolina, or any political subdivision thereof). *Id.* § 8. Gross income was to be included in the income year in which it was received unless, “under the methods of accounting permitted under this Act, any such amounts are to be properly accounted for as of a different period.” *Id.* The Act provided certain deductions, but these deductions did not include a net loss or net operating loss. *Id.* § 13. Additionally, a taxpayer was allowed, with the approval of the Tax Commission, to calculate its net income based on their fiscal year instead of the calendar year. *Id.*

Even though only “net income” was defined, the Legislature seemed to use “net income” interchangeably with “entire net income” and “entire income.” *See, e.g., id.* § 15(1) (using “entire income,” “entire net income,” and “net income” interchangeable when discussing the tax on non-residents and foreign corporations). Case law from this time period also suggests that “net income” and “entire net income” were interchangeable. *See U. S. Rubber Prod.*, 189 S.C. at ___, 1 S.E.2d at 154-155 (discussing the application of the 1932 Code and how to determine “net income” for a tax imposed on the “entire net income” of a foreign corporation).

The next substantial change to the income tax was in 1937 when the Legislature separated the bank tax and the corporate income tax: the corporate income tax in Chapter 6 of Title 12, and the bank tax in Chapter 11 of Title 12.^{22,23} This is essentially the same bank tax that is still

²² In the Code of Laws of South Carolina (1962), the Income Tax Act of 1926 was in Chapter 5 of Title 65, while the Bank Tax was in Chapter 7 of Title 65. Under current law, the South Carolina Income Tax Act is in Chapter 6 of Title 12, while the Bank Tax is in Chapter 11 of Title 12.

²³ Also notable during this same time period, the federal tax code stopped recognizing net operating losses for a period of seven years between 1933 and 1939. *See Mut. Assur. Soc. of Virginia Corp. v. Comm'r*, 505 F.2d 128, 136 (4th Cir. 1974) (“The first enactment of a provision permitting the excess of expenses incurred in one tax year over

applicable today. The corporate income tax, in contrast, has been amended several times since 1937.²⁴ Although the bank tax and corporate income tax were separately codified in 1937, they were both based on “entire net income.” *See* S.C. Code § 65-402 (Supp. 1937) (bank tax); *see also* S.C. Code Ann. § 2676(2) (1942) (bank tax); S.C. Code § 2440 (1942) (corporate income tax). Again, “entire net income” was not defined for the purpose of the bank tax. *See* S.C. Code § 65-401 *et. seq.* (Supp. 1937). Also, no deduction for NOLs was authorized for corporations or banks.

In 1955, the bank tax (by this time recognized as a franchise tax)²⁵ and the corporate income tax remained separate and both continued to be imposed on “entire net income.” But a significant change occurred. The corporate income tax was amended to include NOLs as a specific deduction. *See* S.C. Code Ann. § 65-222 (1952) (corporate income tax); S.C. Code Ann. § 65-402 (1952) (bank tax); S.C. Code Ann. § 65-259 (Supp. 1955) (NOL deduction). In particular, section 65-259 was amended to add an additional deduction for person establishing a new business or industry:

With respect only to taxpayers who have established a new business or industry in South Carolina during the calendar year 1955 and thereafter, in addition to other deductions allowed by this Chapter, there shall be allowed as a deduction from gross income a net operating loss carry over under the following rules:

(A). the net operating loss as herein defined²⁶ for any year ending on or after December 31, 1955, may be carried forward to the next succeeding taxable year and annually thereafter for a total period of three years next succeeding the year of such operating loss, or until such net operating loss has been exhausted or absorbed by the taxable income of a succeeding year. The net operating loss deduction herein allowed shall be allowable only for the first three years of the operation of the said new business or industry in South Carolina.

gross income for such year to be deducted in another tax year came in the Revenue Act of 1918.”); *id.* (“In 1933, the National Industrial Recovery Act abolished all net loss carryovers and carrybacks.”); *id.* at 137 (“In 1939, a net operating loss carryover provision was reintroduced.”). The authorization, prohibition, and re-authorization of NOLs at the federal level indicates NOLs are creatures of statute.

²⁴ For example, in 1985 the Legislature repealed the 1926 Act and made wholesale changes to the entire income tax section of the South Carolina code, including changing the tax base for the corporate income tax from “entire net income” to “taxable income as determined under the [IRC] with the modifications specified.” *See* Act No. 101, 1985 S.C. Acts 280–314; S.C. Code Ann. § 12-6-580 (2014).

²⁵ *See* 1947-48 Op. S.C. Att’y Gen. 294 (March 12, 1948) (“[T]he bank tax is a franchise tax for the privilege of operating, or doing business in this State, the amount thereof being measured by the entire net income.”).

²⁶ “Net operating loss” was defined as “the excess of allowable deductions over gross income for the taxable year arising from the operation of such new business of industry.” § 65-259(13)(C).

§ 65-259(13)(A).

By providing that “there shall be **allowed** as a deduction from gross income a net operating loss carry over under the following rules,” the 1955 Act can only be construed to mean that the General Assembly was creating a NOL deduction in 1955 that did not previously exist. And, like federal law prior to 1926 (and thus applicable in South Carolina), the NOL was restricted to a certain time period.

Implied Authorization of NOL Carryforward

Petitioner claims the word “entire” creates a statutory authorization that allows NOL carryovers. Petitioner argues that this interpretation of the calculation of a bank income following tax years subsequent to a NOL is supported by the inherent breadth of the term “entire net income.” In support of that contention, Petitioner asserts that if the legislature intended to limit a bank’s expenses to one year, then the legislature would have simply used the term “net income.”

In considering Petitioner’s contentions, it is important to recognize that Petitioner seeks an interpretation that it is entitled to NOL carryforwards not based upon just the clear meaning of the term “entire net income” but upon an inference resulting from that meaning. As to the meaning of “entire net income,” the Court clearly agrees with the Petitioner that “entire net income” requires consideration of all income and all expenses. In fact, if the word “entire” captures all different sources of income, it must also capture all expenses. Moreover, Petitioner’s argument appeals to the statutory construction principle that every word must have a purpose.

Nevertheless, the fact that the General Assembly specifically amended the corporate income tax on “entire net income” to include a NOL deduction demonstrates the NOL deduction was not inherently part of the meaning of “entire net income” prior to the 1955 amendment. Moreover, the bank tax was also based on “entire net income” at that time and was not similarly amended to include an NOL deduction. The Court can thus only conclude the term “entire net income” did not inherently authorize NOLs to be carried forward to subsequent tax years. If the Legislature intended NOLs carryforwards to apply to banks, the legislature would have similarly amended the bank tax when it allowed NOLs to be deducted as part of the calculation of “entire net income.” The necessity for legislative action to allow NOL carryovers is even more significant in light of the legislative history of treating “entire net income” interchangeably with “net income.” Therefore, the Court cannot necessarily conclude that the Legislature would have used “net

income” had it intended to constrain the calculation to one year. See 1927 S.C. Act No.1, § 4(a) & § 7 (imposing the income tax on “entire net income” but only defining “net income”); *U. S. Rubber Prod.*, 189 S.C. at ___, 1 S.E.2d at 154-155 (discussing the application of the 1932 Code and how to determine “net income” for a tax imposed on the “entire net income” of a foreign corporation).

I nevertheless recognize the Department’s emphasis upon the fact that “entire net income” can only refer to income, and thus expenses, within one year has a weakness. The income statement would obviously cover one year because the tax laws specifically set the parameters under which the banks are taxed. And, it is obvious that income is routinely taxed in the year that it occurs. In other words, generally in every year that income exceeds expenses, the bank is taxed for that income. Nevertheless, there is a notable distinction between income and expenses. If excess expenses are not carryforward to future tax years, they will be lost. This is an obvious inequity. Indeed, the courts have recognized this inequity. As explained in the *Columbia Law Review*: “The fundamental proposition underlying the carryover concept is one of tax equity: a taxpayer with a given aggregate income over a period of years whose annual returns vary between profit and loss should not be required to bear a greater tax burden than another taxpayer with the same aggregate income who suffers no annual losses.” *The Loss Carryover Deduction and Changes in Corporate Structure*, 66 *Colum. L. Rev.* 338, 339 (1966). NOL carryovers allow fluctuations in business cycles to be spread over both good and bad years, especially for the benefit of new businesses that are likely to begin without strong profits. *Id.* at 339-340 (“The carryover deduction finds further justification as a stimulant to investment in new business and risk enterprise.”); see also § 65-259(13)(A) (1955) (authorizing NOLs for new businesses established in or after 1955).

Yet that inequity should not be cured by a court interpreting the term “entire net income” to create legal right to carryforward excess expenses to another tax year. Tax laws are written with specificity and inferring the creation of a right to carryforward expenses must be based upon more than equity. Interpreting tax laws in that fashion would lead to judicial fiat.

The issue before this Court is thus not an evaluation of what is fair. The issue is whether the General Assembly clearly authorized carryforward NOLs by the use of the term “entire net income.” Indeed, South Carolina courts have generally recognized that NOL carryovers are “allowed” pursuant to certain statutory rules. See *Wasson*, 252 S.C. at 487, 167 S.E.2d at 312

(“[I]n addition to other deductions allowed by this chapter, there shall be allowed as a deduction from gross income a net operating loss carry-over under the following rules . . .”).²⁷ As the court in *Wasson* further noted, the NOL “deduction and benefit is allowed as a matter of legislative grace” and “[i]n order to take advantage of this statute the respondent was required to meet the conditions of the statute which granted the benefit.” *Id.* at 488, 167 S.E.2d at 313; *accord C. W. Matthews Contracting Co. v. S.C. Tax Comm’n*, 267 S.C. 548, 557, 230 S.E.2d 223, 227 (1976); *cf. New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934) (“The statutes pertaining to the determination of taxable income have proceeded generally on the principle that there shall be a computation of gains and losses on the basis of a distinct accounting for each taxable year; and only in exceptional situations, clearly defined, has there been provision for an allowance for losses suffered in an earlier year.”); *Philadelphia Fire & Marine Ins. Co. v. U.S.*, 3 F. Supp. 655, 656 (Ct. Cl. 1933) (“Under our system of taxation each taxable year stands alone and the deduction of the whole or any part of a loss of one taxable year from the net income of another taxable year is wholly within the discretion of Congress and it may constitutionally place any limitation it desires upon such deduction.”). Moreover, both parties’ experts appeared to agree that carrying over NOLs are only the result of statutory authority permitting such carryovers.

Here, Petitioners have put forth no evidence showing that any states, including South Carolina, implicitly allowed NOLs before or after they were introduced by the Revenue Act of 1918. Furthermore, as demonstrated by Regulation 117-1500.3, which discusses a federal income tax deduction for banks, the bank tax is not without an enumerated deduction for taxes paid; yet there is no enumerated deduction for NOLs. S.C. Regs. Ann. 117-1500.3 (2012) (discussing the deduction of taxes paid). The calculation of both income and expenses are made as set forth by the legislature. It is thus improper for Petitioner to infer that expenses should be carried over to another tax year simply because the deduction would be lost if not carried over. NOL

²⁷ See also *Mut. Assur. Soc. of Virginia Corp. v. Comm’r*, 505 F.2d 128, 136 (4th Cir. 1974) (“The first enactment of a provision **permitting** the excess of expenses incurred in one tax year over gross income for such year to be deducted in another tax year came in the Revenue Act of 1918.”); *id.* (“In 1933, the National Industrial Recovery Act abolished all net loss carryovers and carrybacks.”); *id.* at 137 (“In 1939, a net operating loss carryover provision was reintroduced.”). Notably, in 2017, NOL carryforwards were explicitly allowed indefinitely under federal law, demonstrating that a statute is needed to authorize NOLs even when they are indefinite in nature. See PL 115-97 § 13302 (Dec. 22, 2017). Therefore, statutes authorizing NOLs are not simply there to circumscribe them.

carryforwards, as expense deductions, are allowed as set forth by the legislature and thus no equitable right can be inferred.

In sum, the history of the development of NOLs and the 1955 amendment to the corporate income tax to the exclusion of the bank tax shows NOLs are creatures of statute and the term “entire net income” does not inherently authorize NOL carryforwards as part of this State’s tax law. While the basis of the bank tax and corporate tax remained “entire net income” for several decades, the ability to take an NOL deduction has fluctuated and that fluctuation was regulated by statute. Moreover, when an NOL deduction has been allowed, it has been circumscribed by certain time limits for when it can be taken and for how many years it can be taken. These factors demonstrate NOLs are not inherently authorized by the term “entire net income.” Consequently, this Court cannot conclude, in light of statutory history of NOLs, that the term “entire net income” inherently creates a legal right to carryforward excess expenses to another tax year. Even if this conclusion appears to result in a less equitable outcome for banks than for corporations, it is not this Court’s place to judge the wisdom of the Legislature in enacting certain tax policies. *Centex Int’l, Inc. v. S.C. Dep’t of Revenue*, 406 S.C. 132, 151, 750 S.E.2d 65, 75 (2013) (“The result here may appear to be inequitable; however, we are constrained to conclude it is correct under extant law. The wisdom of tax policy is exclusively within the purview of the legislature and may not be supplanted by this Court.”).²⁸

Use of “Book Income” and/or GAAP to Determine “Entire Net Income”

Statutory or regulatory provisions often describe the calculation of taxable income by defining how gross income is calculated and then subtracting statutorily authorized deductions. However, although taxable income for the purposes of the bank tax is based on “entire net income,” there is no definition or reference to what is gross income or what deductions are authorized (with the exception of regulation 117-1500.3’s reference to a deduction for income taxes paid, which is

²⁸ Petitioner contends out-of-state banks that merely hold loans in this State are treated like corporations for income tax purposes and, therefore, are allowed to take NOLs unlike in-state banks are not. Petitioner argues this is an inequitable result. Undoubtedly this would appear to be inequitable. However, as Mr. Beckwith explained, if these out-of-state banks do not engage in “banking” as defined by South Carolina law because of their limited operations in this state, then the inequity is at the very least reduced. Moreover, the definition of a bank under the bank tax could include out-of-state banks regardless of what their activities are in this state. Nevertheless, this issue is not before the Court and I therefore make no determination regarding this asserted inequity. Regardless, this situation would be best addressed by a legislative solution.

really just an expense).²⁹ And, as concluded above, “entire net income” does not inherently create a statutory deduction for NOLs. Therefore, the Court must determine how “entire net income” should be calculated in accordance with the tax laws.

The Department contends that the tax on banks is “a franchise tax that uses book income accounting.” That conclusion is founded upon the Department’s determination that the bank tax is based on financial accounting rather than federal income tax accounting.³⁰ Relying on this premise, the Department infers that the bank tax “should generally be computed using Generally Accepted Accounting Principles (GAAP).” Petitioner argues, however, that if GAAP accounting is used, then GAAP requires NOL deductions to be reflected on the financial statements and, therefore, to be incorporated into the calculation of “entire net income.”

At the outset, there is no definition for the term “book income” in any statute, regulation, or authoritative policy issued by the Department. Nor does GAAP define “book income.” Thus, there is no mandate in the tax laws that “entire net income” be determined by “book income” in accordance with the principles of GAAP. Nevertheless, using “book income” may be a proper means for calculating taxable income for the purposes of the bank tax. As explained by the experts, “book income” is a financial accounting term that refers, very generally, to the revenues and expenses listed in a ledger, which may vary depending upon the accounting methodology used to “keep the books.” Furthermore, if a company uses GAAP to keep its books, it is reasonable to conclude the company’s “book income” will be equivalent to its “net income” under GAAP because both are defined by subtracting expenses from revenues and would be based on the same

²⁹ Petitioner complains the Department allows banks to take other federal credits and deductions, including the deduction in IRC § 162 (Ordinary and Necessary Business Expenses) without specific statutory authority. However, the deduction for ordinary and necessary business expenses in IRC § 162 would be implicitly included in any calculation of “net income” because it reflects expenses during the year. Therefore, explicit statutory authority would not be needed to allow banks to deduct any expenses during the year to arrive at net income.

³⁰ The Department asserts its position is supported by a Tax Commission opinion in 1975 that noted there are “special rules in this State applicable to the taxation of banks.” The Tax Commission further noted that

the bank tax “has **always been construed to be a franchise tax** measured by the bank’s entire net income. The phrase “entire net income” has been construed to mean “all income from whatever source derived, less all expenses incurred”. See BA–OAG–1 (March 12, 1948). **The special base of this tax is, therefore, economic income rather than taxable income.**

Re: Bank Tax, 1975 WL 23740, at *1 (S.C. Tax. Comm. January 24, 1975) (emphasis added). Accordingly, the 1975 Tax Commission decision suggests is that “entire net income” is based on economic or financial income. Notably, financial accounting and book accounting are interchangeable terms and thus, the decision could equally be viewed as stating the tax is calculated according to a bank’s books.

accounting methodology. And here, Petitioner uses GAAP accounting to keep its books and, therefore, its book income is derived by using the principles of GAAP. Therefore, since Petitioner's "book" income" is equivalent to its net income on its income statement under GAAP and, it is reasonable to infer that book income is equivalent of net income pursuant to GAAP in this situation.

Petitioner nevertheless argues that without looking at all the financial statements together, the full financial picture of the company will not be apparent. However, Petitioner provides no theory about how to mesh the four financial statements together to come up with "entire net income." Rather, Petitioner contends that GAAP's recording of NOLs upon the balance sheet supports its theory to use NOL carryforwards to reflect "entire net income." It is also interesting that Petitioner has emphasized GAAP should not be a binding standard, yet for purposes of this contention, Petitioner now asserts NOL carryforwards must be approved because GAAP validates that use.

In evaluating this contention, the Court first looks to the general principles of accounting. The intent of the balance sheet is to give a picture of the health of a company at a particular moment in time for the purpose of informing investors, etc., of the company's over-all financial health. It does this by listing assets minus liabilities equals equity. It is not a reflection of the annual income and expenses of a company, which are the metrics important to an annual income tax.³¹ It is the income statement that reflects the metrics important to an annual income tax—mainly, the revenues and expenses of a business within the its fiscal year or the calendar year, depending upon how it keeps its books. Thus, the weight an NOL carryforward carries as a tax asset upon the balance sheet is only as significant as the authority by which it is established as an equitable tax asset. In this instance, as addressed above, that authority is based upon an insufficient inference. Additionally, although Mr. Branch and Mr. Beckwith indicated GAAP requires NOLs to be documented in the financial statements, they also testified NOLs do not impact the calculation of

³¹ Petitioner makes a blanket statement in its proposed order that using net income from its income statement is inconsistent with prior interpretations of the bank tax because "[p]rior interpretation of the Bank Tax allow for a deduction for all expenses without limitation to one year and other deductions are allowed to be taken in multiple years (even though thither deductions have no impact on the income statement)." This statement is so generic without concrete examples that it is not useful to the Court.

“net income” on the income statement.³² Rather, NOLs may be reflected in footnotes on the income statement or they may be reflected on the balance sheet.

Moreover, while it is true that GAAP requires NOL carryforwards to be reflected in a company’s financial statements, that does not mean GAAP controls what the taxing jurisdiction recognizes as the basis for its tax. It would thus be a mistake to infer that a taxing jurisdiction that does not allow NOL carryforwards would cause a company to be out of compliance with GAAP. If a jurisdiction does not recognize NOL carryforwards for tax purposes, then the NOL would not be a tax impact and GAAP would not require it to be recognized as a carryforward expense. A company who keeps its books according to GAAP will continue to note any NOL carryforwards it may have in the footnotes of its income statements or on its balance sheets; it merely will not get to deduct the NOL from its taxable income in jurisdictions that do not recognize NOL carryforwards. In other words, the Court does not find that GAAP’s requirement to record NOLs supersedes South Carolina’s income tax laws to authorize NOLs under the authority of GAAP. In fact, the provisions dealing with NOLs were developed in response to the creation of NOLs via federal and state tax law, not the other way around. *See* Bulletin No. 23, *supra*. And, indeed, both Mr. Beckwith and Mr. Branch agreed that GAAP is subservient to federal and state tax law.

Conclusion

The term “entire net income” reflects a breadth of income and expenses that requires **all revenues** and **all expenses** be included in the calculation of a bank’s taxable income. Yet despite that breadth, NOL carryforwards are not inherently included by the use of that term. Rather, the legislative history, the testimony of the experts, and the history of GAAP and accounting principles establishes that NOL carryovers are statutory creations of tax law in particular jurisdictions and thus should be reflected in a company’s financial statements as they are authorized in the jurisdiction. Moreover, the word “entire” may have been retained to reflect that certain sources of income that are usually not taxed are included within the calculation of banks’ net income. In fact, interpreting “entire net income” to incorporate this income from non-taxable securities is a long-standing interpretation. Therefore, since NOL carryforwards are not clearly authorized by South

³² An exception to this statement is found in the calculation and use of NOLs federal income taxes. Since the IRC authorizes NOL carryforwards, then a company taking an NOL on a subsequent tax return will have a lesser taxable income than it would have had without using the NOL.

Carolina law, the expenses are limited to the fiscal/calendar year at issue. In this case, because Petitioner's keeps its books according to GAAP, Petitioner's "book income" is equivalent to its "net income" as calculated pursuant to GAAP.³³

CONCLUSION

Petitioner's strongest argument in this case is an equitable one: that banks should be able to benefit from NOL carryforwards just like other corporations, especially when they suffer severe loss as in the financial crisis of 2008, which is when the losses in this case stem from. However, simply because an outcome is more equitable does not mean this Court can ignore the law or usurp the authority of the Legislature. *Centex Int'l, Inc.*, 406 S.C. at 151, 750 S.E.2d at 75 ("The result here may appear to be inequitable; however, we are constrained to conclude it is correct under extant law. The wisdom of tax policy is exclusively within the purview of the legislature and may not be supplanted by this Court."). NOL carryforwards are statutorily authorized deductions; not ordinary annual expenses. As such, NOL carryforwards are allowed as a matter of legislative grace and Petitioner was required to show it squarely met the requirements to take them. *See Davis Mech. Contractors, Inc.*, 268 S.C. at 29, 231 S.E.2d at 301 (holding tax deductions "are a matter of legislative grace and the taxpayer must establish compliance with the statutory conditions imposed"). Thus, a carryforward deduction cannot simply be inferred from an expansive right to take all expenses.

Here, Petitioner failed to show that the Legislature has authorized banks to take those carryforward expenses. Indeed, even if the Legislature's intent was ambiguous, this Court is still required to decide in the Department's favor. *S. Soya Corp. of Cameron*, 252 S.C. at 489, 167 S.E.2d at 313 (holding although ambiguities in tax statutes are generally construed in favor of the taxpayer, this rule "does not apply in the construction of a statute authorizing deductions; rather, the ambiguity will be resolved against the taxpayer"). Therefore, for all the reasons stated above:

³³ To the extent the Department asserts that "book income" means GAAP is the required accounting methodology to be used, the Court finds this is to be incorrect. "Book income" represents the revenues minus losses based upon whatever accounting method is used, which may be GAAP.

ORDER

IT IS HEREBY ORDERED that Petitioner's deductions of net operating loss carryforwards for tax years 2011 through 2014 are **DENIED**.

AND IT IS SO ORDERED.

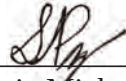
A handwritten signature in black ink, reading "Ralph King Anderson, III". The signature is written in a cursive style with a horizontal line underneath it.

Ralph King Anderson, III
Chief Administrative Law Judge

April 17, 2020
Columbia, South Carolina

CERTIFICATE OF SERVICE

I, Stephanie Michelle Perez, hereby certify that I have 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).



Stephanie Michelle Perez
Judicial Law Clerk

April 17, 2020
Columbia, South Carolina

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Synovus Bank,	)	DOCKET NO. 17-ALJ-17-0418-CC
	)	
Petitioner,	)	
	)	
	)	
	)	ORDER GRANTING PARTIAL
	)	SUMMARY JUDGMENT AND
vs.	)	DENYING PETITIONER’S MOTION
	)	FOR SUMMARY JUDGMENT
South Carolina Department of Revenue,	)	
	)	
Respondent.	)	
_____	)	

STATEMENT OF THE CASE

This case is before the South Carolina Administrative Law Court (Court or ALC) pursuant to a Request for Contested Case filed by Synovus Bank (Petitioner) on November 16, 2017. Petitioner contests the decision of the South Carolina Department of Revenue (Respondent or Department) in which the Department determined Petitioner could not deduct net operating loss (NOL) carryforwards¹ when computing its bank tax liability for tax years 2011 through 2014. Based on the Department’s disallowance of the NOL carryforward deductions, the Department assessed Petitioner with \$1,370,716.00 in outstanding bank taxes and \$184,520.86 in outstanding interest as of November 20, 2017.

On July 25, 2018, Petitioner and the Department filed Cross-Motions for Summary Judgment. Both parties agree the material facts in this case are not in dispute. Both parties also filed Responses and Replies in accordance with each party’s motion. Based upon my review of the undisputed facts in this case and the parties’ submissions, I grant the Department’s Motion for Summary Judgment, in part, and deny Petitioner’s Motion for Summary Judgment for the reasons below.

¹ The term “net operating loss” is defined as “[t]he excess of operating expenses over revenues, the amount of which can be deducted from gross income if other deductions do not exceed gross income.” Black’s Law Dictionary 964 (8th ed. 2004). Further, an NOL “carryforward” or “carryover” is “[a]n income-tax deduction (esp. for a net operating loss) that cannot be taken entirely in a given period but may be taken in a later period.” Black’s Law Dictionary 227 (8th ed. 2004).

FILED

October 22, 2018

SC ADMIN. LAW COURT

MATERIAL FACTS NOT IN DISPUTE

In 2010, the National Bank of South Carolina (NBSC) merged with Columbus Bank and Trust Company (CB&T) and was renamed Synovus Bank (Petitioner). CB&T reported net operating losses for 2009; NBSC reported net operating losses for 2009 and 2010; and Petitioner reported net operating losses for 2010. The total South Carolina losses reported by the three banks for 2009 and 2010 was \$391,050,990, as amended. The losses were thereafter increased to a total of \$482,050,990 pursuant to a proposed audit adjustment by the Department.

Following the merger, Petitioner filed South Carolina Bank Tax Returns for tax years 2011–2014. On its original bank tax returns for 2011-2013, Petitioner did not claim any deductions for NOL carryforwards from the 2009 and 2010 losses. However, Petitioner subsequently filed amended returns. On its amended returns for 2011- 2013, Petitioner deducted NOL carryforwards, which resulted in Petitioner having no bank tax liability for tax years 2011–2013; rather, Petitioner requested refunds. Similarly, on its original bank tax return for 2014, Petitioner reported book income of \$229,295,962 but also claimed a NOL carryforward of \$291,331,561, resulting in a claim for a refund in the amount of \$968,585 for tax year 2014. For tax years 2011-2014, the NOL carryforward deduction was applied to Petitioner’s book income.

The Department initially paid Petitioner its requested refunds for tax years 2013 and 2014. The Department withheld Petitioner’s refund for 2012 due to a procedural problem requiring the refund to be “held for verification.” The Department then conducted an audit of Petitioner’s tax returns for tax years 2011-2014. The Department ultimately issued a Proposed Notice of Adjustment (PNOA) in which it disallowed Petitioner’s claim for NOL carryforwards for 2011–2014 and assessed taxes, penalties, and interest. The Department then issued a revised PNOA updating the interest amount due and deleting the penalties it had originally assessed against Petitioner. On April 6, 2016, the total assessment on the revised PNOA was \$2,076,325. On June 7, 2016, Petitioner filed a written protest regarding both PNOAs. In a letter dated October 17, 2017, the Department issued a determination upholding its decision to disallow the NOL carryforwards. This contested case followed.

ISSUE

Whether a bank can deduct net operating loss carryforwards when calculating its South Carolina bank tax liability.

DISCUSSION

This Court has jurisdiction over this case pursuant to section 12-60-460 of the South Carolina Code (2014) and section 1-23-600 of the South Carolina Code (Supp. 2017).

The Rules of Procedure for the Administrative Law Court (SCALC Rules) provide that the South Carolina Rules of Civil Procedure (SCRCP) “may, in the discretion of the presiding administrative law judge, be applied to resolve questions not addressed by these rules.” SCALC Rule 68. Rule 56(c), SCRCP, provides that summary judgment is properly granted when the “pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that any party is entitled to a judgment as a matter of law.” “The purpose of summary judgment is to expedite disposition of cases which do not require the services of a fact finder.” *George v. Fabri*, 345 S.C. 440, 452, 548 S.E.2d 868, 874 (2001). In this case, the parties have filed cross-motions for summary judgment and have stipulated that certain material facts in this case are undisputed. In these instances, summary judgment is usually appropriate. *See Wiegand v. U.S. Auto. Ass'n*, 391 S.C. 159, 705 S.E.2d 432 (2011) (“Where cross motions for summary judgment are filed, the parties concede the issue before us should be decided as a matter of law.”). Nevertheless, “in cases applying the preponderance of the evidence burden of proof, the non-moving party is only required to submit a mere scintilla of evidence in order to withstand a motion for summary judgment. *Hancock v. Mid-S. Mgmt. Co.*, 381 S.C. 326, 330, 673 S.E.2d 801, 803 (2009).

Petitioner argues this Court should interpret the applicable tax laws to find that banks can deduct NOL carryforwards. Petitioner concedes this is an issue of first impression that requires the Court to engage in statutory construction. Petitioner contends that NOL carryforward deductions were extended to banks pursuant to South Carolina’s adoption of tax conformity with the Internal Revenue Code (IRC), which allows corporations to deduct NOL carryforwards. Petitioner also claims that banks should be allowed to deduct NOL carryforwards regardless of whether they are subject to an income tax or a franchise tax.

In contrast, the Department argues South Carolina’s adoption of conformity with the IRC did not extend the NOL carryforward deduction to banks because they are treated differently than other corporations. Furthermore, the Department contends that deductions must be specifically authorized, and the NOL carryforward deduction is only specifically authorized for calculating corporate income tax based upon “taxable income,” whereas the bank tax is based on “entire net income.” Additionally, the Department maintains the bank tax is a franchise tax.

At the heart of this case is a disagreement about whether Petitioner is entitled to a tax deduction. The parties agree that no statute explicitly gives banks the right to deduct NOL carryforwards. Accordingly, it is necessary to engage in statutory interpretation to determine whether the conformity provisions have extended the right to deduct NOL carryforwards to banks as Petitioner suggests.

Petitioner claims this is a case in equity and the application of the law should be liberally interpreted in favor of the taxpayer. I disagree. While the principle behind NOL carryforwards may be an equitable one—redistributing a loss over a number of years—taking an NOL carryforward is a tax deduction. Tax deductions “are a matter of legislative grace and the taxpayer must establish compliance with the statutory conditions imposed.” *Davis Mech. Contractors, Inc. v. Wasson*, 268 S.C. 26, 29, 231 S.E.2d 300, 301 (1977); *see Allied Corp. v. S.C. Tax Comm’n*, 288 S.C. 197, 199, 341 S.E.2d 139, 140–41 (1986) (“It is settled that a deduction is not a matter of right but is one of legislative grace.”); *S. Soya Corp. of Cameron v. Wasson*, 252 S.C. 484, 488, 167 S.E.2d 311, 313 (1969) (“The deduction and benefit is allowed as a matter of legislative grace.”). Furthermore, although ambiguities in tax statutes are generally construed in favor of the taxpayer, this rule “does not apply in the construction of a statute authorizing deductions; rather, the ambiguity will be resolved against the taxpayer.” *S. Soya Corp. of Cameron*, 252 S.C. at 489, 167 S.E.2d at 313 (citing 47 C.J.S. Internal Revenue 230). Therefore, Petitioner has the burden to show it is entitled to the NOL carryforward deduction and any ambiguity will be construed in the Department’s favor.

Turning to the general rules of statutory construction, “[t]he cardinal rule of statutory construction is to ascertain and effectuate the intent of the legislature.” *Media Gen. Commc’ns, Inc. v. S.C. Dep’t of Revenue*, 388 S.C. 138, 147, 694 S.E.2d 525, 529 (2010). “The determination of legislative intent is a matter of law.” *Id.* at 148, 694 S.E.2d at 529. “The words of the statute

must be given their plain and ordinary meaning without resorting to subtle or forced construction to limit or expand the statute's operation.” *Berkeley Cty. Sch. Dist. v. S.C. Dep't of Revenue*, 383 S.C. 334, 345, 679 S.E.2d 913, 919 (2009). Further, “the statute must be read as a whole and sections which are a part of the same general statutory law must be construed together and each one given effect.” *Sloan v. Hardee*, 371 S.C. 495, 499, 640 S.E.2d 457, 459 (2007). “Where the statute's language is plain and unambiguous, and conveys a clear and definite meaning, the rules of statutory interpretation are not needed and the court has no right to impose another meaning.” *Hodges v. Rainey*, 341 S.C. 79, 85, 533 S.E.2d 578, 581 (2000). Last, it is important to note that generally “[t]he construction of a statute by the agency charged with its administration will be accorded the most respectful consideration and will not be overruled absent compelling reasons.” *Brown v. S.C. Dep't of Health & Envtl. Control*, 348 S.C. 507, 515, 560 S.E.2d 410, 414 (2002).

The South Carolina Bank Tax

Petitioner argues that the bank tax is an income tax and, even if it is a franchise tax, Petitioner is entitled to an NOL carryforward deduction. Petitioner thus contends that ultimately whether the bank tax is an income tax or a franchise tax is not a question this court need answer. In contrast, the Department argues that the bank tax is a franchise tax and that whether the bank tax is a franchise tax carries implications relevant to this case. Therefore, the Court will address this issue first.

The history of the South Carolina bank tax is fairly simple. When the South Carolina General Assembly passed the Income Tax Act of 1926, it adopted a corporate income tax on 4% of a corporation’s “entire net income.” When this act passed, banks were subject to the 4% income tax in the same manner as other corporations. Then, in 1937, the General Assembly enacted a separate tax for banks and excluded banks from the corporate income tax. This new bank tax was a 4.5% tax on the “entire net income” of the bank. The bank tax is codified in Chapter 11 of Title 12 and has remained relatively unchanged since 1937.

Pursuant to Chapter 11, a “bank” or “taxpayer” under this chapter is “any person engaged in a banking business, whether incorporated under the laws of this State, any other state or the United States or whether unincorporated, except cash depositories.” S.C. Code Ann. § 12-11-10 (2014). As mentioned above, a tax of 4.5% is levied upon banks, specifically:

A tax is imposed upon every bank engaged in business in the State which shall be levied, collected and paid annually with respect to the entire net income of the taxpayer doing a banking business within this State or from the sales or rentals of property within this State, computed at the rate of four and one half per cent of the entire net income of such bank or taxpayer.

S.C. Code Ann. § 12-11-20 (2014).

Though the statutory laws do not specify the nature of the tax on a bank's income, the bank tax is specifically described in regulation 117-1500 as a "franchise tax." S.C. Code Regs. Ann. 117-1500 (2012) ("Chapter 11 of Title 12 imposes a franchise tax on banks.").² Regulation 117-1500.1 further provides that the base of the tax, "entire net income," includes "income derived from any source whatsoever including interest on obligations of the United States, the United States Government or its possessions or of any state and any political subdivision thereof." S.C. Code Regs. Ann. 117-1500.1 (2012).

Including interest on government obligations within the definition of "entire net income" is consistent with a franchise tax. Generally, interest on government obligations or nontaxable securities are, as their name suggests, nontaxable when assessing income tax. However, their worth can be included when assessing a franchise tax because a franchise tax, while it can be measured based upon net income, is not a tax on income, but rather a tax levied for the privilege of doing business within the state. See Black's Law Dictionary 1497 (8th ed. 2004) (defining a "franchise tax" as a "tax imposed on the privilege of carrying on a business" that is usually based upon income); 84 C.J.S. *Taxation* § 177 ("The net income of a corporation may be used as a measure of the tax on the privilege of doing business at least with respect to income derived from business done within the state."); 84 C.J.S. *Taxation* § 223 ("The fact that the tax formula reflects the value of tax-exempt securities does not invalidate it since the tax is not on property but on a privilege or franchise."). It is well-settled that government obligations can be included in the calculation of a franchise tax, and this has important implications in this case. *Tradesmens Nat. Bank of Oklahoma City v. Oklahoma Tax Comm'n*, 309 U.S. 560, 563–64 (1940) ("The plain meaning of the amendment [12 U.S.C.A. s. 548] is confirmed by its legislative history showing beyond doubt that Congress intended to authorize a franchise tax measured by net income

² The tax described in section 12-11-20 is the only tax levied upon banks except for the use tax, deed recording fees, and taxes on real property. S.C. Code Ann. § 12-11-30 (2014).

including interest on tax-immune federal securities.”); *Pac. Co. v. Johnson*, 285 U.S. 480, 490 (1932).

Although regulation 117-1500 describes the bank tax as a franchise tax, in its memorandum Petitioner dismisses this regulation in a cursory footnote because the regulation was issued in 2003 and is “contrary to the 2005 conformity statute which included the bank tax and [is] an unconstitutional delegation of taxing powers.” Petitioner further argues the bank tax is an income tax because all statutory references to the bank tax refer to an “income tax” and not a “franchise tax.”

I do not find that the Department’s promulgation of regulation 117-1500 resulted in an unconstitutional delegation of power. “While the legislature may not delegate its power to make laws, it may authorize an administrative agency or board to fill up the details by prescribing rules and regulations for the complete operation and enforcement of the law within its expressed general purpose.” *Hampton v. Haley*, 403 S.C. 395, 407–08, 743 S.E.2d 258, 264 (2013) (internal quotation marks and citation omitted). Further, “[a]s a creature of statute, a regulatory body is possessed of only those powers expressly conferred or necessarily implied for it to effectively fulfill the duties with which it is charged.” *Captain’s Quarters Motor Inn, Inc. v. S.C. Coastal Council*, 306 S.C. 488, 490, 413 S.E.2d 13, 14 (1991).

Here, in 1991, the General Assembly gave the Department the authority to “make rules and promulgate regulations, not inconsistent with law, to aid in the performance of its duties.” S.C. Code Ann. § 12-4-320(1) (2014); Act No. 50, 1991 S.C. Acts ___. Pursuant to this authority, the Department promulgated regulation 117-1500 in 2003, defining the bank tax as a franchise tax. Although, as Petitioner correctly observes, the bank tax is statutorily referred to as an “income tax” on banks or “tax on income of banks,”³ the franchise tax in this instance is also calculated based upon income. Therefore, regulation 117-1500 is not contrary to the plain language of the bank tax statutes. See 84 C.J.S. *Taxation* § 177 (“The net income of a corporation may be used as a measure of the tax on the privilege of doing business at least with respect to income derived from business done within the state.”).

³ S.C. Sate Reg., Vol. 27, Issue 6 (July 27, 2003); § 12-11-10 *et seq.*

Indeed, from a historical perspective, which is not without significant weight since the bank tax has not been amended since 1937, there is no evidence to suggest that South Carolina’s bank tax has ever been treated as anything other than a franchise tax since its inception. As far back as 1948, a South Carolina Attorney General Opinion expressed that:

Section 2676 of the Code of 1942 levies a tax upon, or with respect, to the entire net income of banks. This language includes *all income from whatever source derived, even income from nontaxable securities*. This is for the reason that the bank tax is a *franchise tax* for the privilege of operating, or doing business in this State, the amount thereof being measured by the entire net income.

1947-48 Op. S.C. Att’y Gen. 294 (March 12, 1948) (emphasis added). Similarly, in 1967, South Carolina’s regulations provided that the term “entire net income” included income derived from “any sources whatsoever including interest on obligations of the United States,” which suggests the bank tax was still interpreted as a franchise tax at that time because it included non-taxable obligations. S.C. Regs. BA-R-1: (December 6, 1967).

Additionally, the Department has interpreted the bank tax as a franchise tax for decades as evidence by its opinions and rulings. In 1975, the South Carolina Tax Commission found the bank tax “has been interpreted to be a franchise tax measured by net income.” *RE: BANK TAX*, 1975 WL 23751 (S.C.Tax.Com. Aug. 4, 1975). Similarly, in 1992 the Department issued a revenue ruling noting that “Code Section 12-11-20 provides for a franchise tax based on net income on banks.” S.C. Revenue Ruling No. 92-9, 2 (July 21, 1992).

Thus, there appears to be a long history of interpreting the bank tax as a franchise tax, and a franchise tax that is based on income. Moreover, for the reasons stated in the next section, this Court does not agree with Petitioner’s contention that regulation 117-1500 was repealed by implication when the tax code was amended in 2005 to, according to Petitioner, broaden the South Carolina’s Tax Code’s conformity with the Internal Revenue Code. Indeed, what speaks loudest is the General Assembly’s silence as to this issue. The General Assembly has had many opportunities to amend the bank tax, both before and after regulation 117-1500 went into effect, and has not done so. This Court finds the General Assembly’s failure to enact legislation to contradict the long-standing interpretation of the bank tax as a franchise tax shows it has acquiesced to this interpretation for several decades. See *Etiwan Fertilizer Company v. S.C. Tax Commission*, 217 S.C. 354, 60 S.E.2d 682 (1950) (“[W]here the construction of the statute has

been uniform for many years in administrative practice, and has been acquiesced in by the General Assembly for a long period of time, such construction is entitled to weight, and should not be overruled without cogent reasons.”); *Media Gen. Commc'ns, Inc.*, 388 S.C. at 149, 694 S.E.2d at 530–31 (“An agency's long-standing interpretation of a statute is usually entitled to be given deference and should not be overruled by a reviewing court in the absence of cogent reasons, but the interpretation will not be sustained if it contradicts a statute's plain language.”). Because of this history, the Court finds that in promulgating regulation 117-1500 in 2003, the Department was filling in the details by codifying a long-standing interpretation of the bank tax. *See Hampton*, 403 S.C. at 407–08, 743 S.E.2d at 264. Therefore, pursuant to the applicable and regulations, this Court finds the bank tax is a franchise tax. *See Goodman v. City of Columbia*, 318 S.C. 488, 490, 458 S.E.2d 531, 532 (1995) (“Regulations authorized by the legislature have the force of law.”).

Conformity with the IRC

Next, the Court turns to the issue of whether the legislature intended the bank tax to conform with the IRC such that banks can deduct NOL carryforwards like other corporations when calculating the franchise tax levied upon them.

In its brief, Petitioner argues South Carolina’s adoption of conformity with the IRC through Chapter 6 extended conformity to all of Title 12, including Chapter 11’s bank tax, “as of at least 2005.” Petitioner asks this Court to determine that “through a significant legislative change in the tax conformity statute in 2005, the South Carolina General Assembly granted corporations, including banks, the ability to deduct NOL carryforwards on their South Carolina tax returns and this is true, regardless of whether or not the bank tax is a franchise tax.”

The Department disagrees, arguing that only some provisions of the IRC have been adopted for the purpose of Chapter 11, which otherwise remains a tax scheme for banks that is independent of the IRC. In fact, the Department maintains banks are specifically excluded from the corporate income tax in Chapter 6 under which NOL carryforwards are authorized.

Conformity and Decoupling Provisions

In 1985, the General Assembly enacted the South Carolina Income Tax Federal Conforming Amendments of 1985, which revised the South Carolina Code to conform to the Internal Revenue Code (IRC). However, the General Assembly did not authorize a blanket

adoption of the IRC. Rather, the General Assembly also enacted a “decoupling” statute listing specific IRC sections that were not adopted. The “conformity” and “decoupling” provisions are codified in section 12-6-40 and section 12-6-50 of the South Carolina Code (2014), respectively. Both of these statutes are found in Chapter 6, which is the chapter codifying the South Carolina Income Tax Act.

Section 12-6-40, the “conformity” statute, states in part:

(2)(a) For purposes of this title, “Internal Revenue Code” is deemed to contain all changes necessary for the State to administer its provisions. *Unless a different meaning is required:*

*

*

*

(iv) “Income” includes the modifications required by Article 9 of this chapter and allocation and apportionment as provided in Article 17 of this chapter.

Other terms in the Internal Revenue Code must be given the meanings necessary to effectuate this item.

§ 12-6-40 (emphasis added). Therefore, although this section adopts the IRC for the purpose of Title 12, the phrase “unless a different meaning is required” limits its application to “income.” *Id.* Similarly, section 12-6-50 (the decoupling statute), which excludes certain IRC provisions for the purpose of Title 12, provides that the IRC exclusions are generally applicable to “this title and all other titles that provide for taxes administered by the department, *except as otherwise specifically provided.*” § 12-6-50 (emphasis added).⁴

⁴ Although this Court finds that the conformity statute shows the IRC was adopted for the purpose of Title 12 with certain exceptions and limitations, Petitioner relies heavily on an amendment to the decoupling statute in 2005 to support its argument that conformity applies to the entirety of Title 12, apparently without exceptions or limitations. Specifically, Petitioner observes that just prior to 2005, the decoupling statute stated, “for the purposes of this chapter,” but was amended in 2005 to state, “for the purposes of this title and all other titles that provide for taxes administered by the department.” See Act No. 145, 2005 S.C. Acts § 8. Petitioner argues that the General Assembly’s decision to replace “chapter” with “title” indicates that not only was the application of the decoupling statute broadened, but the application of the conformity statute was likewise expanded to cover all of Title 12, including the bank tax in Chapter 11. This Court finds such a reading of the 2005 amendment strained and unnecessary to broaden the application of the conformity statute to Title 12 because the conformity statute already applies to Title 12. Moreover, the Court will not infer a change in one statute just because a change was made to another, related statute. See *City of Camden v. Brassell*, 326 S.C. 556, 561, 486 S.E.2d 492, 495 (Ct.App.1997) (“Where the language of the statute is clear and explicit, the court cannot rewrite the statute and inject matters into it which are not in the legislature’s language.”).

Further, the Court disagrees with Petitioner’s assertion that the 2005 amendment of the decoupling statute repealed by implication regulation 117-1500. As discussed in the main body of this order, the General Assembly did not endorse a blanket adoption of conformity; rather, there are limitations and exceptions to conformity, including the decoupling statute itself. The Court finds regulation 117-1500 does not conflict with any of the conformity provisions

Thus, the limitations and exceptions referred to in sections 12-6-40 and 12-6-50 imply that the Court must look beyond these sections when determining their applicability to different parts of Title 12. Moreover, the decoupling statute reflects that the General Assembly never intended for the bank tax to fully conform with the IRC because it specifically states that “Sections 581, 582, and 585 through 596 *relating to the taxation of banking institutions*” are not adopted. S.C. Code Ann. § 12-6-50(9) (2014) (emphasis added). The only section relating to banking institutions that was not decoupled is section 584, which discusses common trust funds and is inapplicable to the general taxation of banks. 26 U.S.C.A. § 584 (West 2018).⁵

With these limitations and exceptions in mind, the Court next looks to the overall statutory scheme to ascertain to what extent the bank tax may conform with the IRC. *See Liberty Mut. Ins. Co. v. S.C. Second Injury Fund*, 363 S.C. 612, 622, 611 S.E.2d 297, 302 (Ct. App. 2005) (“Statutes must be read as a whole and sections which are part of the same general statutory scheme must be construed together and given effect, if it can be done by any reasonable construction.”).

Banks Are Not Taxed Like Other Corporations or Entities Under Chapter 6

Looking to the overall statutory scheme in Title 12, it is important to note that almost all individuals and organizations (corporations, partnerships, estates, or trusts) are subject to the income tax described in Chapter 6 (and thus the IRC) except two types of taxpayers: banks and building and loan associations. The bank tax is codified in Chapter 11, and the building and loan association tax is codified in Chapter 13. Although Title 12 and the South Carolina Income Tax Act have been amended several times over the years, including in 2005, the General Assembly never repealed the chapters separately governing banks and building and loan associations to conclusively bring them within the scope of Chapter 6.

that have been incorporated into the bank tax. Accordingly, the Court finds regulation 117-1500 has not been repealed by implication.

⁵ In addition to section 584, section 583 was not decoupled; however, it was repealed in 1976 and, therefore, is not applicable. 26 U.S.C.A. § 583 (West 2018). Interestingly, section 584 specifically disallows NOL carryforward deductions for a bank’s common trust fund. 26 U.S.C.A. § 584. Petitioner argues that the specific disallowance of NOL carryforwards in this context, but not for banks generally, shows that NOL carryforwards are not generally disallowed. This Court disagrees with this logic as Petitioner must affirmatively show it is entitled to the deduction. *See Davis Mech. Contractors, Inc.*, 268 S.C. at 29, 231 S.E.2d at 301 (holding tax deductions “are a matter of legislative grace and the taxpayer must establish compliance with the statutory conditions imposed”).

Moreover, although banks are generally organized as corporations in South Carolina,⁶ the General Assembly distinguished the taxation of incorporated banks from the taxation of other corporations governed by Chapter 6. Section 12-6-550 states:

The following **corporations** are exempt from the tax imposed by **Section 12-6-530** [on corporations] and Section 12-6-540 [on exempt organizations and cooperatives]:

(1) banks as defined in Section 12-11-10;

S.C. Code Ann. § 12-6-550 (2014) (emphasis added). Therefore, although banks are corporations, they are expressly excluded from the corporate income tax under Chapter 6. This is an important distinction because corporations taxed under section 12-6-530 use “taxable income” as their tax base, and the calculation of “taxable income” comprises the NOL carryforward deduction. See S.C. Code Ann. § 12-6-530 (explaining the corporate income tax is based upon taxable income); S.C. Code Ann. § 12-6-1130 (discussing taxable income and NOL carryforwards).

Further, section 12-6-630 provides:

Entities, other than . . . those specifically excluded from income taxation under Section 12-6-550, are taxed as provided in the Internal Revenue Code with the modifications provided in Article 9 of this chapter and subject to allocation and apportionment as provided in Article 17 of this chapter.

S.C. Code Ann. § 12-6-630 (2014). Article 9 includes the NOL carryforward deduction. As discussed above, banks are specifically excluded from income taxation under section 12-6-550; therefore, pursuant to this statute, banks are not an entity taxed as provided in the Internal Revenue Code with the modifications provided in Article 9 (including the NOL carryforward deduction) or Article 17.

The Court must presume the General Assembly had a purpose in excluding banks in sections 12-6-550 and 12-6-630 and in retaining a separate chapter for banks, such as taxing them differently than other corporations and entities. See *Arnold v. Ass'n of Citadel Men*, 337 S.C. 265, 273, 523 S.E.2d 757, 761 (1999) (“There is a basic presumption the General Assembly has knowledge of previous legislation when later statutes are passed on a related subject.”). The remaining question is to what extent are banks treated differently than other corporations and entities. To answer this question, the Court turns to the Chapter 11.

⁶ See S.C. Code Ann. § 34-3-10(A) (Supp. 2017), S.C. Code Ann. § 34-3-210 (1987).

Chapter 11 Partially Adopted Chapter 6

Examining Chapter 11, Petitioner claims that section 12-11-40 shows the General Assembly's intent to bring Chapter 11 into conformity with Chapter 6 and the IRC. The Court disagrees. Looking to the plain language of the statute, section 12-11-40 provides:

[f]or the purpose of administration, allocation and apportionment, enforcement, collection, liens, penalties, and other similar provisions, all of the provisions of Chapter 6 of this title that may be appropriate or applicable are adopted and made a part of this chapter for the enforcement and administration of this chapter, including the requirement to make declarations of estimated tax and make estimated tax payments.

S.C. Code Ann. § 12-11-40 (2014). Dissecting this language, section 12-11-40 does, as emphasized by Petitioner, adopt “all” the provisions of Chapter 6 (and thus the accompanying IRC provisions), but that adoption is circumscribed by the limitation to “appropriate or applicable” provisions for the purposes of “administration, allocation and apportionment.”⁷

This court finds a distinction between adopting certain provisions of Chapter 6 and the accompanying IRC sections for the purposes of allocation and administration versus adopting them for the purpose of calculating the base of the bank tax. This conclusion is supported by a comparison of Chapter 11 and Chapter 13. It is notable that like Chapter 11, Chapter 13 includes a section adopting Chapter 6 for the purposes of administration and enforcement but, unlike Chapter 11, Chapter 13 also includes a statute defining “net income” to mean “taxable income as determined for a regular corporation in Chapter 6 of this title” after certain deductions and additions. S.C. Code Ann. § 12-13-20 (2014). Therefore, the General Assembly specifically incorporated Chapter 6 for calculating the base of the tax for building and loan associations in Chapter 13, whereas they did not specifically adopt Chapter 6 for calculating the base of the tax for banks in Chapter 11.

Furthermore, the Department has historically interpreted Chapter 11 to be subject to only partial conformity, thus recognizing the limitations and exceptions to conformity in Chapter 6. In 1994, and after the conformity provision of 1985 were passed, the Department issued Information

⁷ Section 12-11-40 also indicates parts of Chapter 6 may be adopted for the purposes of “enforcement, collection, liens, penalties, and other similar provisions,” however, the Court finds that these purposes, by their plain definitions, would not incorporate the adoption of a provision providing for the deduction of NOL carryforwards and do not warrant discussion at this time.

Letter #94-35 advising that section 12-11-40 “applies *certain provisions* of Chapter [6] to banks.” S.C. Dep’t of Revenue, Information Letter #94-35 (December 20, 1994) (emphasis added). One of the provisions from Chapter 6 that applies is apportionment; specifically:

the Department will accept multistate bank returns which are based upon the proportion of the bank’s entire net income that reasonably represents the proportion of the bank’s trade or business carried on within this State in the same manner as required of those corporations subject to the corporate income tax of Chapter [6]

Id. Not only does this information letter indicate that only certain provisions of Chapter 6 apply to the bank tax, but it implies that banks are normally taxed differently than “those corporations subject to the corporate income tax of Chapter 6.” *Id.* This Information Letter is also consistent with section 12-11-40 because it incorporates sections of Chapter 6 governing apportionment. *See* 12-11-40 (“[f]or the purpose of . . . allocation and apportionment . . . all of the provisions of Chapter 6 of this title that may be appropriate or applicable are adopted . . .”).

Just a year later, in 1995, the Department issued a Private Letter Ruling in which it concluded that certain provisions of the IRC describing the reorganization of a business should be extended to the reorganization of a bank. S.C. Dep’t of Revenue, P.L. Ruling #95-10 (Aug. 28, 1995). Essentially, the Department adopted the IRC principle that a reorganization involving a mere change in form, as opposed to a change in substance, should not control for tax purposes. *Id.*; *see also RE: BANK TAX*, I-D-200 (S.C.Tax.Com. Aug. 4, 1975) (adopting IRC section 368 in a bank merger where IRC section 368 stands for the principle that a “mere change in form as opposed to economic change should not be controlling for tax purposes”). The Department specifically limited its ruling to the adoption of the specific IRC section governing the reorganization of the bank and did not adopt the entire IRC for the purpose of assessing the bank tax. S.C. Dep’t of Revenue, P.L. Ruling #95-10 (Aug. 28, 1995). In other words, adopting this specific IRC regulation governing the reorganization aided the Department in administering the bank tax. *See* § 12-11-40.

Finally, Form 1101 B, the Department’s Bank Tax Return, states: “For the purposes of allocation and apportionment, all of the provisions of Chapter 6, Title 12 that *may be appropriate or applicable* have been adopted for banks.” (emphasis added). The form does not indicate that Chapter 6 is adopted for calculating the base of the bank tax, or that all of Chapter 6 is adopted.

The partial adoption of provisions of Chapter 6 in Form 1101 B properly reflects section 12-11-40.

The Department's interpretation is entitled to most respectful consideration "assuming the interpretation is worthy of deference." *Kiawah Dev. Partners, II v. S.C. Dep't of Health & Envtl. Control*, 411 S.C. 16, 33, 766 S.E.2d 707, 717 (2014). Here, the Department has uniformly held this interpretation for an extended period of time. This longstanding acceptance is indeed the fundamental tenet to a court's deference to an agency's interpretation of law within its regulations.⁸ See *Media Gen. Commc'ns, Inc.*, 388 S.C. at 149, 694 S.E.2d at 530–31 ("An agency's long-standing interpretation of a statute is usually entitled to be given deference and should not be overruled by a reviewing court in the absence of cogent reasons, but the interpretation will not be sustained if it contradicts a statute's plain language."); *Etiwan Fertilizer Company v. S.C. Tax Commission*, 217 S.C. 354, 60 S.E.2d 682 (1950) ("[W]here the construction of the statute has been uniform for many years in administrative practice, and has been acquiesced in by the General Assembly for a long period of time, such construction is entitled to weight, and should not be overruled without cogent reasons.").⁹

Conclusion

Four conclusions can be drawn from this analysis. First, the General Assembly did not authorize a blanket adoption of the IRC pursuant to Chapter 6; rather, the General Assembly adopted the IRC with certain exclusions and limitations. Second, the General Assembly intended for banks to be treated differently than other corporations subject to income tax under Chapter 6,

⁸ It is notable that in our Supreme Court's recent deference analysis in *Kiawah Dev. Partners, II*, the Supreme Court focused on whether the agency interpretation was rational and not arbitrary and capricious without exploring whether the Department's interpretation was long-standing. *Kiawah Dev. Partners, II*, 411 S.C. at 35, 766 S.E.2d at 719 (holding that the Department's interpretation of regulation 30-11(C)(1) was entitled to deference because the agency's interpretation was not "arbitrary, capricious, nor manifestly contrary to the statute"). Nevertheless, the Supreme Court's lack of consideration of whether the Department's interpretation in *Kiawah Dev. Partners, II* was long-standing should not be interpreted as dismissing that requisite in a deference analysis. Rather, in *Kiawah Dev. Partners, II* the issue of whether the Department's interpretation of regulation 30-11(C)(1) was long-standing was never raised and, therefore, not an issue this court or the Supreme Court ever considered.

⁹ The need for uniformity in the agency's interpretation over an extended time frame as set forth in *Etiwan* is profoundly revealed in the facts and legal discussions in *South Carolina Coastal Conservation v. South Carolina Department of Health and Environmental Control and Oakridge Landfill, LLC*, Docket No. 14-ALJ-07-0221-CC (August 29, 2014) (order denying motion to dismiss). See also *Harry v. S.C. Dep't of Health and Envtl. Control*, 09-ALJ-07-0255-CC, 2010 WL 8425978, at *1 (July 15, 2010).

as evidenced by sections 12-6-550 and 12-6-630 and the retention of a separate chapter for the bank tax. Third, if the General Assembly had intended for the base of the bank tax to be based on the income tax calculation in Chapter 6 and the IRC, it would have incorporated it by reference like it did for building and loan associates in Chapter 13. Fourth, the General Assembly only intended for certain, selective provisions of Chapter 6 and the IRC to apply to Chapter 11 pursuant to section 12-11-40.

Accordingly, Petitioner cannot rely on conformity alone as an argument that banks are allowed to deduct NOL carryforwards like other corporations or entities subject to the income tax in Chapter 6. Petitioner must show that it meets the qualification for the deduction through other means. One way for Petitioner to do this is to show that the bank tax is based upon “taxable income.”

The Bank Tax is Not Based on “Taxable Income”

Whether or not banks are subject to the corporate income tax in Chapter 6 is not necessarily essential to claiming the NOL carryforward deduction. Rather, what is essential is whether banks are taxed, like these other corporations, on “taxable income” as set forth in section 12-6-1130 because it is this section through which Petitioner, in part, seeks a deduction for NOL carryforwards.

The method for calculating corporate income tax imposed under Chapter 6 is found in Article 9 of Chapter 6, which is entitled “Taxable Income Calculation.” “Taxable income” is computed from “gross income” after “making modifications to deductions provided in the Internal Revenue Code as follows.” S.C. Code Ann. § 12-6-1120-1130 (2014 & Supp. 2017) (discussing “gross income” and “taxable income” respectively); *see also* S.C. Code Ann. § 12-6-1110(A) (“For South Carolina income tax purposes, gross income, adjusted gross income, and taxable income as calculated under the Internal Revenue Code are modified as provided in this article and subject to allocation and apportionment as provided in Article 17 of this chapter.”). In other words, “taxable income” is computed by following the provisions of the Internal Revenue Code which specifically sets forth acceptable deductions from a corporation’s gross income.¹⁰

¹⁰ “Gross income,” as calculated pursuant to the applicable IRC section adopted through Chapter 6, excludes nontaxable interest on state and local government bonds. 26 U.S.C.A. § 63 (West 2018); 26 U.S.C.A. § 103 (West 2018). On the other hand, since banks are subject to a franchise tax, their tax on “entire net income” includes “income

Within Article 9, section 12-6-1130 governs the computation of “taxable income” and contains the provision allowing for the deduction of NOLs. It specifically states that “South Carolina taxable income is computed by making modifications to gross income provided in the Internal Revenue Code as follows,” and one of the modifications that follows is the NOL carryforward. § 12-6-1130. Indeed, the NOL carryforward deduction is found exclusively in this section. *See* § 12-6-1130(4). However, as explained above, section 12-6-630 sets forth that banks are not included with the entities that are “taxed as provided in the Internal Revenue Code with the modifications provided in Article 9.” Further, Chapter 11 does not specifically incorporate Article 9 like it incorporates the apportionment principles of Article 17. Therefore, banks are not included within those entities whose tax is calculated using the NOL deduction from “gross income” to determine its taxable income.¹¹

Conclusion

Petitioner has failed to show Chapter 6 grants banks the right to take NOL carryforward deductions. Therefore, summary judgement is appropriate as to Petitioner’s statutory entitlement to take a NOL carryforward deduction.

Calculation of Entire Net Income

Since the IRC provisions modifying gross income do not apply to banks, the Court must look to the provisions of Chapter 11 to determine how the tax base for banks is calculated. The basis of the bank tax under Chapter 11 is “entire net income.” However, the applicable statutes and regulations do not provide how “entire net income” is to be calculated. Regulation 117-1500.1

derived from any source whatsoever including interest on obligations of the United States, the United States Government or its possessions or of any state and any political subdivision thereof.” S.C. Code Regs. Ann. 117-1500.1. Though this distinction between “gross income” and “entire net income” clarifies the application of the IRC, it does not explain the computation of a bank’s taxable income, which is discussed later in this order.

¹¹ Importantly, even when the bank tax and the corporate tax were both based upon “entire net income,” the General Assembly chose to calculate the bases for the taxes differently. In 1955, the South Carolina corporate income tax provisions, which were separate from the bank tax, were amended to increase the corporate tax rate to 5% and to include a provision permitting corporations to deduct NOLs. *See* Act No. 234, 1955 S.C. Acts 437, § 6 (amending S.C. Code § 65-259 (1952), now codified at § 12-6-1130); *see also Chronicle Publishers, Inc. v. S.C. Tax Comm’n*, 244 S.C. 192, 136 S.E.2d 261 (1964) (allowing a deduction for a net operating loss carry-over only for taxpayers who established a new business or industry in the State during the calendar year 1955 and thereafter). Initially, the NOL deduction was only for taxpayers that “established a new business or industry” in the State during the tax year, but it was subsequently expanded to all corporate income taxpayers. Notably, the General Assembly never included a similar NOL deduction provision in the bank tax although, at this time, both taxes were based on “entire net income.”

merely defines “entire net income” as income from all sources including nontaxable obligations. Moreover, though the General Assembly gave the Department the authority to “make rules and promulgate regulations, not inconsistent with law, to aid in the performance of its duties,” the Department has not issued any formal guidance as to how it calculates “entire net income.” S.C. Code Ann. § 12-4-320(1) (2014).

The Department contends that the tax on banks is “a franchise tax that uses book income accounting.” Furthermore, the Department asserts that “[e]ntire net income, or book income, means that a bank may deduct all of its expenses from all of its revenues to calculate entire net income.” That conclusion is founded upon the Department’s determination that the bank tax is based on financial accounting rather than federal income tax accounting. Upon this premise, the Department infers that the bank tax “should generally be computed using Generally Accepted Accounting Principles (GAAP).”

Petitioner claims that the Department’s method of taxing banks based upon “book income” is an unconstitutional delegation of powers under the South Carolina Constitution and violates Federal banking laws. Specifically, Petitioner argues that the Department’s reliance on “book income” as a proxy for “entire net income” is an unconstitutional delegation of power because book income is derived from GAAP, and GAAP principles are governed by the Financial Accounting Standards Board (FASB), an independent, non-profit organization. Petitioner contends reliance upon that organization’s determination of what is “book income” to define “entire net income” improperly delegates legislative authority to the FASB to determine how banks are taxed.

In addressing Petitioner’s constitutional argument, it is necessary to determine the reasonableness of the Department’s reliance upon the GAAP definition of “book income,” including whether it reviews the GAAP definition if/when it is revised by the FASB to ensure that it remains a good method of calculating “entire net income.” It also appears necessary to determine whether the Department’s use of “book income” as a proxy for “entire net income” is reasonable and consistent with the applicable regulation. This, however, is a factual determination which is subject to dispute. In other words, there are factual issues that need to be resolved before this Court can determine whether the Department’s method of use of “book income” as a proxy for “entire net income” is appropriate.

Furthermore, the Department asserts that “under GAAP, entire net income, or book income, does not include a net operating loss deduction.” It supports its position by referencing a 1975 Tax Commission decision in which the Commission held the bank tax is a franchise tax and “the method of measuring the tax would be circumvented unless a taxpayer is require[d] to pay its tax based on the economic gain generated by its business during the prior year.” *RE: BANK TAX*, I-D-200, 1975 WL 23751 (S.C.Tax.Com. Aug. 4, 1975). Thus, the Department argues the bank tax is based upon economic income rather than financial income.

However, there is no definition for the term “book income” in any statute, regulation, or authoritative policy issued by the Department.¹² Nor is there any reference that the calculation of “entire net income” is based upon economic income rather than financial income. Thus, there is no statutory or regulatory authority to support the Department’s assertion. On the other hand, Synovus argues that “NOL carryforward deductions can be properly taken under the GAAP book income accounting principles.” Synovus further contends that “entire net income” does not exist within GAAP and has not been defined by the FASB.

In sum, equating “book income” to “entire net income” is a factual contrivance of the Department—not an interpretation of law. In fact, there is no statutory or regulatory guidance on how to calculate “entire net income” outside of regulation 117-1500, which only provides that “entire net income” means income from all sources including nontaxable obligations.¹³ Moreover, this issue is clearly subject to dispute. Accordingly, to the extent this was raised as a sub-issue in the case, the Court does not grant summary judgment as to this issue. Therefore, summary judgement is denied as to this sub-issue. See Rule 56(c), SCRCP (providing summary judgment is properly granted when the “pleadings, depositions, answers to interrogatories, and admissions

¹² The Department asserts that “entire net income” is sometimes referred to as ‘book income.’” Yet it also utilizes other terms such as, “financial accounting,” “economic income,” and “GAAP income.” The implication of these terms also appears to be factually important.

¹³ An Attorney General opinion issued 1948 discussing “entire net income” opined that “banks in this State filing a return required under this Section of the Code, are permitted to *deduct all expenses* incurred in the operation of their banks including Federal and State income taxes.” *Id.* (emphasis added). However, there is no evidence that opinion was formally adopted as Department and an Attorney General opinion while persuasive is not binding upon a court. *Charleston Cty. Sch. Dist. v. Harrell*, 393 S.C. 552, 713 S.E.2d 604 (2011).

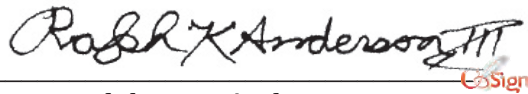
on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that any party is entitled to a judgment as a matter of law”).

ORDER

IT IS HEREBY ORDERED that Petitioner’s Motion for Summary Judgment is DENIED.

IT IS FURTHER ORDERED the Respondent’s Motion for Summary Judgment is GRANTED in part and DENIED in part.

AND IT IS SO ORDERED.

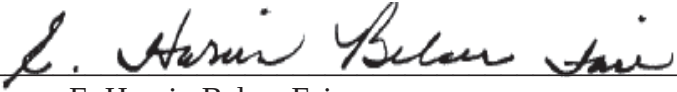
A handwritten signature in black ink, reading "Ralph King Anderson, III". To the right of the signature is a small red "eSign" logo.

Ralph King Anderson, III
Chief Administrative Law Judge

October 22, 2018
Columbia, South Carolina

CERTIFICATE OF SERVICE

I, E. Harvin Belser Fair, hereby certify that I have this date served this Order upon all parties to this cause by depositing a copy hereof in the United States mail, postage paid, in the Interagency Mail Service, or by electronic mail, to the address provided by the party(ies) and/or their attorney(s).

A handwritten signature in cursive script, reading "E. Harvin Belser Fair", written over a horizontal line.

E. Harvin Belser Fair
Judicial Law Clerk

October 22, 2018
Columbia, South Carolina

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT
Docket No. 17-ALJ-17-0418-CC

Synovus Bank)
)
)
)
 Petitioners,)
)
 v.)
)
 South Carolina Department)
 of Revenue)
)
 Respondent.)
 -----)

ADMINISTRATIVE HEARING

Thursday, October 17, 2019
10:01 a.m. - 4:58 p.m.

The hearing before the Honorable Ralph King Anderson, III was taken at the Edgar A. Brown Building, 1205 Pendleton Street, Suite 224, Columbia, South Carolina, on the 17th day of October, 2019 before Tiffany V. Evans, Court Reporter and Notary Public in and for the State of South Carolina.



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(803) 252-3445 / (800) 822-0896

APPEARANCES

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Also Present:

Neil Kinnebrew, Esquire (Synovus)
Mark Robinson, Esquire (Synovus)
Doug Branch, Witness
John von Lehe, Jr., Witness
Robert Beckwith, Witness



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EXHIBITS

(Joint Exhibit Numbers 1 through 47 were marked prior to the hearing and introduced as follows:)

Joint Exhibit Number 1 7, 8
 (NBSC-Form SC 1101 B and Proforma Form 1120
 for year ended 12.31.08)

Joint Exhibit Number 2 7, 8
 (NBSC Amended Form SC 1101 B and Proforma
 Form 1120X for year ended 12.31.09)

Joint Exhibit Number 3 7, 8
 (NBSC Form SC 1101 B and Proforma Form 120
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Joint Exhibit Number 4 7, 8
 (CB&TC - Amended Form SC 1101 B and Amended
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Joint Exhibit Number 5 7, 8
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Joint Exhibit Number 7 7, 8
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Joint Exhibit Number 8 7, 8
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Joint Exhibit Number 9 7, 8
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 (Synovus - 2nd Amended Form SC 1101 B and
 Form 1120 for year ended 12.31.12)

Joint Exhibit Number 14 7, 8
 (Synovus - Form SC 1101 B and Proforma Form
 1120 for year ended 12.31.13)



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(Income Tax Guide - PWC, relevant portions)	
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(Ernst & Young, Financial Reporting Developments, a Comprehensive Guide - Income Taxes, 2017, relevant portions)	
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(Price Waterhouse Coopers LLP, Financial Statement Presentation, 2014, 2d ed. 2015, relevant portions)	
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(The original exhibits were retained by the Court.)

STIPULATIONS

It is stipulated and agreed that this hearing is being taken pursuant to the rules of the Administrative Law Court and the South Carolina Rules of Civil Procedure.



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1 (Joint Exhibit Numbers 1 through 47 were marked prior
2 to the hearing.)

3 CALL TO ORDER:

4 **THE COURT:** Y'all be seated. Thank you. All right.

5 This is a hearing in Synovus Bank, Petitioner
6 versus South Carolina Department of Revenue,
7 Respondent, the Docket Number is
8 17-ALJ-17-0418-CC.

9 I don't imagine there's any more motions. I
10 normally ask if there's any motions or
11 stipulations the parties wish to make. Of
12 course, stipulations is on option. Motions
13 y'all probably have resolved.

14 **MR. LUTHER:** I don't think we have any -- no motions
15 from the Department.

16 **MR. MAYBANK:** We don't have any motions either. As
17 usually the case, we have agreed to all of the
18 exhibits but one, so we'd like to jointly
19 introduce the exhibits just so we don't forget
20 to do it later on during the course of the
21 trial.

22 The only exhibit that we disagree -- we
23 disagree with Exhibit 28 of the DOR's Exhibit,
24 the TRAC report, but other than that, we agree
25 with all the exhibits and would like to go



1 ahead and introduce those. We also -

2 **THE COURT:** What are those? When you say 28 ---

3 **MR. MAYBANK:** Is the TRAC report.

4 **THE COURT:** Well, what's -- so all of them are 1
5 through what?

6 **MR. LUTHER:** I think it's 1 through 47.

7 **THE COURT:** 1-47, so you are making a motion that 1
8 through 47 except for 28 are admitted without
9 objection?

10 **MR. LUTHER:** That's correct, Your Honor.

11 **MR. MAYBANK:** Correct.

12 **THE COURT:** All right. Well, then they're admitted.
13 (Joint Exhibit Numbers 1-27 and 29-47 are admitted
14 into the record.)

15 **MR. MAYBANK:** And then we would introduce all the
16 Synovus' Exhibits as well which the Department
17 has no objection. How many exhibit numbers do
18 we have?

19 **MS. CUTTINO:** They're all numbered 1 through 20,
20 they're all together.

21 **THE COURT:** Okay. And so we've taken care of that?

22 **MR. MAYBANK:** Correct.

23 **MR. LUTHER:** It's a consolidated Exhibit book, 2
24 books actually, but 1 through 47 is ours and
25 theirs. Everything admitted except for Exhibit



1 28.

2 **THE COURT:** Oh, okay.

3 **MR. MAYBANK:** And then we also stipulate that the
4 experts qualify as experts. There are three
5 expert witnesses. We would, of course, have a
6 very brief examination of their background, but
7 because we are stipulating that they qualify as
8 experts, it will be very short.

9 **THE COURT:** Oh, okay.

10 **MR. MAYBANK:** And then we have a trial brief, which
11 we are giving Jason a copy of our trial brief
12 and that's it. I'm here today to assist Ms.
13 Cuttino.

14 **MR. LUTHER:** One other thing, Burnie, I might
15 mention. We had talked about the stipulated
16 facts. So we have submitted, Your Honor,
17 stipulated facts in support of summary judgment
18 motions, however many months ago that was, and
19 I think we just wanted to make sure it was
20 clear that those continue to be stipulated for
21 purposes of this hearing.

22 **THE COURT:** Yeah, because that was per motion, so
23 you wish those ---

24 **MR. MAYBANK:** We're agreeable, Your Honor.

25 **THE COURT:** --- to be made part of this hearing?



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1 MR. LUTHER: Yes.

2 THE COURT: Do you have it as a document?

3 MR. LUTHER: I think we can get you one if we don't

4 ...

5 THE COURT: Yeah, so we'll have one for that record.

6 That's helpful.

7 MR. LUTHER: We can do that.

8 THE COURT: Not that our appellate courts aren't
9 confident enough to figure it out, but it would
10 be helpful. Anything else?

11 MR. MAYBANK: That's it for us, Your Honor.

12 THE COURT: Well, I'll hear your opening statements
13 if you wish to make them.

14 Mr. von Lehe.

15 MR. VON LEHE: Your Honor, yes.

16 THE COURT: How are you here?

17 MR. VON LEHE: I'm here as a witness, Your Honor.

18 THE COURT: Oh, okay.

19 MS. CUTTINO: We're having to switch seats today.

20 THE COURT: I thought you just got so used to coming
21 up into Administrative Law Court that when the
22 doors opened you just decided to come on in and
23 hang out.

24 MR. VON LEHE: The closer I get to that, the better
25 I like it.



1 **THE COURT:** Well, you might like being a witness
2 better than being a lawyer, who knows.

3 **MR. VON LEHE:** That's to be determined.

4 **MR. MAYBANK:** And he likes to be over here lately
5 better than being over at the USC Board of
6 Trustees maybe.

7 **THE COURT:** You got to look out after my Gamecocks.
8 Okay. Go ahead.

9 **PETITIONER'S OPENING STATEMENT:**

10 **MS. CUTTINO:** Well, good morning, Your Honor. My
11 name is Ashley Cuttino, and I'm here on behalf
12 of Synovus Bank, of course, with Burnie
13 Maybank and Lewis Smoak. We are here today
14 because this case focuses on whether or not a
15 bank in South Carolina may take an NOL
16 carryforward deduction. This analysis, of
17 course, requires us to look at the definition
18 of entire net income.

19 As the Court's aware, you've already made a
20 partial ruling on summary judgment. You've
21 left open for us today three questions to be
22 answered.

23 The first one is is the Department's reliance
24 upon the GAAP definition of book income
25 reasonable. Part of that includes whether or



1 not the Department actually reviews the
2 definitions issued by the FASB to ensure that
3 it is an appropriate calculation for entire net
4 income.

5 The second question you've asked us is is the
6 Department's use of book income as a proxy for
7 entire net income reasonable and consistent
8 with the applicable regulations, and then
9 finally under GAAP or otherwise, does net
10 income or book income include a net operating
11 loss deduction.

12 We're going to present evidence to you today
13 that the Department's reliance upon GAAP
14 actually is not reasonable. They are ignoring
15 the use of the term, "entire" from the bank tax
16 statute and instead are only focusing on the
17 words "net income" and we believe all words in
18 the statute have meaning.

19 We're also going to present evidence to the
20 Court that using GAAP as a proxy for entire net
21 income actually flies in the face of the
22 regulations that have been longstanding in this
23 case in the bank tax. The regulations state
24 that the bank tax can be based on accrual or a
25 cash based method of accounting. You're going



1 to hear evidence that GAAP is only accrual
2 based accounting. It is not cash-based
3 accounting.

4 **THE COURT:** All right. So using GAAP as a proxy for
5 you said ...

6 **MS. CUTTINO:** Entire net income.

7 **THE COURT:** Entire net income. And then you moved
8 to some other terms.

9 **MS. CUTTINO:** Yes, so using GAAP as a proxy for
10 entire net income is not consistent with the
11 regulation.

12 **THE COURT:** I got that, but ...

13 **MS. CUTTINO:** GAAP is a method of accounting.

14 **THE COURT:** Okay.

15 **MS. CUTTINO:** The regulations state that there are
16 two appropriate methods of accounting that can
17 be used under the bank tax. Those two methods
18 are the accrual based method of accounting or
19 the cash based method of accounting. GAAP only
20 applies to accrual based accounting; therefore,
21 it could not cover any bank using a cash based
22 method of accounting pursuant to the
23 regulation.

24 You're also going to hear evidence that GAAP is
25 controlled by the Financial Accounting



1 Standards Board. In short, we often call that
2 FASB. It is an independent, non-profit
3 organization and delegating the taxing power to
4 the FASB would be unconstitutional under the
5 South Carolina Constitution.

6 You're going to hear that the Department has
7 never issued any final guidance involving GAAP
8 and, in fact, no one has testified that they
9 have ever seen, heard, or read the Department
10 use the term GAAP before this litigation began.
11 And you're going to hear evidence that GAAP are
12 procedures and protocols for how you do
13 financial accounting. They are not firm rules,
14 so they allow for interpretation. That is why
15 it's important if the DOR was going to use GAAP
16 that they would issue advice pieces on how you
17 would apply those differences.

18 Once you hear this evidence, though, you're
19 going to have to still decide whether or not a
20 net operating loss carryforward can be used by
21 the bank, and so we're going to present you
22 evidence in the alternative. If you believe --

23 -

24 **THE COURT:** I'm going to have to decide that because
25 since GAAP is something that is flexible then



1 ...

2 **MS. CUTTINO:** At the end of the day, this Court must
3 decide if a bank may use an NOL carryforward.

4 **THE COURT:** Okay.

5 **MS. CUTTINO:** --- that's the question in the case.
6 If ---

7 **THE COURT:** What I'm asking is you is ---

8 **MS. CUTTINO:** Uh-huh.

9 **THE COURT:** --- you said -- you didn't use the term
10 "flexible", but GAAP is ...

11 **MS. CUTTINO:** They are the accounting protocols that
12 you use.

13 **THE COURT:** But GAAP can or cannot apply in certain
14 situations?

15 **MS. CUTTINO:** Correct, and so we're going to present
16 you evidence to tell you when it would apply
17 and when it would not.

18 **THE COURT:** Okay.

19 **MS. CUTTINO:** So if GAAP does apply, our expert,
20 Doug Branch is going to explain why an NOL
21 carryforward is mandatory under GAAP. Once the
22 Department says we are following GAAP, then NOL
23 carryforwards become mandatory not optional.

24 **THE COURT:** If GAAP applies?

25 **MS. CUTTINO:** If GAAP applies. If GAAP does not



1 apply, we still have the outstanding question
2 of whether or not NOL carryforwards are
3 available under the bank tax.

4 We are going to present the Court with evidence
5 that, yes, they are still allowable under the
6 bank tax. When you look back to the 1948
7 attorney general's opinion, which is truly what
8 the bank tax is based on and has grown from.

9 The original attorney general said entire net
10 income is to be based on all income and
11 deductions of all expenses. That is not
12 limited to the year in which the expense is
13 incurred, and if you have more expenses than
14 revenue in year one, the only way you can take
15 all expenses is to allow those expenses to be
16 deducted in future years. The method in which
17 we do that is a carryforward. How we -- what
18 we call that on the bank tax form would be an
19 issue for the Department to figure out, but it
20 is the equivalent of a carryforward because you
21 are taking all deductible expenses in a future
22 year.

23 We are also going to talk about the bank tax
24 form and how the Department starts the bank tax
25 form with federal tax income. They then decide



1 to take out federal net operating losses.
2 There is no statute that told them to take out
3 federal net operating losses, and so we're
4 going to talk about whether or not that is an
5 appropriate removal in light of the -- again,
6 the AG's opinion that says all deductible
7 expenses. And then finally, we're going to ---

8 **THE COURT:** We started off with three questions, and
9 I think we're at a lot more than three now.

10 **MS. CUTTINO:** Your ten fingers that you didn't
11 realize that you were asking us to do.

12 **THE COURT:** These three questions have subsets.

13 **MS. CUTTINO:** That's right. That's right. That's
14 right. And then finally we're going to show
15 you why under old precedent from the
16 Department, it's inequitable for the Court not
17 to allow the carryforward. There is old ---

18 **THE COURT:** Say that again.

19 **MS. CUTTINO:** Why under historical precedent from
20 the Department -- there are old opinions from
21 the Department that talk about out-of-state
22 banks who have losses that are a result of
23 foreclosures like Synovus and how they are
24 allowed to take net operating loss
25 carryforwards, and then we're also finally



1 going to show why the Department has,
2 historically, when there's a question on the
3 bank tax, what they look to is the IRC to try
4 and figure out how to handle it, which is
5 essentially what we've asked this Court to do.
6 So at the end of the day, we're going to have
7 to talk about whether GAAP does or does not
8 apply, but we're going to show you how NOL
9 carryforwards should be allowed regardless of
10 the answer to that initial question.

11 **THE COURT:** Okay. We're going to start down one
12 path, and then we're ultimately going to
13 potentially end up back to that IRC?

14 **MS. CUTTINO:** Yes, sir.

15 **THE COURT:** Okay, that's an interesting path.

16 **RESPONDENT'S OPENING STATEMENT:**

17 **MR. LUTHER:** Morning, Your Honor.

18 **THE COURT:** I think you're going to take a divergent
19 path.

20 **MR. LUTHER:** Well, I'll start on common ground and
21 that is I think I might slightly tweak the
22 three questions, but I would generally agree
23 with what we're here to talk about today in the
24 scope of this hearing.

25 As I understood, Your Honor's, previous



1 opinion, the three issues would be one, how is
2 the entire net income, how is the tax base for
3 a bank, the entire net income calculated. That
4 would be question one.

5 Second question would be taking the
6 Department's position, is it reasonable to
7 equate entire net income with book income and
8 particularly the book income as determined or
9 calculated under GAAP. That would be the
10 second question.

11 And the third question would be ---

12 **THE COURT:** You said book income is what?

13 **MR. LUTHER:** As determined under GAAP, or calculated
14 using GAAP, generally accepted accounting
15 principles.

16 The third question would be does book income as
17 calculated under GAAP, and in particular ASC
18 740, which is a portion of GAAP, does it permit
19 the bank to deduct NOL carryforwards in a way
20 that reduces their entire net income where the
21 statute, as Your Honor has already ruled, does
22 not. So is GAAP a way to back into a deduction
23 of the statute in the time frame.

24 And I want to emphasize at the beginning of
25 this hearing that ultimately what we're talking



1 about is a deduction. So it's a deduction, and
2 under our case law, deductions are strictly
3 construed. It is the taxpayer that has to
4 prove it comes within the deduction and the
5 burden of proof is upon the Petitioner in this
6 case.

7 And so I think at the end of this hearing
8 today, those three issues when you hear the
9 testimony and see the evidence presented, I
10 think that we'll answer those questions for
11 you, and I actually think you'll find that
12 there is more agreement between the parties
13 than there is disagreement.

14 So there are two experts you'll hear from today
15 for the bank and one for the Department and
16 this is what they agree on. Book income and
17 entire net income are synonymous terms in their
18 view. Entire net income, therefore, is
19 properly calculated using GAAP. That's common
20 ground. And GAAP, the ASC 740, permit an
21 entity like Synovus to record an NOL deferred
22 tax asset on their financial statements.

23 **THE COURT:** I didn't follow -- I was typing. I
24 didn't follow that last sentence.

25 **MR. LUTHER:** Sure.



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1 **THE COURT:** Give it to me again.

2 **MR. LUTHER:** This is the third area that I think
3 you'll hear agreement that is that ASC 740,
4 this portion of GAAP, allows an entity like
5 Synovus to record a net operating loss as a
6 deferred -- what's called a deferred tax asset.
7 They can record that on their financial
8 statements, particularly, their balance sheet.

9 **THE COURT:** All right. Deferred is starting to
10 sound a lot like carryforward.

11 **MR. LUTHER:** It is and that's why I'm going to get
12 to why we agree in one sense, but we disagree,
13 perhaps, we're splitting hairs a little bit,
14 but it's an important disagreement.

15 **THE COURT:** Okay.

16 **MR. LUTHER:** I think what you'll hear is that GAAP
17 in financial accounting, and particularly ASC
18 740, is an accounting method to recognize tax
19 benefits. So a deferred tax asset is a way to
20 recognize on your financial tax statements and
21 anticipate a tax benefit in the future, a
22 deduction, and in this case, an NOL deduction.
23 So we agree that ASC 740 allows that to take
24 place, but it presupposes that the taxing
25 jurisdiction allows that deduction in the



1 future. That's where we disagree.

2 **THE COURT:** Okay.

3 **MR. LUTHER:** So ASC 740 does ---

4 **THE COURT:** You are splitting hairs.

5 **MR. LUTHER:** I know, and I think it's important --
6 to be quite honest with you, it took me a while
7 in going through this case and hearing the
8 experts to understand what this distinction is.

9 **THE COURT:** Well, how long is it going to take me?

10 **MR. LUTHER:** Hopefully, less than a day.

11 Let me explain it this way, and I may regret
12 this example, but this is the best I could come
13 up with, and I thought about it last night
14 watching baseball. Baseball has a set of
15 rules, and we all apply -- those rules apply in
16 every game, and they got a particular rule
17 called an infield fly rule.

18 **THE COURT:** Yep.

19 **MR. LUTHER:** And you're familiar with that. You got
20 a runner on first, and second, or first, second
21 and third, there's fewer than two outs.
22 Batter hits a pop fly that the umpire says with
23 ordinary effort this infielder can catch it, so
24 the batter is out. That situation is governed
25 by the rules of baseball. That's ASC 740, but



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1 that doesn't mean -- in order for that rule to
2 kick in in the course of the game, you'd have
3 to have that scenario come into play. You have
4 to have runners on first and second, less than
5 two outs, pop fly, et cetera. So just because
6 the rule says here's what you do when you have
7 an infield fly rule doesn't mean you
8 necessarily will have an infield fly rule in
9 the course of the game, and that's the best I
10 can come up with ASC 740. We're not saying the
11 rule doesn't apply, per say. It's there and it
12 does, but in South Carolina, because there's no
13 statutory authority to deduct an NOL
14 carryforward for purposes of your bank tax
15 liability, the value of a deferred tax asset in
16 South Carolina under ASC 740 is zero, and you
17 will hear that that's the case from both
18 experts in this case. ASC 740 necessarily
19 assumes and presupposes ---

20 **THE COURT:** If a value of a deferred asset is zero,
21 than how can it be a deferred asset?

22 **MR. LUTHER:** Because there is no deduction to be
23 taken in the future years because the
24 jurisdiction in South Carolina doesn't allow
25 it.



1 **THE COURT:** Then it's not deferred.

2 **MR. LUTHER:** Right. There's just nothing. It's a
3 zero. Now, they may have deferred tax assets
4 for those NOLs in other jurisdictions, or for
5 federal tax purposes, but for purposes of South
6 Carolina, it's zero.

7 **THE COURT:** Okay.

8 **MR. LUTHER:** But maybe we're on a subset of question
9 three now, and this is in the alternative ---

10 **THE COURT:** I think I need you all to be able to put
11 the questions on the board.

12 **MR. LUTHER:** I thought about doing a PowerPoint in
13 honor of Mr. Ray Stevens who isn't even
14 involved in this case.

15 **THE COURT:** He would have like ten of them.

16 **MR. LUTHER:** He would.

17 **THE COURT:** I'll get by staff attorney to give me
18 the ---

19 **MR. LUTHER:** Hopefully we can lay this out for you.

20 **THE COURT:** Okay.

21 **MR. LUTHER:** But even if -- the other thing we want
22 to show is even if Synovus had said -- and I
23 don't want to get too technical with it, but if
24 they have said, we think GAAP requires us to
25 claim a deferred tax asset for these net



1 operating losses.

2 **THE COURT:** Even if they say it requires.

3 **MR. LUTHER:** Because I think the language of Ms.
4 Cuttino earlier was that NOL carryforwards
5 become mandatory under GAAP.

6 **THE COURT:** Okay.

7 **MR. LUTHER:** So fine. They claim that on their
8 financial documents, their balance sheet is
9 deferred tax assets in the future. When those
10 assets are utilized in future years, that
11 impacts only the balance sheet. It doesn't
12 impact the income statement, and the income
13 statement is ultimately where you find entire
14 net income. So if the bank tax -- under our
15 view, if the bank tax is book income, and book
16 income is not affected in future years by the
17 utilization of these deferred tax assets, then
18 ultimately it does not get Synovus what they
19 want, which is to reduce their entire net
20 income in future years by these deferred tax
21 assets.

22 **THE COURT:** What benefit would it be of them to
23 reduce book income but not -- what was it book
24 ...

25 **MR. LUTHER:** Book income, think bottom line on their



1 income statement.

2 **THE COURT:** Yeah, so what benefit is it to reduce
3 book income and not net income?

4 **MR. LUTHER:** Well, we think book income and net
5 income are the same thing.

6 **THE COURT:** All right. So let me follow what you
7 just said.

8 **MR. LUTHER:** Sure.

9 **THE COURT:** You said it reduces one but not the
10 other, so what ...

11 **MR. LUTHER:** What it does is it affects their
12 balance sheet.

13 **THE COURT:** Balance sheet, okay.

14 **MR. LUTHER:** And we're going to have our expert walk
15 through all these different terms because I
16 know it's technical.

17 **THE COURT:** Okay. All right.

18 **MR. LUTHER:** Balance sheets are part of the
19 documents that make up a business's financial
20 statements.

21 **THE COURT:** It reduces their balance sheet?

22 **MR. LUTHER:** It actually is -- it's a wash because
23 when they use that deferred tax asset, on the
24 one hand they're reducing a liability, but on
25 the other hand, it is a benefit or income to



1 them in a sense, and so the two zero out, but
2 when you take that, it does not have any impact
3 on their income statement, which is where you
4 find entire net income. So this is all
5 accounting, but it has nothing to do with the
6 tax base in South Carolina.

7 **THE COURT:** Okay.

8 **MR. LUTHER:** So we think those three questions will
9 be answered, and that actually there's more
10 agreement than disagreement, and at the end of
11 this day, we think the evidence will show that
12 the Department's determination should be
13 affirmed that there is no net operating loss
14 carryforward deduction for a bank in South
15 Carolina.

16 **THE COURT:** You know, I was reading my summary
17 judgment order and I was thinking if this goes
18 up on appeal, I'll look forward to y'all trying
19 to explain all this to the appellate courts and
20 that was before I just heard all of this.

21 **MR. LUTHER:** I'm not sure what I just said to be
22 honest with you. I'm just reading my notes
23 here.

24 **THE COURT:** Okay.

25 **MR. LUTHER:** Thank you, Your Honor.



1 THE COURT: You got all this down, right?

2 COURT REPORTER: Yes.

3 THE COURT: All right. Call your first witness.

4 MS. CUTTINO: Your Honor, we call John von Lehe.
5 Your Honor, I know that we gave you the
6 electronic exhibits. We do have an extra copy
7 on paper if you'd like any of them on paper.

8 THE COURT: Do I have the electronic exhibits?

9 MR. LUTHER: I failed to hand them up.

10 MS. CUTTINO: Jason did not give you -- let me
11 rephrase. Jason failed to give it to you.

12 MR. LUTHER: In my excitement to talk about
13 accounting principles, I forgot to give them to
14 you. This is a flash drive. It's a digital
15 copy of those two notebooks. We'll certainly
16 put stuff up on the Elmo.

17 THE COURT: Okay. Sit it right there. I'll get it
18 later. I might take a break, a short break
19 soon and get it loaded into my computer ---

20 MS. CUTTINO: Okay.

21 THE COURT: --- so I can get it pulled up on the
22 screen.

23 MS. CUTTINO: John does have some exhibits we're
24 going to talk about would you like to go ahead
25 and ---



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1 THE COURT: Yeah ---

2 MS. CUTTINO: --- do that real quick.

3 THE COURT: --- let's just go ahead down the path.

4 MS. CUTTINO: All right.

5 JOHN C. VON LEHE, JR., CPA, having been duly sworn,
6 testifies as follows:

7 THE COURT: That's going to be a distinctive
8 different aspect of being a lawyer.

9 (Laughter.)

10 MR. MAYBANK: Hope it doesn't happen again.

11 MS. CUTTINO: And, John, I believe all of the
12 exhibits we are going to use are going to be in
13 this book, not the first book for you.

14 MR. LUTHER: All right.

15 MS. CUTTINO: And, again, Your Honor, we stipulated
16 that all of the witnesses are experts in this
17 case.

18 MR. VON LEHE - DIRECT EXAMINATION BY MS. CUTTINO:

19 Q: Mr. von Lehe, can you turn with me to what's
20 been marked as Exhibit 29.

21 THE COURT: Are you going to explain to me what -- I
22 know he's an expert.

23 MS. CUTTINO: Yes, that's what I'm doing right now.
24 This is -- this the designation of expert
25 witnesses.



1 CLERK: Judge Anderson, can we grab -- is this the
2 second copy of the book, do you mind if I grab
3 it?

4 MS. CUTTINO: So that is just the second volume of
5 it. Would you like a copy of that?

6 CLERK: Uh-huh.

7 MS. CUTTINO: Montana, could you pull a copy of all
8 these.

9 CLERK: Oh, I thought you had one.

10 MS. CUTTINO: She has them in this box. She can
11 pull them real quick.

12 CLERK: Or you can use the Elmo. Just something we
13 can put up.

14 Q: Mr. von Lehe, is this the Synovus Designation
15 of Expert Witnesses?

16 A: Yes, it is.

17 Q: And you have been designated as an expert
18 witness regarding the application of the South
19 Carolina bank tax to ASC 740 based on the
20 history of the bank tax as a franchise tax
21 based on income, correct?

22 A: That is correct.

23 Q: Mr. von Lehe, can you now turn with me to
24 Exhibit 30. Is this your CV?

25 A: It is.



1 Q: Is this the CV that was presented to opposing
2 counsel during discovery in this case?

3 A: It is.

4 Q: Have there been any significant updates to your
5 CV since your deposition?

6 A: No, not since my deposition.

7 Q: And just briefly, I know the Court is very
8 familiar with you but for purpose of the
9 record, I just want to give a brief history.
10 Can you tell me what your occupation is?

11 A: I'm a tax lawyer.

12 Q: Can you tell me about your education?

13 A: Yes, I'm a graduate of the University of South
14 Carolina, the University of South Carolina
15 School of Law. I'm a graduate of Washington
16 University in St. Louis for a master's in
17 taxation.

18 Q: Are you a member of any accounting societies?

19 A: Yes, I'm a member of the South Carolina
20 Association of CPAs. I'm a former member of an
21 organization known as Beta Alpha Psi which was
22 the scholastic accounting organization for
23 undergraduates. I'm a member of the Bar
24 Association.

25 Q: Can you tell me about your professional work



1 history as it relates to taxes in South
2 Carolina?

3 A: Yes. I -- I began after graduating from
4 Washington University in St. Louis. I worked
5 for the Internal Revenue Service in Washington
6 D.C. for two years. I then worked in
7 Greenville for one year with a tax lawyer up
8 there before I became one of the lawyers
9 representing the Department of Revenue, then
10 called the tax commission and I did that for
11 about seven and a half years. During that
12 time, I taught taxes in the business school at
13 night at the University of South Carolina for
14 those seven and a half years. Then after
15 leaving the attorney general's office, I worked
16 for a CPA firm in Columbia for approximately
17 two years and then had an opportunity to go to
18 Charleston, which I did in 1980, spent 19 years
19 with Young, Clement, Rivers & Tisdale there and
20 then this is my 20th year as a tax lawyer with
21 Nelson Mullins.

22 Q: Do you have any accounting certifications?

23 A: I am a CPA.

24 Q: Do you ever give any speeches on tax
25 accounting?



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1 A: Yes, I have for the past, I would say, at least
2 four years been invited to speak to the CPA
3 Association on current tax legislation, which
4 involved, of course, tax accounting.

5 Q: Have you written any books on the South
6 Carolina tax code?

7 A: Yes, I've written a number of books on South
8 taxation. I wrote -- the earliest and first
9 book was with Professor Lad Boyle having to do
10 strictly with South Carolina income taxation,
11 and then I think we did that twice. This was
12 a long time ago and then followed up with a
13 book on South Carolina taxation in general,
14 which applies to all types of South Carolina
15 taxes and that book has been -- there are three
16 editions of that book the last one having been
17 done about maybe two or three years ago.

18 Q: Have you ever written any books on tax
19 accounting?

20 A: No, I've never written an article or a book
21 specifically entitled *Tax Accounting*, but tax
22 accounting is a part of my books, certainly,
23 and on the various -- my teaching at the
24 University of South Carolina for -- I did that
25 adjunct teaching for it actually was nine to



1 ten years and tax accounting is certainly an
2 integral part of the Internal Revenue Code.

3 Q: Now, you said you were at one time employed in
4 the rulings division?

5 A: Yes, I was in the rulings division of
6 Department of Revenue in Washington from 1969
7 to 1970 I believe it is, or it was, and at that
8 time that was almost exclusively tax
9 accounting. We dealt with bad debt research
10 and that is a tax accounting concept.

11 Q: Have you ever served in the capacity as a
12 lawyer for the Department of Revenue?

13 A: I have. I was one of the lawyers in the
14 attorney general's office assigned to the
15 Department of Revenue from around 197- -- maybe
16 '71 to -- I think it was for seven years.

17 Q: Have you been engaged as an expert previously?

18 A: Yes, I've testified, not frequently, I've
19 testified a couple of times as I recall a long
20 time ago, at least -- it's been at least 15
21 years.

22 Q: What did you review in preparation to give your
23 opinion in this case?

24 A: I reviewed the Department Determination of the
25 Department of Revenue. I reviewed the



1 pre-trial statements filed by the parties. I
2 reviewed the briefs. I reviewed the
3 regulations to the extent -- excuse me, I
4 reviewed the Bank Tax Code. I reviewed the
5 regulations to the extent they exist. I
6 reviewed what pronouncements are outstanding
7 from the Department on the bank tax, which are
8 few and far between. I reviewed the 1948
9 attorney general's opinion. It references an
10 early income tax decision, which I also
11 reviewed. That's all I can recall.

12 Q: In the past, how does the Department describe
13 the bank tax?

14 A: The bank tax has been described by the
15 Department as a franchise tax based on income.

16 Q: Does the term "economic income" have any
17 meaning in accounting terminology?

18 A: It does not.

19 Q: Has the legislature ever used the terms "book
20 income" or franchise tax to describe the bank
21 tax?

22 A: No. It has not.

23 Q: Are you aware of any other litigation involving
24 the bank tax?

25 A: I'm not.



1 Q: I know you said you reviewed what's happened
2 previously in this case, do you recall whether
3 or not the Court in its Motion for Summary
4 Judgment determined if the bank tax is a tax
5 based on income?

6 A: Yes, the Court did determine, I think it's
7 around page 8 of his Honor's opinion, that the
8 bank tax is a tax based on income.

9 Q: All right. And will you turn with me to
10 Exhibit 43. Just for purposes of the record
11 that is the order, the previous order in this
12 case; is that correct?

13 A: Yes, it is.

14 Q: Did you review any statutes to arrive at your
15 opinion in this case?

16 A: Well, I reviewed the Bank Tax Statute,
17 12-11-20, in particular.

18 Q: Do you recall what Statute 12-11-20 says?

19 A: Yes, it says that the bank tax is imposed on
20 entire net income.

21 Q: Has the attorney general's office ever
22 described the bank tax?

23 A: Yes, as I mentioned in their 1948 opinion it
24 discussed the bank tax as a tax based on entire
25 net income, which included all income and all



1 deductions. Well, it may ---

2 Q: And would you.

3 A: --- I have to look at the terminology. It may
4 have said all income and all expenditures.

5 Q: So would you turn with me to Exhibit 25, and
6 within Exhibit 25, it's Bates number 1380.

7 **THE COURT:** Could you put some of those up on the
8 Elmo.

9 **MS. CUTTINO:** Yeah, sure.

10 **THE COURT:** That is if it's going to be something
11 that's very relevant, I want it on the Elmo, so
12 I can look at it until I can get myself of the
13 computer.

14 **MR. MAYBANK:** Ashley has a copy of those on his
15 computer.

16 **MS. CUTTINO:** Jason has given him the thumb drive.

17 **THE COURT:** When I can get the thumb drive loaded,
18 then I won't need this.

19 **MS. MAYBANK:** Do we have an extra copy I can hand
20 him?

21 **THE COURT:** No, I'm fine. As long as it's on the
22 Elmo, I'm good.

23 **MR. MAYBANK:** It's hard to read that thing.

24 **THE COURT:** I can read it. Go ahead.

25 Q: Mr. von Lehe, within the 1948 opinion, can you



1 read to us what it says regarding how the tax
2 is to be calculated?

3 A: I'm looking at Exhibit 25 which appears to be
4 in my book ID 116.

5 Q: It should be ---

6 A: Is it supposed to be the attorney general's
7 opinion?

8 Q: Is it -- let me see. Is it this? Yeah, okay,
9 turn to page 13, 83 within here.

10 MS. CUTTINO: Hold on one second.

11 Jason?

12 MR. LUTHER: Yeah.

13 MS. CUTTINO: Oh, there is it. Your Honor ---

14 THE COURT: Yes.

15 MS. CUTTINO: --- for purposes of the record, I'm
16 not sure why but we have two Bates numbers that
17 are 1380 in the notebook. We are referring to
18 the June 15th, 1937 -- sorry, to the March 12,
19 1948 opinion is what we are referring to.

20 THE COURT: Mr. von Lehe, you can actually touch the
21 screen if you wish and highlight. We'd have to
22 bring that function up, but then we could do
23 the highlighting. Go ahead and proceed.

24 Q: Mr. Von Lehe, in 1948 when this opinion was
25 issued, did it provide what deductions are



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1 allowed for the bank tax?

2 A: Well, the opinion states that it's my opinion
3 that banks in this state filing returns
4 required under this section of the code are
5 permitted to deduct all expenses incurred in
6 the operation of their bank including federal
7 and state income taxes.

8 Q: And there's no limitation in this opinion as to
9 what all expenses means; correct?

10 A: That is correct.

11 Q: Does this opinion also give you any indication
12 as to whether or not the bank tax is a tax
13 based on income?

14 A: It says that in this person's opinion it says
15 that the code section levies a tax upon them
16 with respect to the entire net income of the
17 banks. This language includes all the income
18 from whatever source derived, et cetera, et
19 cetera.

20 Q: Has the legislature ever defined entire net
21 income in a statute?

22 A: No.

23 Q: Under the regulations regarding the bank tax,
24 what methods of accounting does the bank tax
25 allow for?



1 A: The bank tax according to the Department of
2 Revenue is based on generally accepted
3 accounting principles or GAAP.

4 Q: And how about under the regulations and I'll
5 show you the regulations that have been passed
6 regarding the bank tax. What methods of
7 reporting are allowed under the regulations?

8 A: The regulation allows a bank to use both
9 accrual basis accounting and cash-basis
10 accounting regulation 117-11500.2.

11 Q: Is GAAP accrual or cash based accounting?

12 A: GAAP is accrual accounting.

13 Q: Can GAAP be cash based accounting?

14 A: Not to the best of my knowledge.

15 Q: Has the Department ever referred to the bank
16 tax as a tax based on income?

17 **THE COURT:** Hold on one moment. Okay.

18 Q: Has the Department ever referred to the bank
19 tax as a tax based on income?

20 A: They have. I think that's generally accepted
21 at the Department to the best of my knowledge.

22 Q: Are you aware prior to this case of the
23 Department ever instructing a bank tax payer to
24 use GAAP as the basis for entire net income?

25 A: Yes. It's my memory that with that -- what



1 sparse encounters I had with the bank tax while
2 I was one of the lawyers for the Department of
3 Revenue that the bank tax was based on income,
4 so, yes, I do recall that.

5 Q: Do you recall them using the words GAAP to
6 define income?

7 A: I don't recall that. It's my understanding
8 based on reading through the depositions, et
9 cetera in this case, that the Department
10 believes that the bank tax is based on GAAP.

11 Q: When you worked for the Department, did the
12 Department do anything to actually follow GAAP?

13 A: Well, in the application of the bank tax there
14 would have been -- they would have followed it
15 to some extent, not entirely. This regulation
16 does not follow it entirely, but they would
17 have followed it to some extent, but I don't
18 remember the Department of Revenue ever
19 publishing anything that discusses GAAP. I
20 don't remember any internal or external law of
21 considerations of GAAP as a guide to taxation,
22 no, certainly not as a general guide.

23 Q: Has the Department ever publicly stated that
24 entire net income is equivalent to GAAP?

25 A: Not that I'm aware of.



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1 Q: What is GAAP?

2 A: Generally accepted accounting principles.
3 That's what GAAP stands for; therefore, GAAP is
4 a -- is a statement of those accounting
5 principles which should be generally accepted.

6 Q: Now, we talked a minute ago about that GAAP is
7 accrual based accounting. Under the Internal
8 Revenue Code, are you allowed to use cash based
9 accounting?

10 A: You are.

11 Q: Are you familiar with ASC 740?

12 A: Yes, I am familiar with it.

13 Q: And I'm going to have you turn to Exhibit 38.
14 Is this a full copy of ASC 740?

15 A: Yes.

16 Q: And did you review ASC 740 in arriving at your
17 opinions?

18 A: I did.

19 Q: And what did you glean from ASC 740?

20 A: ASC 47 is a compilation ---

21 **THE COURT:** All right. Wait a minute. You said ---

22 Q: 740.

23 **THE COURT:** Okay.

24 A: ASC 740 is a compilation by the Financial
25 Accounting Standards board, FASB, of the rules



1 of accounting which apply to income taxes and,
2 in particular, deferred tax benefits.

3 Q: What do you have to have for a tax to -- for
4 ASC 740 to be applicable to a tax? Let me
5 rephrase. Is ASC 740 applicable to all taxes?

6 A: No, ASC 740 is only applicable to taxes based
7 on income. I'll distinguish that if I may from
8 -- it also would apply -- and as I distinguish
9 that from -- I did not say that it applies only
10 to income taxes that would be incorrect. It's
11 clear that it applies to taxes other than
12 income taxes, for example, franchise taxes, and
13 you had mentioned state franchise taxes so long
14 as those taxes are based on income. It
15 wouldn't have to be an income tax, but it would
16 have to be a tax based on income.

17 Q: And, in fact, doesn't ASC 740 give particular
18 guidance to franchise taxes in when they would
19 and would not apply?

20 A: Yes.

21 Q: Did you also look at any advice pieces from any
22 accounting firms in arriving at your
23 conclusions?

24 A: Yes. In addition to reading this ASC 740, I
25 read two pronouncements of two of the national



1 CPA firms in which they give guidance as to
2 what ASC 740 means. So ASC 740 is a monumental
3 work of these two accounting firms, PwC and
4 Deloitte. They have published -- they've each
5 published guides. One of them is called a
6 *Guide*, the other one is called a *Roadmap* to
7 accounting standards codification ASC 740 in an
8 attempt to explain it. So I read those two
9 publications a number of times.

10 Q: And are those two publications found in
11 Exhibits 39 and 40?

12 A: Yes, 39 is the PwC publication and 40 is the
13 Deloitte publication. PwC being what they term
14 the *Guide*. Deloitte being what they call a
15 *Road Map*.

16 Q: And now you were asked to determine whether or
17 not the South Carolina bank tax is a tax based
18 on income, correct?

19 A: I was. I wrote an opinion on that.

20 Q: And that is important because if it is not a
21 tax based on income, then ASC 740 would not
22 apply, correct?

23 A: That's correct.

24 Q: You were not asked to give your opinion on what
25 ASC 740 actually means or does under the



1 accounting principles, were you?

2 A: I was not, for purposes of that opinion, no.

3 Q: And you've testified today that the bank tax in
4 South Carolina is based on income, correct?

5 A: I did testify to that.

6 Q: And as a result of that testimony, do you
7 believe that ASC 740 does apply to the bank
8 tax?

9 A: I do.

10 **MS. CUTTINO:** One second, Your Honor.

11 That's all I have, Your Honor.

12 **MR. MAYBANK:** Your Honor, we may have one more
13 question.

14 Q: Mr. von Lehe, does the term "entire net income"
15 appear in GAAP?

16 A: No, it does not.

17 Q: Does the term "net income" appear in GAAP?

18 A: Yes, net income does appear in GAAP.

19 Q: But the term "entire net income", does not?

20 A: That is correct.

21 **MS. CUTTINO:** Thank you.

22 **THE COURT:** Give me just a second to catch up.

23 Go ahead.

24 **MR. VON LEHE - CROSS-EXAMINATION BY MR. LUTHER:**

25 Q: Good morning, Mr. von Lehe.



1 A: Good morning.

2 Q: When you first started practicing in South
3 Carolina that was in your capacity as an
4 assistant attorney general; is that correct?

5 A: That's correct. There was a brief period in
6 Greenville with a tax lawyer up there for about
7 a year, but then following that, I was an
8 assistant attorney general; that is correct.

9 Q: And in that capacity, you assisted the attorney
10 general in preparing advisory opinions?

11 A: I did.

12 Q: But you never worked on any advisory opinions
13 involving the South Carolina bank tax, correct?

14 A: That's correct.

15 Q: But you agree with me that as a tax
16 practitioner, an attorney general opinion is
17 helpful in understanding the legal landscape of
18 taxes, correct?

19 A: Correct.

20 Q: And you give a great deal of deference to aging
21 opinions in your practice, don't you?

22 A: I do.

23 Q: Now, when you served as counsel for the South
24 Carolina Tax Commission, you were still in your
25 capacity as an Assistant attorney general; is



1 that right?

2 A: That's correct.

3 Q: You were not technically an employee of the
4 Department, correct?

5 A: That's correct.

6 Q: And you provided advice to the Tax Commission
7 on legal matters, correct?

8 A: I did.

9 Q: But you never assisted the Commission in
10 rendering any opinions on bank tax?

11 A: Not that I can recall.

12 Q: And you never litigated any cases involving the
13 bank tax?

14 A: I did not.

15 Q: And you've never prepared any tax returns on
16 behalf of the bank in South Carolina?

17 A: No, I have not.

18 Q: And never represented any banks in any dispute
19 with the Department of Revenue?

20 A: That is correct.

21 Q: Now, you agree with me that GAAP and financial
22 accounting and book accounting are
23 interchangeable terms?

24 A: I believe they are interchangeable terms, yes.

25 Q: And entire net income and book income are



1 synonymous in your view, right?

2 A: The more I think about it ---

3 **THE COURT:** Wait a second. GAAP -- what was the
4 three things you said that are ---

5 **MR. LUTHER:** GAAP, financial accounting, and book
6 accounting.

7 **THE COURT:** Okay.

8 A: Please repeat your question.

9 Q: Sure. Entire net income and book income are
10 synonymous in your opinion, right?

11 A: If -- let's assume that book income means, as
12 I just agreed, that it means GAAP that book
13 income and GAAP are synonymous. They are the
14 same thing. The term "entire net income" does
15 not appear in GAAP.

16 Q: Understood, but you agree, and I believe you
17 testified in your deposition, that in your view
18 entire net income and book income are
19 synonymous terms?

20 A: I did say that; however, that is incorrect.

21 Q: Okay.

22 A: That it is incorrect because by definition, it
23 can't be right because the term "entire net
24 income" does not appear in GAAP. It's just the
25 facts.



1 Q: Understood, but my question is not whether
2 entire net income appears in GAAP. My question
3 is in practice you view entire net income and
4 book income as synonymous, correct?

5 A: I do not, and after contemplating this, I
6 believe that entire net income is a broader
7 statement than GAAP.

8 Q: But you do agree with me that in your
9 deposition you said entire net income?

10 A: I do agree with that.

11 Q: And in your opinion, book income and GAAP
12 income are synonymous terms, right?

13 A: That is correct.

14 Q: So if that's the case if entire net income and
15 book income are synonymous, then entire net
16 income would be calculated using GAAP, right?

17 A: I do not believe that entire net income and
18 book income are synonymous.

19 Q: Okay. Do you believe calculating entire net
20 income using GAAP would be appropriate?

21 A: Not necessarily. I -- I think we could find
22 accounting principles, I know we could find
23 accounting principles, that would show us how
24 to calculate net income under GAAP. We can
25 find no accounting principles that will show us



1 how to calculate something by the name of
2 entire net income because it is not referenced
3 in GAAP.

4 Q: Okay, and I appreciate that explanation. What
5 I want to focus in on is the question that I
6 asked in your deposition and we can reference
7 it if we need to, but calculating entire net
8 income using GAAP would be appropriate,
9 correct?

10 A: I did say that. That is not correct.

11 Q: Okay. You said it in your deposition, but it
12 is not correct now?

13 A: That is correct.

14 Q: Okay. You also said that calculating entire
15 net income using GAAP would be reasonable,
16 didn't you?

17 A: I did say that.

18 Q: And I assume that's not your testimony now?

19 A: You are correct.

20 Q: In your view, entire net income means all
21 revenue minus all expenses; is that fair?

22 A: Yes, that is fair.

23 Q: Okay. And that's been the Department's
24 longstanding interpretation of how entire net
25 income is calculated, right?



1 A: That is correct.

2 Q: And you agree that's a correct interpretation?

3 A: That is the Department of Revenue's
4 interpretation, whether it's correct or not, I
5 don't know. It certainly is the Department of
6 Revenue's interpretation. It's in that
7 attorney general's opinion that we went over a
8 few minutes ago, yes.

9 Q: Okay. And in your deposition, your testimony
10 was that that was a correct interpretation,
11 wasn't it?

12 A: Yes, that's my memory, yes.

13 Q: Okay. And just like you, the Department has
14 interpreted entire net income to mean book
15 income for a long time, correct?

16 A: I have not interpreted it to be -- the entire
17 net income to mean book income for a long time.
18 When you took my deposition, I said that.

19 Q: So up until we took your deposition, that was
20 your view, but in the last four months, it's
21 changed; is that correct?

22 A: On the day you took my deposition, that's what
23 I said. After contemplating it, I do not
24 believe that to be correct.

25 Q: Okay. Fair enough. But you agree with me that



1 the Department's longstanding interpretation of
2 book income has been financial income, correct?

3 A: That is correct.

4 Q: And that's GAAP?

5 A: That is correct.

6 Q: And the Department's longstanding practice has
7 been to calculate the bank tax based on
8 financial accounting rather than federal income
9 tax accounting, right?

10 A: That is correct.

11 Q: And those interpretations by the Department are
12 consistent with the regulations that the
13 Department has propagated regarding the bank
14 tax, right?

15 A: They are consistent to a large extent. There
16 are some statements in this regulation that
17 would not be consistent with GAAP such as the
18 statement in this regulation that the bank tax
19 is to allow cash basis reporting that would not
20 be consistent with GAAP.

21 Q: But those interpretations by the Department, in
22 the Department's practice, have been consistent
23 at least since you became aware of the bank
24 tax; is that right?

25 A: Yes. Yes, it has been my understanding that



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1 the Department's position has been that the
2 bank tax is based on entire net income and
3 entire net income means all expenses -- excuse
4 me, it means all income minus all expenses.

5 Q: And you first became aware of the bank tax when
6 you were an assistant attorney general in the
7 early 70s, right?

8 A: That is correct.

9 Q: And I think you agree that the Department has
10 long interpreted the bank tax as a franchise
11 tax; is that correct?

12 A: That is correct.

13 Q: And you interpret it as a franchise tax as
14 well, right?

15 A: I haven't been asked to give that opinion until
16 this moment, but to answer your question, yes,
17 I believe it is a franchise tax.

18 Q: We can flip back to -- but correct me if I'm
19 wrong. I thought the designation of you as an
20 expert said that you had testified that the
21 South Carolina tax is a franchise tax based on
22 entire net income; is that correct?

23 A: That is correct.

24 **MR. LUTHER:** I'm going to ask him about Exhibit 28,
25 which is the one y'all objected to.



1 Amber, would you pull up Exhibit 28, please.

2 **THE COURT:** Opposed exhibit.

3 **MR. LUTHER:** Opposed exhibit. Disputed Exhibit 28.

4 Q: Mr. von Lehe are you familiar with the ---

5 **MS. CUTTINO:** Your Honor, we object to the TRAC
6 report.

7 **THE COURT:** Do you want to explain that objection?

8 **MS. CUTTINO:** Yes, Your Honor, the TRAC report to
9 the extent it's going to be used for any sort
10 of legislative history or legislative intent.
11 It's not appropriate to use a TRAC report or a
12 commission report because it does not give the
13 intent of the legislature.

14 **THE COURT:** All right. You said to the extent it is
15 used for any legislative history or intent?

16 **MS. CUTTINO:** Correct.

17 **THE COURT:** All right. So history ---

18 **MS. CUTTINO:** Legislative intent.

19 **THE COURT:** Intent. Yeah, so let's stick with
20 that. All right.

21 **MR. LUTHER:** Your Honor, Mr. von Lehe was asked
22 about this report in his deposition. He said
23 it was relevant for his opinions. This is no
24 different than an attorney general opinion to
25 the extent we're looking at what is the



1 longstanding interpretation of the bank tax.
2 It's not being admitted to say this is what the
3 legislature intended. It's being admitted and
4 he'll be questioned on how it is evidence of
5 how the statute has been interpreted over time.

6 **THE COURT:** All right. What's your -- I think I can
7 split that hair.

8 **MS. CUTTINO:** Sure, I believe that this report
9 contains hearsay and Mr. von Lehe has direct
10 testimony that he can give providing the
11 history of how the Department has interpreted
12 the bank tax and the Department has the ability
13 to call their own expert to explain how the
14 Department has interpreted the bank tax without
15 relying on a report that is hearsay and is
16 unneeded in the case.

17 **MR. LUTHER:** Your Honor, he's an expert. He can
18 rely on things that are otherwise not
19 admissible such as hearsay.

20 **THE COURT:** He can. That's what I was about to say,
21 but then we have to move to the next question.

22 **MR. LUTHER:** Sure.

23 **THE COURT:** Did he rely upon it?

24 **MR. LUTHER:** He did. In his deposition, he said
25 that it was relevant for his opinions in this



1 case.

2 **THE COURT:** Well, I'll allow you to cross-examine
3 him not concerning legislative intent but the
4 extent to which he relied upon this report and
5 then I will tell you, though, that if he says
6 he did not rely upon the -- and I don't even
7 know anything about this report so the hearsay
8 aspects of this report, those number one would
9 not come under the truth of the matter anywhere
10 under the rules of evidence. They you would
11 only come in concerning impeaching his
12 testimony.

13 And, secondly, if he says that he didn't rely
14 upon them, then we're not going to go down that
15 road.

16 **MR. LUTHER:** Well, understood.

17 **THE COURT:** Any objection to what I just said?

18 **MR. LUTHER:** I just want to -- we can get to it in a
19 second. To the extent he said he didn't rely on
20 it, I think what's relevant is what he said in
21 his deposition when he said he did rely on it.

22 **THE COURT:** Okay.

23 **MR. LUTHER:** Since we had some changes.

24 **THE COURT:** Well, I don't know whether he said it or
25 didn't say it.



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1 MR. LUTHER: Right.

2 THE COURT: When I just said that, I'm not aware of
3 his deposition.

4 Q: Mr. von Lehe, you recall discussing this South
5 Carolina Taxation Realignment Commission Report
6 in your deposition?

7 A: I recall it vaguely. Is it possible to have
8 that read?

9 Q: Sure.

10 MR. LUTHER: Your Honor, may I open the deposition?

11 THE COURT: Yes, sir. I bet you're a mess at
12 Christmas.

13 MR. LUTHER: I am.

14 MR. MAYBANK: To speed it up, I got a copy here.

15 Q: Mr. Von Lehe, I'll just give you this condensed
16 version. Can you see that or do you want the
17 full?

18 A: This will be fine.

19 Q: It's hard for me to see.

20 A: Depending on where it may be.

21 Q: How about this. Here's the big -- the Reader's
22 Digest large print edition, and if you will
23 flip to -- let me borrow this one real fast.
24 I believe it's page 73 but let me confirm that.
25 I'm sorry 63, 61 through 63. On page 61, if



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1 you'll look at line 7. "Let me ask you another
2 question ---

3 **THE COURT:** Are you reading this or asking a
4 question?

5 **MR. LUTHER:** I'm reading it.

6 **A:** I can't -- I don't find it there. It must be
7 different.

8 **Q:** Line 17 on page 61.

9 **Q:** Fair enough you're familiar with the
10 report, correct?"

11 Referring to the TRAC report.

12 **A:** I know what it is, yes, I've read it.

13 **Q:** To the extent it addresses the bank tax at
14 all, in your view, would it be relevant
15 for your opinions, or is it not something
16 that you would normally consider?

17 **A:** Well, it wouldn't be relative to my
18 opinion with regard to financial
19 accounting principles unless it delved
20 into that, which I would be very surprised
21 if it did.

22 **Q:** Would it be relevant to your opinions as
23 to whether the South Carolina bank tax is
24 a tax based on income to the extent it
25 addressed it?



1 A: It would be worthwhile to find out what it
2 said, which I don't know.

3 And then we proceeded to discuss it and you'll
4 see that in the next couple of pages. Do you
5 recall that discussion?

6 A: I do.

7 Q: Okay. And let's pull up page -- what's Bates
8 labeled SC 1338. It's on the screen there in
9 front of you. I want to start with the section
10 that's highlighted. I'll just read it for you.
11 This is the portion that we discussed in your
12 deposition. "Banks are exempt from South
13 Carolina income tax; however, South Carolina
14 Code title 12, Chapter 1, imposes a franchise
15 tax based upon the entire net income of the
16 banks."

17 Next page, "The tax is 4.5 percent of the
18 "entire net income" of the bank doing business
19 in South Carolina or from the sales or rentals
20 of the properties within South Carolina.
21 Although the Chapter is entitled income tax on
22 banks and several of the sections refer to it
23 as an income tax, this tax has always been
24 considered a franchise tax based upon net book
25 income."



1 Do you recall reading that in your deposition?

2 A: I do not.

3 Q: Okay. Let's look at your deposition again then
4 page 63, line 8, do you see that?

5 A: "I want to just read it for the record",
6 beginning?

7 Q: Yes. That was the question. Let me just read
8 it to you. "I want to just read it for the
9 record, 'Although the chapter is entitled
10 Income Tax on Banks and several of its sections
11 refer to it as an income tax, this tax has
12 always been considered a franchise tax based
13 upon net book income,' do you see that?"

14 And your answer was, "Yes, I do see that."

15 A: Okay.

16 Q: And I said, "Does that finding by the TRAC
17 Commission have any bearing on your opinions?"
18 Do you see your answer there?

19 A: I do.

20 Q: What was your answer?

21 A: "There's a couple of things on it. First,
22 that's it's always been considered a franchise
23 tax."

24 Q: Let me stop you for a second. I think you
25 forgot the first line of your answer on line



1 16.

2 A: "Yes, it does. There's a couple of things in
3 it."

4 Q: Okay.

5 A: "First, it's always been considered a franchise
6 tax. That is accurate by the Department of
7 Revenue, but it is a franchise tax based on net
8 book income I find to be a very interesting
9 statement because it appears to say that it's
10 based on instead of using the term in the
11 statute "entire net income", it uses the term
12 "net book income", which is financial income,
13 so I would find that consistent with my view of
14 it."

15 Q: And then the next question, "You can correct me
16 if I'm wrong, I think you said earlier in your
17 deposition that at least as you used the term,
18 entire net income and book income are
19 synonymous?"

20 And your answer was ...

21 A: "That is correct. I did say that."

22 Q: Out of curiosity, do you know who the chair of
23 the TRAC Commission was off of that board?

24 A: I believe I do know who he was. I believe that
25 was Mr. Maybank.



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1 Q: Okay.

2 MR. MAYBANK: I have an icon for cat's meow anywhere
3 on there.

4 Q: Just to wrap it up, Mr. von Lehe. I think you
5 testified earlier that you've also authored
6 several books on the South Carolina tax; is
7 that correct?

8 A: I did.

9 Q: And one of those is the *South Carolina Taxation*
10 *and Economic Tax Incentives* book, right?

11 A: Is that the third edition?

12 Q: This is the third edition from 2013 I believe.

13 A: Yes.

14 Q: Okay. And there is a section in here on the
15 bank tax, correct?

16 A: That's correct.

17 Q: Page 17, I've got it flagged for you. Can you
18 just read for me what the first sentence of
19 your section on the bank tax is?

20 A: "Banks are taxed under section 12-11-10 through
21 12-11-60. Based on book income, the bank tax
22 is a franchise tax measured in the language of
23 the statute by entire net income. The term is
24 not defined. All income is included and all
25 expenses -- expenditures are deducted. Rate of



1 tax is four and a half percent of net income."

2 Q: That's the entirety of the bank section in your
3 book?

4 A: That's what I wrote, yes.

5 Q: But according to your book and the term "book
6 income" is an appropriate proxy for entire net
7 income; is that not right?

8 A: I don't read it that way.

9 Q: But you certainly said that the South Carolina
10 bank tax is based on book income, correct?

11 A: Yes, I made the statement that it is based on
12 book income. I did make that statement.

13 Q: Okay. I'll take that back from you.

14 A: And that is -- if I may, that is what the
15 Department of Revenue has always done. Now,
16 this book for I would say 99 percent of that
17 book is based on what the Department of Revenue
18 has done and what its opinions are. There are
19 very few opinions in that book that are my
20 opinions. I tried to limit those as much as
21 possible because the opinions of the Department
22 of Revenue mean something. My opinions are an
23 entire different thing.

24 Q: And I would agree with you that the
25 Department's opinions mean something. I



1 understand your testimony to be that it has
2 been consistently the Department's position
3 that the bank tax is based on book income,
4 correct?

5 A: The Department has also said many, many times
6 that the bank tax is based on entire net income
7 including in this regulation we just looked at.

8 Q: Because the bank tax and entire -- because the
9 Department has interpreted entire net income
10 and book income to be the same thing, correct?

11 A: It has.

12 MR. LUTHER: Thank you, Mr. von Lehe.

13 THE COURT: Redirect.

14 MR. VON LEHE - REDIRECT EXAMINATION BY MS. CUTTINO:

15 Q: Mr. von Lehe, I just have a few follow-up
16 questions for you. If you would, in that TRAC
17 report that you have been looking at, would you
18 turn to -- it is page 141 of the TRAC report
19 itself. It's Bates number 1342.

20 A: Bates what?

21 Q: 1342 and it actually starts on 1341.

22 A: With the paragraph beginning, "Banks are exempt
23 from South Carolina income taxes."

24 Q: Yes, and I'm just looking at the end where the
25 last sentence flows over into page 1342.



1 A: Yes.

2 Q: In the TRAC report it says, "This tax has
3 always been considered a franchise based upon
4 net book income," and then there's a footnote
5 with a citation, correct?

6 A: Yes.

7 Q: That citation is to the 1948 attorney general's
8 opinion, isn't it?

9 A: It is.

10 Q: Does the 1948 attorney general's opinion use
11 the term "net book income"?

12 A: It does not. It uses the term "entire net
13 income".

14 Q: You weren't aware of the DOR calculating the
15 bank tax using GAAP until this litigation, were
16 you?

17 A: I was generally aware that the bank tax was
18 based on financial accounting more so than on
19 tax. I was generally aware of that.

20 Q: But the Department had never told any taxpayer,
21 bank taxpayer, that that equated to GAAP, did
22 they?

23 A: It had not. It had told taxpayers it equated
24 to book.

25 Q: Doesn't all expenses include an NOL



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1 carryforward because if it didn't, you wouldn't
2 be allowed to deduct all of the expenses, would
3 you?

4 A: A net operating carryforward is an expense.

5 **MS. CUTTINO:** Thank you that's all I have.

6 **MR. VON LEHE - RECROSS-EXAMINATION BY MR. LUTHER:**

7 Q: Would you turn to Exhibit 26. This is Synovus'
8 Exhibit 26. You're familiar with the process by
9 which the Department publishes written
10 guidance?

11 A: I am.

12 Q: And that comes out first in the form of a draft
13 opinion, correct?

14 A: Correct.

15 Q: Or ruling?

16 A: Correct.

17 Q: Some of which are ultimately finalized, some of
18 which are not, correct?

19 A: Correct.

20 Q: I'm going to show you Exhibit 28. This is a
21 public draft of South Carolina Revenue ruling
22 16-X.

23 **MR. LUTHER:** And if you flip to, Ms. Hogan, page --
24 what's Bates labeled 1363.

25 Q: You see there at the top of the page the first



1 full paragraph beginning with the South
2 Carolina bank tax, do you see that?

3 A: Yes.

4 Q: Could you read that sentence for me?

5 A: "The South Carolina bank tax is generally
6 computed using financial reporting income based
7 on generally accepted accounting principles,
8 GAAP."

9 Q: So I understand that this is a public draft but
10 your statement earlier is that the Department
11 has never said anything about GAAP applying to
12 the bank tax is not entirely correct, right?

13 A: That's correct assuming that I had read this,
14 but I had never concentrated on that statement.
15 That is correct. It is what it is.

16 Q: Was the statement you were focusing on
17 paragraph 13 where it says is a net operating
18 loss deduction allowed in calculating the bank
19 tax and the answer is no?

20 A: I was particularly interested in that.

21 MR. LUTHER: Thank you, Mr. von Lehe. No further
22 questions.

23 MS. CUTTINO: Just A quick redirect, Your Honor.

24 THE COURT: Okay.

25 MR. VON LEHE - REDIRECT EXAMINATION BY MS. CUTTINO:



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1 Q: Was this public draft ever finalized by the
2 Department?

3 A: Not to my knowledge, and I think if it had
4 been, it would be in the book rather than the
5 public draft.

6 Q: And it says the date of this public draft, the
7 comments review in 2016, correct?

8 A: It does.

9 Q: And that was after Synovus filed the returns in
10 this case, correct?

11 A: To the best of my knowledge, yes.

12 **MS. CUTTINO:** That's all. Thank you.

13 **MR. LUTHER:** Nothing further.

14 **THE COURT:** All right. Mr. von Lehe, in your
15 testimony you said that entire net income and
16 book income are synonymous, now you testify
17 that they're not. Can you explain to me what
18 occurred in your thinking from the deposition
19 until today that brought you to that
20 conclusion?

21 A: Yes, Your Honor, counsel pointed out to me that
22 I had agreed in my deposition that they were
23 synonymous. I had never really thought about
24 there being a difference between entire net
25 income and net income or financial income, but



1 I thought about it, and it is not -- it's not
2 possible because GAAP does not use the term
3 "entire net income", so entire net income by --
4 by its wording cannot be GAAP. There's no such
5 term "entire net income" in GAAP so they cannot
6 be equated.

7 **THE COURT:** All right. Anyone follow up on what
8 I've asked?

9 You may step down.

10 A: Thank you.

11 **MS. CUTTINO:** Your Honor, do you want to load those
12 logs in for the next ---

13 **THE COURT:** Let's just take a short break.

14 (A break was taken from 11:21 a.m. - 11:33 a.m.)

15 **MS. CUTTINO:** Your Honor, we did have a clean copy
16 of those stipulated facts for the record.

17 **THE COURT:** Okay. I've got the exhibits loaded if I
18 can pull them up but I can also tell you, y'all
19 can put it on the computer.

20 **MR. LUTHER:** That's what we'll do.

21 **THE COURT:** It looks to me like you're ready to call
22 your next witness.

23 **MS. CUTTINO:** Yes, Your Honor, I call Doug Branch.

24 **DOUG BRANCH, CPA,** having been duly sworn, testifies
25 as follows:



1 MR. BRANCH - DIRECT EXAMINATION BY MS. CUTTINO:

2 Q: Mr. Branch, according to the designation of
3 expert, you've been designated to provide
4 testimony regarding GAAP accounting and the
5 application of ASC 740 to deferred tax assets
6 including a net operating loss, correct?

7 A: That is correct.

8 Q: And again for purposes of the record, we have
9 stipulated that all of the experts in this case
10 are, in fact, qualified. Briefly, can you tell
11 me, where did you go to school?

12 A: College, I went to -- my bachelor's degree was
13 at the University of Texas at Austin and I also
14 obtained a Master's Degree in Accounting from
15 the University of Texas at Austin.

16 Q: And do you have any accounting certifications?

17 A: I do. I'm a Certified Public Accountant.

18 Q: All right. And did you receive any special
19 distinctions after your CPA exam?

20 A: I did I received special distinction from the
21 Texas Board of Public Accountancy for scoring
22 among the top ten scores on the CPA exam.

23 Q: And where do you work?

24 A: I am currently a partner in
25 PricewaterhouseCoopers, what is commonly



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1 referred to as PwC, and PwC is known as one of
2 the four largest accounting firms in the world.

3 Q: And what is your position with PwC?

4 A: I'm a partner within the forensic services
5 group and I lead in the US the dispute services
6 practice.

7 Q: And in that position, do you work with GAAP?

8 A: I do.

9 Q: Have you testified as an expert before?

10 A: Yes, ma'am, I have.

11 Q: Approximately how many times?

12 A: Approximately 30 to 35 times.

13 Q: And of those times, approximately how many have
14 involved GAAP?

15 A: In some form or fashion maybe ten or so.

16 Q: And within PwC, do you have other opportunities
17 to work with GAAP accounting?

18 A: I do. For a period of time, I was in our audit
19 practice, and within our audit practice, I
20 would have been analyzing and applying GAAP.
21 Currently, in my role now, I'm frequently
22 brought in when our firm has -- I call them
23 sensitive situations and I am brought in to
24 consult with practitioners within our firm as
25 a GAAP subject matter expert.



1 Q: So almost as an internal subject matter expert?

2 A: That's correct.

3 Q: And of those times, have any of them involved
4 ASC 740?

5 A: They have.

6 Q: And can you tell me what is GAAP?

7 A: GAAP is generally accepted accounting
8 principles.

9 Q: And are there other methods of accounting other
10 than GAAP?

11 A: There are, they're -- I'll just name a few but
12 there's several. There could be cash basis of
13 accounting. There could be what is known as
14 international financial reporting standards or
15 IFRS. There could be what's known as other
16 comprehensive basis of accounting. There could
17 be governmental accounting such as yellow book
18 accounting.

19 Q: When was GAAP first created?

20 A: It probably goes back to the time during or
21 shortly after the Great Depression and there
22 was a committee that was established to really
23 try to get some alignment on consistency and
24 reliability in financial reporting. So there
25 were certain publications that were issued at



1 that time.

2 And then beginning in 1973, the FASB, the
3 Financial Accounting Standards Board, I refer
4 to it as the FASB, was created, and it was
5 created as an independent non-profit
6 organization to publish and issue accounting
7 standards under GAAP. And then in 2009 those
8 accounting standards were codified in what is
9 known as the Accounting Standards Codification
10 and that's where we get the terminology of ASC.

11 Q: Now, if you are an accountant, can you tell me
12 how do you go find what you're looking for in
13 GAAP? How is it organized?

14 A: It's organized now through the Accounting
15 Standards Codification, so within the
16 codification, all the GAAP standards are in one
17 central place versus multiple places, and then
18 you could go within that, within the ASC is an
19 index. So you go through the index to find
20 specific GAAP guidance on a particular topic.

21 Q: And prior to the codification in 2009, how was
22 GAAP organized?

23 A: It was -- there were different -- I'll call
24 them pronouncements or guidelines that would
25 come from different sources. So, for example,



1 you may have the FASB statements. There could
2 have been what are known as accounting research
3 bulletins. You could have had AICPA, or The
4 American Institute of Certified Public
5 Accountants Statements, and there was a
6 hierarchy within those different levels of
7 accounting guidance. So it was very hard to
8 find and pull together and the Accounting
9 Standards Codification pulled all that
10 information together, so it was a good thing
11 for the profession.

12 Q: Does GAAP set out hard and fast rules, or are
13 they principles?

14 A: GAAP or its principles?

15 Q: Does GAAP allow for interpretation?

16 A: There is some interpretation and judgement that
17 is involved in GAAP.

18 Q: Can you give me an example of what kind of
19 interpretation is allowed under GAAP?

20 A: Maybe an example specific to ASC 740, and this
21 doesn't really -- it doesn't apply to this
22 case, but just to give you some flavor of it.
23 There is some guidance around investment tax
24 credits and there is some interpretation or
25 judgment on when those investment tax credits



1 can be recognized. Whether they can be
2 recognized in the first year of a project or
3 over time. So it's just an example of some
4 judgement and interpretation that may be
5 applied.

6 Q: Are there other areas of GAAP that allow
7 interpretation and flexibility other than the
8 investment tax credits?

9 A: There are and as another example, depreciation
10 methods. There's different depreciation
11 methods that require judgment.

12 Q: How often does GAAP change or update?

13 A: Frequently.

14 Q: And I'd like for you to look at Exhibit number
15 38, which is ASC 740 in its entirety. Can you
16 tell me how often the ASC 740 has been updated?

17 A: At the begin- -- at the front of ASC 740,
18 there's a table that lays out the dates and the
19 changes to ASC 740. And just for ASC 740 and
20 since 2010, ASC 740 has been updated over 50
21 times.

22 Q: Do accounting firms in the world like yours
23 issue interpretations when GAAP changes?

24 A: They do.

25 Q: Why do they do that?



1 A: To help provide guidance on that interpretation
2 for practitioners and for companies.

3 Q: If a taxing authority wanted to use GAAP as a
4 way to define the tax basis, would you expect
5 that taxing authority to also issue
6 interpretations so the taxpayer would know what
7 to do?

8 A: I think that would be reasonable.

9 Q: Do publicly traded companies in the US use
10 GAAP?

11 A: They are required to use GAAP.

12 Q: Did Synovus use GAAP?

13 A: Yes, they did.

14 Q: How do you know that Synovus used GAAP?

15 A: For one, I reviewed the Synovus publicly
16 available filed financial statements that were
17 audited and approved by KPMG, which is another
18 one of the big four accounting firms, and
19 within those financial statements, it
20 explicitly states that the financial statements
21 have been prepared in accordance with GAAP.

22 Q: And can you turn with me to Exhibit 44?

23 A: Okay.

24 Q: Is that the 2014 financial annual report that
25 you were just discussing?



1 A: Yes, it is.

2 Q: Can GAAP be cash based accounting?

3 A: No, it cannot.

4 Q: Is GAAP only accrual based accounting?

5 A: That's correct.

6 Q: Is there a way for a bank to use cash based
7 accounting as its method for reporting and be
8 in compliance with GAAP?

9 A: No, it cannot.

10 Q: What is the difference between cash ---

11 **THE COURT:** Wait a second. Is there a method by
12 which a bank can use ---

13 **MS. CUTTINO:** Cash-based accounting.

14 **THE COURT:** --- cash based accounting and be in ---

15 **MS. CUTTINO:** Accordance with GAAP.

16 **THE COURT:** --- accordance with GAAP. And the
17 answer was no?

18 **MS. CUTTINO:** And the answer was no.

19 Q: What is the difference between cash based and
20 accrual based accounting?

21 A: A cash base -- a cash basis will give
22 recognition to transactions when cash changes
23 hand and just to maybe give you an example.
24 Let's take revenue for example. If I sell a
25 product under the cash basis of accounting, I



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1 would recognize revenue when I received the
2 cash. Under the accrual basis of accounting,
3 I would recognize and record revenue at the
4 point of sell regardless of when the cash is
5 collected. So it impacts the timing of
6 recognition in your financial statements.

7 Q: When you look at Synovus' financial statements,
8 did they indicate to you what the source of
9 their losses were?

10 A: Do you mean the net losses?

11 Q: Yes.

12 A: From my understanding from reading the annual
13 report it was from significant losses from
14 mortgage loans that they had held or acquired
15 during the financial crisis.

16 Q: And is that a type of expense that results in
17 a net operating loss?

18 A: It can if those expenses exceed your revenues.

19 Q: What is a net operating loss?

20 A: A net operating loss is a situation where your
21 expenses have exceeded your revenues for a
22 certain period of time.

23 Q: What is a net operating loss carryforward?

24 A: A net operating loss carryforward recognizes
25 that there is a tax benefit by carrying forward



1 those excess expenses into future years. And
2 by carrying those excess expenses into future
3 years, it will offset future taxable income;
4 therefore, it gives you a future tax benefit by
5 reducing your taxes.

6 Q: Does GAAP use the term "book income"?

7 A: It does not.

8 Q: Does the term "book income" mean GAAP?

9 A: Not necessarily. Just maybe to step back.
10 Book income really -- it takes its foundation
11 from in the time before you had, really,
12 software systems that would capture your
13 accounting data. So you would literally have
14 books, ledger books, and so you would keep your
15 accounting within those ledger books. So
16 that's where the term books comes from. Now,
17 of course, we have software systems, but your
18 books could be determined based on a number of
19 different methodologies. One of those
20 methodologies to keep your books could be the
21 cash basis. Another methodology to keep your
22 books could be international financial
23 reporting standards. Another methodology, for
24 example, would be under yellow book
25 governmental standards. Another way that you



1 could keep your books could be under GAAP. So
2 there's multiple different ways or
3 methodologies in which you could keep your
4 books. So when you refer to book income, it
5 depends on the methodology that you're using to
6 calculate that book income.

7 Q: Does the term net income mean GAAP?

8 A: It could. Net income is reflected in GAAP, but
9 net income could be calculated under multiple
10 different methodologies. You could calculate
11 net income under GAAP. You can calculate net
12 income under cash basis of accounting. You can
13 calculate net income under international
14 financial reporting standards, so it depends on
15 the basis or the methodology that you're using
16 to get to net income.

17 Q: Does GAAP use the term "entire net income"?

18 A: It does not.

19 Q: When you hear the term "entire" in association
20 with GAAP, what financial statements would you
21 look at?

22 A: Sorry could you repeat that?

23 Q: Sure. When you hear the term "entire" in
24 association with GAAP, would that mean you look
25 at multiple financial statements contained



1 within GAAP?

2 A: Yeah, I'll first say that entire net income, as
3 an accountant without more context or
4 definition, it doesn't mean much to an
5 accountant, but when you put GAAP onto it, and
6 you clarify GAAP, and then when you say "entire
7 net income" to me that would mean that you need
8 to take into account all of the financial
9 statements that GAAP requires. And GAAP
10 requires an income statement, a balance sheet,
11 a statement of cash flows, and a statement of
12 changes in owner's equity. So you have to
13 consider and look at the interplay between all
14 of those financial statements in accordance --
15 to be in accordance with GAAP. In other words,
16 you can't just look at one of those financial
17 statements in isolation.

18 Q: So you can't just look at the income statement
19 in isolation?

20 A: That's correct. Under GAAP, you'd have to look
21 at and consider all of the financial statements
22 taken together and taken as a whole.

23 **THE COURT:** All right. So I can stop you here. So
24 you said entire net income doesn't mean much to
25 an accountant, but it is only when you add GAAP



1 to that phraseology that it produces certain
2 meanings to an accountant and then you went
3 onto explain those meanings?

4 A: That's correct.

5 **THE COURT:** All right.

6 Q: What is ASC 740?

7 A: ASC 740, it's the Accounting Standards
8 Codification 740 and it is the accounting
9 guidance that captures the accounting for taxes
10 and specifically taxes that are based upon
11 income.

12 Q: So just to be clear, ASC 740 is a part of GAAP?

13 A: It is, a required part of GAAP.

14 Q: Is ASC 740 applicable to South Carolina banks?

15 A: It is because my understanding is that the
16 South Carolina bank tax is a tax based on
17 income.

18 Q: And under ASC 740, does it matter if the tax is
19 called a franchise tax?

20 A: It doesn't. The key is whether or not that tax
21 is based on income. So it could be called a
22 franchise tax, but if the tax is based on
23 income, it would fall under the scope and the
24 requirements of ASC 740.

25 Q: When the Department says that entire net income



1 is defined to mean in accordance with GAAP, do
2 we pull in ASC 740?

3 A: You do.

4 Q: What is the impact of ASC 740 on financial
5 accounting?

6 A: Yeah, when you add GAAP to entire net income,
7 I think it makes this question and answer very
8 linear.

9 **THE COURT:** It makes it very ...

10 A: Very linear.

11 **THE COURT:** Okay.

12 A: So your first step is that you need to go to
13 ASC 740. So you would look at ASC 740 and ASC
14 740 requires an entity to recognize the
15 benefits of a tax asset. So it requires the
16 recognition of a deferred tax asset regardless
17 of the source. So then you would look to what
18 are sources of income tax benefits and then you
19 would see that under the IRC, the Internal
20 Revenue Code, the IRC allows a deduction for
21 net operating loss carryforwards. So under
22 GAAP, it is required to record the impact of
23 those net operating losses under the ITC.

24 Q: The ITC?

25 A: I'm sorry, the IRC. So what is happening here



1 is that when the Department adds GAAP to its
2 definition of entire net income, it is
3 inextricably linking the IRC to the South
4 Carolina bank tax. Said another way, you
5 cannot have financial statements that are in
6 accordance with GAAP without recognizing those
7 net operating losses.

8 **THE COURT:** Why is it linking the IRC to --
9 inextricably linking the IRC to -- finish that.

10 A: To the South Carolina bank tax.

11 **THE COURT:** And it's doing that for what reason?

12 A: Because according to the Department, entire net
13 income is based on GAAP, and to have your
14 financial statements to be in accordance with
15 GAAP, the entity must record the NOL benefits.
16 So now you've got GAAP financial statements
17 that must record ---

18 **THE COURT:** If you must record the NOL -- you said
19 benefits. I would think of it as loss, net
20 operating loss benefit. So why -- how do you
21 -- where do take the jump to the IRC there?

22 A: Because under GAAP, under ASC 740, you have to
23 look everywhere that you may have tax impacts.
24 So under the IRC, you have tax impacts. Under
25 the IRC, you have certain deductions, credits,



1 one of which is the NOL carryforward. So since
2 you have the NOL carryforward under the IRC,
3 you're now required under GAAP, under ASC 740,
4 to reflect that impact into your financial
5 statements. So now I have financial statements
6 that have been impacted by the IRC, mainly the
7 NOL carryforward.

8 **THE COURT:** So the NOL carryforward only exists
9 under the IRC; is that what you're telling me?

10 **A:** No, that's not exactly what I'm saying. I'm
11 saying that under the South Carolina bank tax,
12 there's obviously a dispute as to whether the
13 NOL carryforward would apply. So the
14 Department has said you have to look at it
15 under GAAP and you have to create your
16 financial statements under GAAP. So to create
17 those financial statements under GAAP, you now
18 have to link in the benefits from the IRC. So
19 you can't have GAAP compliant financial
20 statements without having these NOLs from the
21 IRC linked into your financial statements. You
22 would have to have another mechanism. In other
23 words, some sort of an explicit requirement
24 that says entire net income based on GAAP
25 except for the deduction for an NOL



1 carryforward, but if it doesn't have that sort
2 of exclusion, and you're just basing it on
3 GAAP, now you've linked in the IRC
4 requirements.

5 **THE COURT:** Okay.

6 Q: And I just want to back up for a second, Mr.
7 Branch. What is a deferred tax asset?

8 A: I'll start with defining an asset. An asset is
9 a future economic benefit to an entity and an
10 asset is recorded on an entity's balance sheet.
11 So a deferred tax asset recognizes that there
12 is some future economic benefit from a tax
13 deduction or a tax credit. In other words,
14 there are future tax deductions that can be
15 taken to reduce taxable income. The tax
16 liability will be smaller in the future.

17 Q: How does an NOL generate a DTA?

18 **THE COURT:** Why don't you start with what a DTA is?

19 Q: What is a DTA, a deferred tax asset?

20 A: A DTA is a deferred tax asset, correct.

21 Q: And how is a deferred tax asset created? What
22 happens to your expenses and your revenues?

23 A: In the year in which you have the net operating
24 loss, you would have -- in that year, you would
25 create this deferred tax asset because you are



1 going to have in the future the ability to take
2 those excess expenses and offset income
3 reducing your tax income. So in that first
4 year, you are going to record a deferred tax
5 asset. You're also going to record an entry to
6 your income statement. And then in the years
7 following, as you use the deferred tax asset,
8 you would remove the deferred tax asset and
9 reduce your tax liability or your taxes
10 payable.

11 Q: Is an NOL carryforward a deferred tax asset?

12 A: It is.

13 **THE COURT:** DTA would occur only when there is a --
14 when the losses exceed the revenue, wouldn't
15 it?

16 A: That's correct. So you record your DTA.

17 **THE COURT:** You just said this occurs -- it is
18 created when it occurs -- it's created when you
19 cannot utilize it one year, and, therefore,
20 allow the carryforward.

21 A: That's correct. In the year that your expenses
22 exceed your revenues, and you've created your
23 net operating loss ---

24 **THE COURT:** That's when it's created?

25 A: That's when it's created because you can then



1 use that net operating loss ---

2 **THE COURT:** Yeah.

3 A: --- those extra expenses that you weren't able
4 to utilize.

5 **THE COURT:** I was just trying to be exact on the
6 language. We're good.

7 A: Thank you. Appreciate that.

8 Q: And, Mr. Branch, I would like to give you a
9 hypothetical example.

10 **MS. CUTTINO:** Our screen is off, Your Honor.

11 **THE COURT:** That can be remedied.

12 **MR. LUTHER:** Do you have a copy that I can look at?

13 **THE COURT:** On the screen.

14 **MR. LUTHER:** My eyes are getting worse.

15 **MR. MAYBANK:** I've got one here.

16 Q: And, Mr. Branch, I created this assumption with
17 round numbers to try to make the math easy for
18 us all. I want you to assume you have a South
19 Carolina bank and that the tax rate on that
20 bank is 30 percent. The bank has \$2 million in
21 revenues, and \$3 million in expenses in year
22 one. Assume the company becomes profitable in
23 year two. Can you explain to us how you would
24 record this loss under GAAP?

25 A: Yes, and I'm halfway through the page after the



1 assumptions are laid out there. So in year one
2 -- and I'm going to talk about debits and
3 credits, so this is when you go into really the
4 nuts and bolts of accounting and you record
5 these entries in what's known as your general
6 ledger. These entries will then flow up to
7 your balance sheet and your income statement or
8 your statement of cash flows.

9 So in year one, you would recognize the
10 deferred tax asset. So you would take your
11 million dollar loss and you would multiply it
12 by the tax rate to get to the tax impact of
13 that loss, so that's \$300,000. So what you
14 would do is you would have a debit and that's
15 the first line there in red. You would have a
16 debit to the deferred tax asset for \$300,000.
17 The impact of that is an increase of an asset
18 on your balance sheet.

19 So maybe just real quick to explain what a
20 balance sheet is. A balance sheet is
21 essentially the statement of position for the
22 company. So you have listed your assets minus
23 your liabilities equals your equity. So with
24 this entry, you've now increased an asset, a
25 future economic benefit to the company on the



1 balance sheet in the form of an NOL
2 carryforward deduction. The credit, and this
3 is double bookkeeping accounting, you must have
4 a debit and credit. So the credit would go to
5 tax expense for \$300,000. What this will do is
6 really it will reduce your tax expense which
7 increases your income statement. So that's
8 year one and it's really important here to note
9 that you have this interplay between the
10 income statement and the balance sheet. You
11 have to take them together because it's a whole
12 set of financial statements under GAAP.
13 So in year two, now you're going to use the
14 deferred tax asset because the bank is now
15 profitable. The debit would go to taxes
16 payable for \$300,000. What this does is
17 because now you're using this tax asset, you've
18 now reduced your tax payable on your balance
19 sheet. In other words, you're going to pay
20 less cash to the taxing authority. So that's
21 a debit to taxes payable of \$300,000. You
22 would also have to have a credit and that
23 credit would go to deferred tax asset for
24 \$300,000 and you're going to have that because
25 you've now used your assets. You used it to



1 reduce your tax payable, so now you would no
2 longer have that asset, so you would need to
3 reduce it on your balance sheet.

4 So one of the things that's very important to
5 note here is this -- as I've said, it's this
6 connection between the balance sheet and the
7 income statement. You have to have both to be
8 in accordance with GAAP and it's on the balance
9 sheet that it's capturing this tax asset that
10 can be used in the future to reduce taxes
11 payable.

12 Q: Now, just to clarify a little bit about what
13 you said. You defined balance sheet for us.
14 What is the income statement?

15 A: An income statement is a statement the
16 statement that will list revenues less your
17 expenses, which will equal your net income.

18 Q: What is double entry accounting?

19 A: Double entry accounting means that you will
20 have an impact to two different sets of
21 financial statements, or to different accounts
22 within the same financial statement, and when
23 I say financial statement, I mean balance
24 sheet, income statement, or statement of cash
25 flows. So when you have double entry, you must



1 have a debit and a credit related to every
2 transaction so you're impacting -- as you can
3 see in year one, it's impacting both the
4 balance sheet and the income statement.

5 Q: If you're looking at your losses under GAAP,
6 can you look at only the income statement?

7 A: No, that would not be a complete view. Under
8 GAAP, you're required to analyze and include
9 the consideration of the balance sheet, the
10 income statement, the statement of cash flows
11 and what's known as a statement of changes in
12 owner's equity.

13 Q: So if you don't look at all four of those
14 statements, you're not actually acting in
15 accordance with GAAP, are you?

16 A: That's correct.

17 Q: Now. I know you've reviewed a lot of documents
18 in this case, and the DOR has spent a lot of
19 time trying to separate the Internal Revenue
20 Code from the state bank tax. Are you saying
21 that if we act in accordance with GAAP, you
22 must look to the IRC?

23 A: Yes, because the IRC will -- provides that you
24 have the NOL and you would be required to
25 record that NOL under the IRC in the GAAP based



1 financial statements.

2 Q: So to be in accordance with GAAP, you would
3 have to recognize the tax benefits from the
4 Internal Revenue Code including NOL
5 carryforwards?

6 A: That's correct.

7 Q: Is this a consistent principle with allowing a
8 bank to deduct all expenses?

9 A: That would seem consistent because the whole
10 notion of the NOL carryforward is that in a
11 certain year, your expenses will exceed your
12 revenues. So if you do not allow an NOL
13 carryforward, those excess expenses will just
14 go away.

15 Q: And then you would not be deducting all of
16 them, right?

17 A: That's correct.

18 **THE COURT:** Can I rephrase that and see if I capture
19 what you are saying. Is it if you're not
20 comporting the NOL, then you're actually only
21 recording entire income and not entire net
22 income, would that be correct?

23 A: Just want to be careful with the words the
24 entire because to me I'm thinking net income.

25 **THE COURT:** So I parsed it.



1 A: Okay.

2 **THE COURT:** If you don't do the NOL, you are
3 recording entire income rather than entire net
4 income and that's what I'm asking is that
5 something that proper reasoning emanating from
6 your testimony?

7 A: I'm not sure I'm quite following the question,
8 so can I -- I can restate my answer in a
9 different way and maybe that will help.

10 **THE COURT:** No, go ahead. I'm just trying to figure
11 out how entire net income operates in this
12 little area.

13 A: So I guess what I'm saying is is in year one if
14 you have let's say revenues of a hundred and
15 then you have expenses of 150, now you have a
16 net operating loss of the 50. So what I'm
17 saying is those expenses were 150. If you are
18 not allowed to carryforward that loss of 50 and
19 apply it to future years, those expenses in
20 future years, that loss then goes away. You're
21 not capturing all of those losses. So under an
22 NOL, an NOL carryforward is giving an entity to
23 essentially deduct all of those expenses.

24 **THE COURT:** Go ahead.

25 Q: Mr. Branch, I just want to ask you a few follow



1 up questions on that. Isn't it true that the
2 term "entire" plus the words "net income" do
3 not appear in GAAP, correct?

4 A: That's correct.

5 Q: Net income has a meaning in financial
6 accounting?

7 A: That's correct.

8 Q: And it has a meaning under GAAP or other
9 methods of accounting, correct?

10 A: That's correct.

11 Q: But entire when used in a statute you assume
12 has a meaning, correct?

13 **MR. LUTHER:** You're Honor, I'm going to object to
14 the extent her question is trying to solicit
15 what the statute means. That would be an
16 interpretation of law that, obviously this
17 Court is ...

18 **MS. CUTTINO:** I will rephrase it.

19 **THE COURT:** Maybe you should have objected to my
20 question then.

21 **MS. CUTTINO:** That doesn't seem wise.

22 **MR. LUTHER:** That would be a first.

23 **MS. CUTTINO:** I'll let Mr. Luther do that.

24 **THE COURT:** Go ahead.

25 Q: When you see the word "entire" with net income,



1 how do you apply that to GAAP? Is it limited
2 to only the income statement?

3 A: I would first say if you say the words entire
4 net income without the words GAAP, that doesn't
5 have a meaning to me. It's when you apply GAAP
6 and you say entire net income under GAAP what
7 that means to me is that it's net income
8 calculated under GAAP and it means you must
9 look at the entirety of the financial picture,
10 which means the balance sheet the income
11 statement, the statement of cash flows, and the
12 statement of changes in owner's equity.

13 Q: Because if you did not do that, you would not
14 be acting in accordance with GAAP?

15 A: That is correct.

16 MS. CUTTINO: That's all.

17 MR. BRANCH - CROSS-EXAMINATION BY MR. LUTHER:

18 Q: Good morning, Mr. Branch.

19 A: Good morning.

20 Q: I want to cover just some background stuff
21 first and then we'll talk about opinions, but
22 you lead the dispute services solutions
23 practice at PwC, correct?

24 A: In the US, correct.

25 Q: And that's a group that provides litigation,



1 consulting and expert witness services, right?

2 A: That's correct.

3 Q: And litigation consulting is about 50 percent
4 of your practice year to year, right?

5 A: It varies. It depends on the particular year,
6 but it could be 50 percent of my practice.

7 Q: It's been as high as 75 percent some years,
8 right?

9 A: Ball park rough estimate it might be.

10 Q: And you're being paid \$795 an hour to provide
11 expert testimony in this case, correct?

12 A: I'm not being paid that.

13 Q: Your firm is being paid that, is that correct?

14 A: My firm.

15 Q: And I assume you get some portion of that; is
16 that fair?

17 A: I do not.

18 Q: So you're just here testifying for free?

19 A: I make a salary and an owner's draw from the
20 firm. So my salary is not linked to my
21 testimony in this case whatsoever.

22 Q: Okay. At the time of your deposition in this
23 case, you had prepared a report; is that
24 correct?

25 A: That's correct.



1 Q: And at the time of your deposition, your firm
2 had already billed Synovus approximately
3 \$30,000; is that correct?

4 A: I don't recall specifically but that sounds
5 reasonable. It sounds in the ballpark.

6 Q: You've never taught any courses specifically on
7 ASC 740, have you?

8 A: Specifically on ASC 740, no, but I've given
9 other speeches on other topics that really
10 would include the concepts under ASC 740.

11 Q: Okay. You've never written or published any
12 materials specifically about ASC 740, correct?

13 A: Not specifically to ASC 740.

14 Q: Okay. And you've never written or published
15 any material that specifically addressed the
16 application of ASC 740 to a bank tax, right?

17 A: That's correct.

18 Q: Okay. You've never published any articles
19 specifically on net operating losses, correct?

20 A: Specific to a net operating loss, no, but,
21 again, I published articles around business
22 evaluation concepts, GAAP concepts, and within
23 those, it could include the concepts of net
24 operating losses.

25 Q: You're not an expert on the history of the



1 South Carolina bank tax; is that fair?

2 A: That's fair.

3 Q: Never prepared a South Carolina bank tax
4 return, correct?

5 A: That's correct.

6 Q: And you've never tested the financial
7 statements of any banks that operate in South
8 Carolina, correct?

9 A: I don't know that that is correct. I've worked
10 on as a subject matter expert for audits of
11 banks that our firm conducts. Those banks are
12 national banks and they could have operations
13 and branches and I believe they do, actually,
14 in South Carolina.

15 Q: Okay. I'm going to get into your opinions. I
16 want to make sure I understand what your
17 opinions are and at least in my view there
18 appear to be two and we can talk about these,
19 but your first is that ASC 740 applies to the
20 South Carolina bank tax; is that fair?

21 A: It's fair, yes.

22 Q: Okay. And there's -- as I understand it, you
23 have two components of this opinion. First, is
24 you say ASC 740 applies to franchise taxes
25 bases on income, correct?



1 A: That's correct.

2 Q: And ASC 740 -- and your opinion is because ASC
3 740 specifically says that its scope includes
4 franchise taxes based on income, correct?

5 A: That's correct.

6 Q: And the second aspect of your opinion is that
7 Mr. von Lehe has opined that the South Carolina
8 bank tax is a tax based on income, correct?

9 A: Well, I think I'm utilizing Mr. von Lehe's
10 opinion that the South Carolina bank tax is
11 based on income. Then I'm taking that opinion
12 and applying it to ASC 740 in taxes that are
13 based on income fall within the scope of ASC
14 740.

15 Q: So maybe to summarize it this way. ASC 740
16 says on its face that it applies to a tax based
17 on income. Mr. von Lehe in his report says
18 South Carolina's bank tax is a tax based on
19 income, ergo, ASC 740 applies to the South
20 Carolina bank tax; is that fair?

21 A: That's fair.

22 Q: And those are both self-evident from those
23 documents, both ASC 740 and his report,
24 correct?

25 A: I don't know what you mean by self-evident, but



1 I think that you could read those documents and
2 as a GAAP accountant, come to those
3 conclusions.

4 Q: All right. Your second opinion, as I
5 understand it, is that under ASC 740, net
6 operating losses are recorded as a tax asset
7 because they provide an expected reduction of
8 future taxes payable; is that fair?

9 A: That's fair.

10 **THE COURT:** Can you read that again for me?

11 **MR. LUTHER:** Sure.

12 **THE COURT:** NOL ...

13 Q: Net operating losses under ASC 740.

14 A: NOLs are recorded as a tax asset because they
15 provide an expected reduction of future taxes
16 payable.

17 **THE COURT:** Okay.

18 Q: I want to make sure I understand, just to
19 clarify some terms. You said a net operating
20 loss is a situation in which expenses exceed
21 revenues, correct?

22 A: Generally, yes.

23 Q: For federal tax purposes a net operating loss
24 carryforward deduction is where your deductions
25 exceed your taxable income in a year, correct?



1 A: I think it's really the same thing because you
2 have expenses. Under your federal tax return,
3 your expenses are -- your business expenses are
4 deductions. So if you have a situation in
5 which your expenses, those deductions, are
6 higher than your revenues, it triggers a net
7 operating loss. And then if you have -- if you
8 don't have enough taxable income to absorb
9 those expenses, or those net operating losses,
10 you would carry that forward to reduce your
11 future taxes payable.

12 Q: Does ASC 740 use the term "deduction"?

13 A: I don't recall specifically. It's a hundred
14 plus pages.

15 Q: But it typically uses the term "expenses",
16 right?

17 A: ASC 740. I think it does use the term
18 deductions and credits.

19 Q: Okay. Let's back up and maybe lay some
20 foundation here. GAAP you said is propagated
21 by the FASB, correct?

22 A: That's correct.

23 Q: And it's the authoritative source for generally
24 accepted accounting principles, correct?

25 A: That's correct.



1 Q: And all the banks that you have represented,
2 GAAP is the accounting standard that they
3 follow, right?

4 A: What do you mean by represented?

5 Q: That either in some of the dispute services
6 that you provided or in the services that you
7 provided in your capacity as a partner at PwC.
8 The banks that you have worked with, how about
9 that, have used GAAP as their source of
10 accounting principles; is that fair?

11 A: My involvement would have been the -- they have
12 used GAAP at least with my involvement.
13 Whether or not they use other sources to
14 calculate their financial statements. For
15 example, some of the international banks could
16 be using what is known as international
17 financial reporting standards, or IFRS, so they
18 could be using other methodologies. My work
19 with those banks has been under the context of
20 GAAP.

21 Q: Right. Okay. So you listed earlier several
22 different accounting methodologies that you say
23 could be used, but in your experience, it's
24 always GAAP, right?

25 A: Well, in my experience working with those banks



1 because, keep in mind, I'm a GAAP accountant
2 and a GAAP expert.

3 **THE COURT:** I was going to say, Mr. Luther, if he is
4 a GAAP expert would not they only call in a
5 GAAP expert when they utilize GAAP?

6 **MR. LUTHER:** And that may be the case, I agree.

7 **Q:** but I just want to qualify in your deposition
8 we talked about different methodologies and
9 your testimony was in my experience everybody
10 uses GAAP, and in fact I think you said earlier
11 in your testimony that's mandatory for publicly
12 traded companies, correct?

13 **A:** GAAP is mandatory for publicly traded
14 companies, but it doesn't mean that they may
15 not also be calculating the financial
16 statements under different methodologies such
17 as international financial reporting standards.

18 **Q:** When you hear the term book income, you
19 generally equate that with GAAP based income,
20 right?

21 **A:** It would depend on the context. To be precise,
22 book income could be calculated under a number
23 of different methodologies and I laid those
24 out. It could be cash basis. It could be
25 IFRS, governmental accounting. It could be



1 GAAP, but if you're dealing frequently in the
2 world of GAAP, and you are working with clients
3 that are using GAAP, and you hear book income,
4 one could infer that they are referring to book
5 income under GAAP, but to be precise book
6 income could mean under a number of different
7 methodologies.

8 Q: So regardless of which methodology you use,
9 ultimately it will result in a thing called net
10 income, right?

11 A: I believe so, yes, on the income statement.

12 Q: All right. Let's talk about NOLs. Under
13 federal law, a company can carryforward a net
14 operating loss as a tax benefit in future
15 years, right?

16 A: That's correct.

17 Q: Okay. And that's what we call the NOL
18 carryforward deduction?

19 A: That's fair, correct.

20 Q: And so ASC 740 is what instructs a company on
21 how to recognize an NOL carryforward on its
22 financial statement, right?

23 A: That's correct.

24 Q: Okay. And so if an NOL may be used to reduce
25 taxable income in a future year, ASC 740 says



1 you recognize that as a deferred tax asset on
2 your financial statements, right?

3 A: That's generally correct, yes.

4 Q: So when we looked at this example, and I'll
5 talk to you about it in a minute, but the NOL
6 carryforward is used in the future to reduce
7 taxable income but it doesn't reduce book
8 income, right?

9 A: Well, could you clarify what you mean by book
10 income?

11 Q: It doesn't reduce net income how about that?

12 A: Are you referring to net income under GAAP?

13 Q: Let's just go with GAAP since that's your
14 expertise, how about that?

15 A: Okay.

16 Q: Under GAAP, the NOL carryforward is used in the
17 future to reduce taxable income but it doesn't
18 reduce book income, right?

19 A: Under GAAP, it would not reduce your financial
20 statement income but you would record the asset
21 that would generate a future tax deduction.

22 Q: Okay. And I think as you made very clear
23 earlier, you got to read the balance sheet and
24 the income statement in tandem; right?

25 A: That's correct.



1 Q: Okay. And a generation of a deferred tax asset
2 if I'm looking at your example here, the
3 generation of a deferred tax asset has an
4 impact on the income statement in the year it's
5 created, correct?

6 A: Sir, could you repeat that?

7 Q: Sure. If I look at your example, we've got
8 year one. And in year one, when you generate
9 -- when you have a net operating loss, which is
10 what generates a deferred tax asset, that has
11 an impact on the income statement on that year,
12 right?

13 A: That's correct.

14 Q: Okay. But in the future, when the deferred tax
15 asset is utilized, or I think in your
16 deposition you used the colloquial term "burned
17 off", which I like. When that tax asset is
18 burned off, it impacts only the balance sheet,
19 right?

20 A: It would impact the balance sheet by using the
21 deferred tax asset to reduce your taxes
22 payable, but, again, your balance sheet and the
23 income statement as you can see in the examples
24 double entry accounting you have to look at
25 both together.



1 Q: Right. And I noticed that on year two -- all
2 right. So let's back up. Year one you've got
3 in red the impact of the deferred tax asset on
4 the balance sheet, right?

5 A: That's correct.

6 Q: And then right below that you have the impact
7 on the income statement in blue, correct?

8 A: That's correct.

9 Q: Okay. And on year two I see a blue line
10 because it doesn't impact the income statement
11 in future years, right?

12 A: That's correct. It impacts the balance sheet
13 in the future years, which is part of a
14 financial statement to be in accordance with
15 GAAP.

16 Q: Right. And I understand that in keeping all
17 your financial statements in accordance with
18 GAAP, you've got to do all those in accordance
19 with GAAP, not just one, but we're talking
20 about a specific component, which is reducing
21 your tax liability in a particular jurisdiction
22 like South Carolina and the bank tax. And my
23 point here is under your scenario in future
24 years, the utilization of the deferred tax
25 asset has no impact on the income statement,



1 right?

2 A: It was a long question.

3 Q: All right. I'll move on. How about that. Do
4 you agree with me that different tax
5 jurisdictions have ---

6 **THE COURT:** Hold on. If he can answer it, that's an
7 answer I would like to know.

8 **MR. LUTHER:** Okay.

9 A: Could you repeat it.

10 Q: Sure I think I already asked it, which is why
11 I moved on, but I'll ask it again. Under your
12 scenario ---

13 **THE COURT:** Well, he never answered the only part.

14 **MR. LUTHER:** Okay. I thought he did, but I'll ask
15 it again.

16 **THE COURT:** Okay.

17 Q: Under your scenario, in year one when the net
18 operating loss is generated, and there's a
19 deferred tax asset that's then recognized on
20 the financial statements, it impacts the
21 balance sheet and the income statement,
22 correct?

23 A: Correct.

24 Q: But in year two, or in any future years when
25 you utilize that deferred tax asset, it does



1 not impact the income statement, correct?

2 A: That is correct, but under the Department's
3 definition of entire net income based on GAAP,
4 you have to look at those future years in the
5 balance sheet, or it is no longer in accordance
6 with GAAP.

7 Q: Right. You can look at that balance sheet all
8 day long, but if you're looking for the net
9 income of the business, you look at the income
10 statement, right?

11 A: You would look at the net income of the
12 business on the income statement but you also
13 have to take into account the balance sheet
14 because the balance sheet is reflecting these
15 future reductions in taxes payable. If you
16 don't look at the balance sheet, you're not
17 going to pick up the benefit to the entity for
18 these assets and you're only looking at it
19 myopically from the income statement and that
20 is not in accordance with GAAP.

21 Q: Okay. Let's talk about what is in accordance
22 with GAAP. You agree with me that different
23 tax jurisdictions have different rules about
24 whether excess deductions may be carried
25 forward?



1 A: They may, I don't know one way or the other.

2 Q: Okay. Would it surprise you if that language
3 comes straight out of ASC 740?

4 A: It wouldn't.

5 Q: The evaluation of a deferred tax asset in
6 accordance with GAAP is dependent on whether
7 tax law actually provides the deduction that
8 might result in a deferred tax asset, right?

9 A: I think you used the word actually provides.
10 I think the language in ASC 740 is more likely
11 than not, and if we look to the IRC, it's more
12 likely than not, in fact, it happens, that an
13 NOL carryforward is a deduction under the IRC;
14 therefore, under ASC 740, it must be recorded
15 in the financial statements to be in accordance
16 with GAAP.

17 Q: And that would be a reduction in future years
18 of your taxes under federal law, right?

19 A: That's correct.

20 Q: Okay. But you got to look at each taxing
21 jurisdiction including the states in order to
22 evaluate the deferred tax assets, right?

23 A: Well, that would depend and here the Department
24 is saying entire net income based on GAAP. So
25 for it to be in accordance with GAAP, you are



1 looking at the IRC and you would apply that
2 unless there was an explicit exclusion for the
3 state to exclude it out of the GAAP based
4 entire net income and my understanding is that
5 exclusion does not exist.

6 Q: Okay. So your opinion is you have to have some
7 statute or regulation in a state that
8 explicitly says no NOL carryforward deductions?

9 A: If you're going to use the terminology GAAP
10 based entire net income, yes.

11 Q: For federal tax purposes an NOL carryforward
12 deduction is a creature of the Internal Revenue
13 Code, right?

14 A: That's my understanding.

15 Q: So, again, in accordance with GAAP, a company
16 would only claim an NOL carryforward deduction
17 for federal tax purposes because IRC section
18 172 specifically allows it, right?

19 A: Your terminology about specifically allowing
20 it. Under GAAP, I believe the terminology is
21 more likely than not.

22 Q: Okay. So if there's a federal law that says
23 you can claim an NOL carryforward deduction,
24 more likely than not you can claim that
25 deduction, right?



1 A: That's fair.

2 Q: And what about if the state says you can't
3 claim an NOL deduction, more likely than not
4 you couldn't, right?

5 A: If it explicitly says you cannot, that's fair.

6 Q: So if the law in a specific taxing jurisdiction
7 says there is no NOL carryforward deduction
8 permitted, then the deferred tax asset would be
9 zero; is that right?

10 A: Based on your hypothetical, I think that's
11 fair, but I think that's inconsistent with what
12 we have here.

13 Q: You were not asked to render a opinion on the
14 value of any deferred tax assets generated by
15 Synovus; is that correct?

16 A: That's correct.

17 Q: And you were not asked to perform any
18 calculations on how the utilization of any
19 deferred tax assets on Synovus' balance sheet
20 might reduce its tax liability in South
21 Carolina, right?

22 A: I'm not sure I understood that question.

23 Q: Sure. You weren't asked to calculate -- let's
24 put it this way. Synovus claimed deferred tax
25 assets, or recognized them on their financial



1 statements for NOLs in 2009 and 2010, right?

2 A: Correct.

3 Q: And you think -- your opinion is that under ASC
4 740 those NOLs should have been recognized as
5 deferred tax assets on their balance sheets,
6 correct?

7 A: They were.

8 Q: Okay. But you have not been asked to opine on
9 how utilizing those deferred tax assets in
10 future years would reduce their tax liability
11 in South Carolina, correct?

12 A: I haven't done that calculation but what I know
13 from the deferred tax asset and the fact that
14 those balance sheets were audited by an
15 external accounting firm that those deferred
16 tax assets had benefit and were expected to be
17 utilized at some point in the future.

18 Q: Okay. What's that expectation based on?

19 A: The expectation that they'll be utilized?

20 Q: Yes.

21 A: It's generally the expectation that the entity
22 will have taxable income in order to offset
23 with the net operating loss carryforward.

24 Q: All right. And the expectation that that
25 taxing jurisdiction allows a deduction for such



1 NOL carryforward, right?

2 A: Again, your terminology "allows", I mean, I
3 guess it's inferring that there's not going to
4 be some legislation that would disallow,
5 explicitly disallow.

6 Q: Would you agree with me that if a court were to
7 rule that the IRC has not been incorporated for
8 South Carolina bank tax purposes, particularly
9 section 172 of the NOLs, that that would cause
10 any deferred tax assets that Synovus claimed
11 for NOLs to be written down to zero at least
12 for purposes of South Carolina?

13 A: I'm sorry. If a court determines that?

14 Q: Yes.

15 A: If a court determines that there's no NOL
16 carryforward, then I would agree you would have
17 to write those down but that would also be
18 inconsistent with -- that opinion would be
19 inconsistent with GAAP.

20 MR. LUTHER: I think that's all. Thank you very
21 much.

22 THE COURT: Redirect?

23 MS. CUTTINO: No more questions.

24 THE COURT: All right. You may step down. We're
25 going to take a lunch break.



1 (A lunch break was taken from 12:38 p.m. to 1:54
2 p.m.)

3 THE COURT: Y'all be seated. Thank you.

4 Okay. I'm ready, y'all.

5 MR. LUTHER: Your Honor, at this time, the
6 Department would like to call Bob Beckwith.

7 THE COURT: Have they rested?

8 MR. LUTHER: I think they -- I'm sorry. I thought
9 y'all had rested; is that right?

10 MS. CUTTINO: We have.

11 MR. MAYBANK: We have.

12 THE COURT: Oh, okay.

13 ROBERT J. BECKWITH, CPA, having been duly sworn,
14 testifies as follows:

15 MR. BECKWITH - DIRECT EXAMINATION BY MR. LUTHER:

16 Q: Would you state your name for the record,
17 please.

18 A: Robert James Beckwith.

19 Q: All right. Mr. Beckwith, where are you from
20 originally?

21 A: I grew up in Northeast Nebraska and lived most
22 of my life in Nebraska and moved to South
23 Carolina in 2006 and lived in South Carolina
24 since then.

25 Q: Okay. Where do you live in South Carolina?



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1 A: In Greer, Gure (ph)

2 Q: Go ahead.

3 A: Gure (ph)?

4 Q: Gure?

5 A: Yeah.

6 Q: I'm not sure how the record will reflect that
7 pronunciation, but what do you for a living?

8 A: Well, right now, I'm mostly retired. I do some
9 work for a couple of banks, putting together
10 their income tax provision work papers at least
11 on an annual basis, and I do a little bit of
12 consulting when somebody gives me a call, but
13 most -- I don't know how many hours I put
14 together during the total year, but mostly I'm
15 supposed to be retired.

16 Q: Okay.

17 **MR. LUTHER:** Ms. Hogan, can you pull up Exhibit 34?

18 Q: You should be able to see it on the screen
19 there, Exhibit 34, do you recognize that
20 document?

21 A: Yes.

22 Q: And what is that?

23 A: That's my, I guess, resume or CV, whatever you
24 want to call it.

25 Q: Is that a correct and accurate and updated



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1 version of your CV?

2 A: Yes, sir. I believe it's still correct.

3 Q: Okay. And as we stipulated for your
4 qualifications as an expert, but I do want to
5 walk through, just very briefly, some of your
6 background. Tell me about where you went to
7 school.

8 A: I attended the University of Nebraska in
9 Lincoln for my bachelor's degree, and then
10 about five years later, I went to Colorado
11 State University to obtain a master's degree.

12 Q: Okay. And what did you study for your
13 bachelor's?

14 A: My bachelor's, they just had one degree in the
15 business college, Bachelor's in Business
16 Administration, but I, basically, went through
17 all the accounting track there.

18 Q: And then your master's, what field was that in?

19 A: That was primarily in taxation.

20 Q: Can you walk us through just your work
21 experience very briefly?

22 A: Yes, I -- after I graduated from the University
23 of Nebraska, I worked for a small Nebraska
24 based accounting firm for about five years
25 before I went back to school. After I got my



1 master's degree, I went to work for the old
2 Touche Ross and Company, which then merged to
3 become part of Deloitte/Touche. Worked for
4 them for -- 'till about 1990, left to work for
5 a Madison, Wisconsin based CPA firm for just a
6 year, and then I came back to Lincoln to go
7 into partnership with my former mentor from
8 Deloitte. I did that for six years and then
9 Deloitte recruited me back into the fold, and
10 I was at Deloitte for -- until 2006, so until
11 I had about 20 years with Touche Ross/Deloitte.

12 Q: Okay.

13 A: And then I came down to South Carolina to work
14 as a shareholder for Elliott Davis in their
15 bank taxation area.

16 Q: Okay. And are you a CPA?

17 A: I am.

18 Q: And you were with Elliott Davis for what years?

19 A: 2006 through -- I had to retire as of June 30,
20 2015 because I had reached mandatory retirement
21 age. I actually worked for them on less than
22 a full-time basis for the next year and then
23 went to an hourly basis for a little while
24 before they finally -- before they finally
25 decided that it just wasn't necessary to keep



1 me on any employee roles.

2 Q: When you came to Elliott Davis, how many other
3 shareholders were handling bank tax matters?

4 A: There were none.

5 Q: Okay. Were you the lead bank tax shareholder?

6 A: Yes, for all the years that I was a
7 shareholder, yes.

8 Q: Do you have an estimate of how much of your
9 work was related to the bank tax for the banks?

10 A: Yeah, that's a hard one to guess at, but I
11 guess I'd say about 70 percent was bank
12 related.

13 Q: And of that, do you have a ballpark of how much
14 was related to South Carolina banks, or banks
15 filing South Carolina returns?

16 A: Maybe half and half. I also handled almost all
17 of the banks that Elliott Davis eventually
18 added through mergers that were located in
19 Virginia and North Carolina. I think there was
20 also one over in Tennessee.

21 Q: When you first came to South Carolina to start
22 practicing with Elliott Davis, what did you do
23 to learn up, so to speak, on the South Carolina
24 bank tax?

25 A: Well, we actually had a client that had elected



1 to -- a bank client that had elected to be
2 taxed as a subchapter S corporation for federal
3 purposes, but there was a problem in that there
4 was no distinction between sub S banks and C
5 corp. banks for South Carolina bank income tax
6 purposes. So they were getting taxed under the
7 bank income tax and then the income that was
8 passed through to the shareholders was getting
9 taxes under the South Carolina income tax
10 returns with no relief for the -- what we
11 deemed was double taxation.

12 So at that time, I began studying up as much as
13 I could on the Bank Tax Act, which was very
14 short, and having had some experience with the
15 way Iowa had handled the same situation, I
16 worked with either about four of the five
17 escort banks at that time to try to get some
18 relief on that, and we engaged Mr. Maybank, as
19 he recalls, to lobby the legislature to get a
20 fix through.

21 Q: Okay. Other than the statute, did you review
22 anything else in terms of learning about the
23 bank tax in South Carolina?

24 A: That's a long time ago. I believe I tried to
25 search for other precedential matters. I don't



1 recall how much I accumulated at that point in
2 time.

3 Q: Okay. At Elliott Davis, you were a reviewer;
4 is that right?

5 A: Yes, I reviewed returns that were prepared by
6 staff and had a first review by a manager, but
7 I was the final reviewer and signer, which the
8 IRS would say I was the return preparer for
9 those returns.

10 Q: Okay. And about how many bank tax returns did
11 you say you prepared in your time there?

12 A: Best guess I can do is between a 100 to 150.

13 Q: Okay. Do you have a best guess about how many
14 different South Carolina banks you prepared
15 returns for?

16 A: Twelve to fifteen.

17 Q: Have you done any speaking on tax matters
18 affecting banks?

19 A: The only speaking I've done on two occasions go
20 back quite a ways. I was once a panelist at
21 the Bank Tax Institute in Florida when I was
22 with, I believe it was Touche Ross at that
23 time, and then my partner and I put on the
24 First Community Bank tax class, which was added
25 as an extra day of the Bank Tax Institute,



1 which is like I said, anymore it's put on down
2 in Florida all the time and pretty much the
3 only other speaking I would have is each year,
4 starting about two or three years after I
5 joined Elliott Davis, we started putting on, I
6 believe it was a two-hour webcast, where three
7 or four of us would take different subjects and
8 discuss them for participants, and I'm sure I
9 covered some ASC 740 and some tax pieces there,
10 but it's been a long time since I've done any
11 of that.

12 Q: Okay. Are you familiar with GAAP?

13 A: Yes.

14 Q: Okay. What's your experience with GAAP?

15 A: Well, of course I studied it for my bachelor's
16 degree ---

17 Q: Okay.

18 A: But then I -- in the small firm I worked with,
19 I was the senior auditor for all the hospitals
20 that the firm audited, and then after I got my
21 master's degree and started work for Deloitte,
22 well, for Touche Ross and Deloitte and then at
23 Elliott Davis, also, I worked with the auditors
24 in their review of the accounting provision and
25 financial audits that they were doing.



1 Q: Are you familiar with ASC 740?

2 A: Very much so.

3 Q: And what's your experience with ASC 740?

4 A: Well, when I graduated from college the first
5 time around, ASC 740 did not exist. The
6 pronouncement at that point in time was APB
7 Statement 11. APB standing for Accounting
8 Principles Board.

9 Eventually, they started to replace that with
10 FAS 96, which I don't recall whether it ever
11 went -- that it ever went effective, but there
12 were problems with it and eventually they
13 reissued it as FAS 109 and that was the primary
14 guidance for accounting for income taxes until
15 the codification that Mr. Branch discussed
16 earlier.

17 Q: Okay. I want to move into maybe providing --
18 I know we talked about a lot of different terms
19 this morning and maybe let's just lay the
20 foundation for what some of these different
21 terms, documents, and things like that are
22 referring to. What if financial accounting?

23 A: I would say financial accounting is the
24 recording of transactions, assets and
25 liabilities for financial reporting purposes.



1 Q: Okay. Are there specific rules or guidelines
2 that govern financial accounting?

3 A: I suppose you could -- you know, we talked
4 about the different -- or Mr. Branch talked
5 about the different basis for the financial
6 reporting, but in my experience, it's always
7 been based upon GAAP accounting.

8 Q: Okay. If I talk about financial statements,
9 what does that term mean to you?

10 A: It means the balance sheet, income statement,
11 statement of cash flows, statement of owner's
12 equity and the footnotes. I think that's
13 generally the main items included in a set of
14 financial statements.

15 Q: Okay. Let's just take each of those just
16 briefly. So you said a balance sheet, what's
17 a balance sheet?

18 A: A balance sheet is a statement that shows the
19 assets, the liabilities and the shareholder's
20 equity, assets being equal to the sum of the
21 liabilities and shareholder equity.

22 Q: Okay. And what's an asset?

23 A: An asset is something of value that the
24 reporting company would claim on its balance
25 sheet. It can be tangible such as depreciable



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1 assets, or it could be intangible such as good
2 will or some other type of asset without
3 physical substance. I suppose you could corral
4 loans in there, although, they are documented
5 by contractual agreements.

6 Q: Okay. And what is a -- what's a liability?

7 A: A liability would be an amount that the
8 reporting entity owes to other parties and it
9 could be based on actual purchases that have
10 not yet been settled in cash. It could be
11 accrued liabilities such as payroll, payroll
12 liabilities, or in the case of a bank, a really
13 big one, would be deposits.

14 Q: Okay. And then you mentioned shareholder's
15 equity, what is that?

16 A: Shareholder's equity is the amount that is
17 shown on the balance sheet as available to
18 shareholders, so it's the excess of assets over
19 liabilities that would be available to
20 shareholders at some point in time, I guess.

21 Q: Would a company's assets need to balance with
22 the sum of its liabilities and shareholder
23 equity?

24 A: Yes, like I said, I mean, it's a Tax 101, or
25 Accounting 101 item where assets equals



1 liabilities plus shareholder equity.

2 Q: And you also mentioned the income statement
3 earlier. What's an income statement?

4 A: The income statement is a statement that shows
5 all revenues and gains that the reporting
6 entity has and it shows the expenses, losses,
7 that were generated in the course of earning
8 that revenue and the net of those two come down
9 to an amount called net income.

10 Q: An income statement, does it cover a certain
11 period of time?

12 A: Generally, it's a one-year period.

13 Q: Okay. How about the balance sheet?

14 A: The balance sheet is a snapshot of a period of
15 time usually in the year end.

16 Q: What's the bottom line? We use that term
17 sometimes. What is the bottom line?

18 A: Of the income statement?

19 Q: Yes.

20 A: Net income. Well, yes, sometimes you'll see
21 something beneath the net income line such as
22 amounts accruing to preferred shareholders and
23 then you get the amount of income that's
24 available to common shareholders, but basically
25 the bottom line of the income and expense



1 portion is net income.

2 Q: You also mentioned a statement of cash flows.
3 What is that, just briefly?

4 A: That's a statement that takes the net income of
5 a company and adjusts for the differences
6 between cash basis and accrual basis
7 accounting. So, for example, the one that
8 we'll be talking about today, taxes. Taxes are
9 shown on the income statement on an accrual
10 basis, and on the statement of cash flows, it's
11 adjusted back to reflect the amount that's
12 actually paid for -- paid to the jurisdictions
13 for taxes, so it doesn't reflect, you know,
14 payables or over accruals.

15 Q: I think the last thing you said was footnotes
16 as part of the financial statements. What are
17 the footnotes you're talking about?

18 A: The footnotes are the major -- the greatest
19 part in volume in a set of financial statements
20 and there's where the real meat of the issues
21 lie. In particular for banks, just the single
22 statement on the loans can go for multiple,
23 multiple pages, but it just reflects all kinds
24 of information based on the loans that the bank
25 has, the securities that it carries, including



1 the fair value of the securities and the cost
2 of those securities, fixed assets, so on and so
3 forth. Deposits, compares year-to-year
4 balances for all those items, and there is a
5 footnote on the income taxes where it -- the
6 main part of that footnote is it shows the
7 components of the income tax, which is broken
8 down, generally, between current and deferred
9 tax expense. Shows the components of the
10 deferred tax asset or liability, whatever it
11 turns out to be. Discusses things like the
12 amount of net operating loss carryovers that
13 the bank is showing for federal and state tax
14 purposes, and it reconciles the amount of tax
15 that you would compute on the basis of net
16 income before taxes from the income statement
17 times the statutory rate to the actual rate
18 that the bank pays, which would be after
19 certain expenses, current expenses, such as
20 state income tax, non-taxable state and local
21 interest, things like that.

22 Q: Okay. What is tax accounting?

23 A: Tax accounting, I think that's more of a term
24 of art, but that would be the process of
25 determining the tax basis of assets and the



1 adjustments to income and expenses from the
2 balance sheet to come to taxable income and
3 deductible expenses.

4 Q: Okay. Are there specific rules that govern tax
5 accounting?

6 A: I would say that would basically be ASC 740 at
7 this time.

8 Q: Is there any relationship or interplay between
9 financial accounting under GAAP and then tax
10 accounting?

11 A: Well, tax accounting would be used to first of
12 all determine the current taxes payable, which
13 would be based on what the firm expects to show
14 on its federal tax returns and state tax
15 returns, and financial accounting as we
16 discussed before would be in my experience
17 anyway would generally be based upon GAAP.

18 **THE COURT:** Based on what?

19 A: GAAP.

20 Q: Is there a relationship between GAAP and
21 federal taxable income?

22 A: Well, sort of like what I said, it would be
23 basically like the federal taxable income and
24 GAAP income would be somewhat similarly
25 composed, but the taxable income would have



1 adjustments to the GAAP numbers. For example,
2 interest income on state and local bonds would
3 generally show up on the financial -- on the
4 GAAP financial statement but it would be in
5 most cases zeroed out or presented as zero on
6 the tax income statement so to speak.

7 Q: And is that because of specific federal laws or
8 regulations related to that?

9 A: It's dependent upon the Internal Revenue Code
10 and the regulations, court decisions, rulings,
11 and so on and so forth.

12 Q: So federal taxable income starts with GAAP and
13 then makes adjustments to that based on federal
14 law and regulations?

15 A: Correct.

16 Q: Are you familiar with the term net income?

17 A: Yes.

18 Q: What does that mean?

19 A: Net income is the difference between financial
20 reporting income and financial reporting
21 expenses including tax, income tax expenses.

22 Q: Is net income synonymous with book income?

23 A: Book income is more of a term of art, or maybe
24 you could even -- you could call it slang, but
25 in practice, we generally looked at book income



1 as being the income right off of the general
2 ledger, which supposedly by the time any
3 required adjustments are made to the year-end
4 numbers, book income would be computed under
5 the GAAP principles.

6 Q: Okay. And under GAAP, generally, how would you
7 compute book income?

8 A: You basically take book income in gains and
9 subtract book expenses from losses.

10 Q: Are there specific usages of net income in the
11 banking industry?

12 A: Yes.

13 Q: Can you give me some examples?

14 A: Well, for regulatory reporting purposes, the
15 bank files what we call a call report every
16 quarter and at year end with the regulators and
17 line 14, I believe it is, on Schedule RI, which
18 is the income statement included in the call
19 report is specifically labeled as net income.
20 On SEC reporting or other balance -- or other
21 financial statements that may be presented to
22 shareholders or to the SEC depending on whether
23 they're SEC reported or not, the income
24 statement eventually comes down to a line
25 that's net income or loss depending on what it



1 shows.

2 Q: Have you had an opportunity to review any of
3 Synovus' financial reporting documents?

4 A: Yes, yes.

5 Q: Does the term "net income" appear on any of
6 those documents?

7 A: Yes, as I said, in some places.

8 Q: Okay. Any other examples on Synovus in
9 particular?

10 A: I mean, net income would be shown as an
11 adjustment to -- as an increase or decrease
12 depending on whether it's a net income or net
13 loss on the statement of shareholder's equity.
14 Net income would be an increase -- the
15 statement of shareholder's equity shows the
16 shareholder's equity at the beginning of the
17 year and shows the components of the change to
18 the end of the year.

19 Q: Okay.

20 A: The -- a net income item -- a net income from
21 the income statement would increase the
22 beginning to ending balance of shareholder's
23 equity; whereas, a net loss for the year would
24 decrease shareholder's equity and then you got
25 the statement of cash flows, which would start



1 out with net income and adjust it to a cash
2 basis number.

3 Q: In your experience as a CPA that prepared bank
4 tax returns in South Carolina, what does the
5 term "entire net income" mean to you?

6 A: Well, based on my experience in reading tax law
7 regulations, rulings, and so on and so forth,
8 I've always thought of the term -- I guess I
9 haven't thought that much of the term "entire
10 net income", but when I look at it, I think you
11 have to break it into two pieces. "Entire" is
12 fairly well known in common vernacular to mean
13 the total amount. "Net income" is a term that
14 at least in the accounting world is pretty
15 familiar to us all and that is the net income
16 I was talking about before.

17 Since there is nothing in the South Carolina
18 law that defines entire net income, I assume
19 that the legislature felt that it was
20 sufficiently apparent what it meant that what
21 they were talking about was all of the
22 company's gross income minus gross expenses or
23 net income.

24 Q: In what ways, if any, would a bank utilize GAAP
25 to calculate their entire net income for bank



1 tax purposes?

2 A: Well, since I earlier said that net income
3 would be based upon GAAP, in most cases, I
4 think for South Carolina banks, that would be
5 what they were using. Net income would be
6 based upon GAAP. I can't think of any other
7 part of the return itself that would reflect
8 GAAP numbers.

9 Q: In your opinion, is it reasonable for the
10 Department to rely on GAAP for the definition
11 of book income?

12 A: I believe so in my practice that's the only
13 thing we -- that's the only interpretation that
14 I, or any other return preparer that I've had
15 the opportunity to review has based it on.

16 Q: In coming to your opinions in this case, did
17 you have a chance to review any of the attorney
18 general's opinions that we talked about earlier
19 or commission decisions from the tax
20 commission?

21 A: I reviewed a 1975 tax commission decision and
22 basically what I gleamed out of that as
23 meaningful was that the tax commission equated
24 the term "entire net income" to economic
25 income.



1 Q: So could you put it ---

2 A: He specifically said that it was not taxable
3 income.

4 **MR. LUTHER:** Okay. Can you pull up Exhibit 25?

5 Q: Let's see this is -- Mr. Beckwith, this is
6 Exhibit 25, is this the commission decision
7 from 1975 you're talking about?

8 A: It is.

9 Q: And which part, in particular, were you just
10 referencing just for the record?

11 A: Second paragraph -- okay. That's better.
12 Second paragraph, the end of the fourth line,
13 starts, "The phrase entire net income has been
14 construed to mean all income from whatever
15 source derived less all expenses incurred. The
16 special base of this tax is, therefore,
17 economic income rather than taxable income."

18 Q: Okay. You may have said this earlier, but
19 explain to me how this factors into your
20 opinions?

21 A: Well, it certainly says that you don't use
22 taxable income and economic income, at least
23 from an accountant's standpoint, would have to
24 be based upon the accounting principles they
25 work under which would be GAAP again and under



1 the ASC.

2 **MR. LUTHER:** Could you pull up Exhibit 45.

3 Q: I want to take a look just at a blank South
4 Carolina bank tax return.

5 A: Okay.

6 Q: Are you familiar with this return?

7 A: Oh, yes.

8 Q: And I really just want to walk through how you
9 would utilize these various lines, but when you
10 were a tax shareholder at Elliott Davis, how
11 did you calculate the tax base for banks when
12 you were preparing a return like this?

13 A: Well, I'm not sure I've ever agreed with the
14 way they get to it, but the way this form is
15 designed, you start out on line one with
16 federal taxable income right off of the federal
17 return, 1120.

18 And then on the second page -- can we move to
19 the second page? There we go. Here, and if
20 you go to the instructions, basically, what
21 it's telling you to do is to -- yeah, what it's
22 telling you to do with the items lines 1
23 through 17, or however far it goes, is to
24 essentially add back all of the items that
25 reduced net income to taxable income and then



1 subtract out all the items that were used to
2 increase book income from tax -- or taxable
3 income from book income and this is off of
4 either the Schedule M-1 or the Schedule M-3,
5 whichever the bank was required to file. So,
6 basically, what it does is just kind of reverse
7 the entire M-1, M-3 process to -- instead of
8 just going to book income, it starts you out
9 with taxable income and walks you right back up
10 the line.

11 Q: So line one starts with federal taxable income?

12 A: Then line two uses the net of these two
13 schedules, A and B, to basically get you back
14 to net income.

15 Q: Okay. And then you said at line three, net
16 income, is essentially the number that you
17 would have on the schedule M-1 or M-3 for
18 federal tax return purposes?

19 A: Correct.

20 Q: Which is book income?

21 A: Net income, book income, yeah.

22 Q: When you prepared returns in South Carolina,
23 did you use federal deductions to reduce the
24 bank taxes' liability?

25 A: No. When I would -- when I would do my own



1 calculations, I would just take the book income
2 times four and a half percent, which was the
3 bank income tax rate. That's why I said I
4 don't necessarily agree with the way the form
5 is set up because I think the first two lines
6 are somewhat unnecessary.

7 Q: What importance did you place on instructions
8 that accompanied a form like this?

9 A: I believe that they are necessary to follow
10 unless there is a well-documented position to
11 do something other than what the forms require.

12 Q: Would that be a manner of guidance for you from
13 the Department in terms of how to interpret the
14 tax that the form applies to?

15 A: Yeah, I would say the instructions reflect the
16 Department's interpretation of the law.

17 Q: So if you go down lower, Mr. Beckwith, I think
18 it's page 45 where the instructions are.

19 A: There we go.

20 Q: So you see there on line 2 this is the
21 instructions from where we're essentially
22 adjusting federal taxable income back to book
23 income or net income.

24 A: Uh-huh.

25 Q: And there's an instruction there about net



1 operating losses; is that correct?

2 A: Right.

3 Q: And what does it say?

4 A: Well, it says, "Federal net operating loss
5 deduction banks are not allowed the net
6 operating loss deduction."

7 What this line does is it takes any federal net
8 operating loss claimed on the federal return
9 and adds it back to -- in the process of
10 getting back to book income.

11 Q: Have there been any material changes to this
12 form that you know of since you started ---

13 A: Not to my knowledge.

14 Q: All right. What's a net operating loss?

15 A: A net operating loss is a creation of federal,
16 and in some cases, state income tax laws. It
17 is the excess of deductible expenses over
18 taxable income.

19 Q: And so what is a net operating loss
20 carryforward?

21 A: Net operating loss carryforward is the
22 utilization of that net operating loss created
23 in a prior year to offset taxable income of the
24 organization in a future year to claim back
25 some of the taxes that have been paid sort of



1 -- might even call it some sort of income
2 averaging type of approach.

3 Q: Okay. Where does the authority for a net
4 operating loss carryforward deduction come
5 from?

6 A: Internal Revenue Code Section 172.

7 Q: Okay. In your experience, do states permit
8 that operating loss deduction, carryforward
9 deduction?

10 A: Some states do, but not all.

11 Q: And what would be the basis of the states that
12 do? What would be the basis for that net
13 operating loss carryforward deduction?

14 A: Depending on the way the state computes net
15 taxable income for their purposes, it would be
16 either that number, or if they're a multi-state
17 return, it might be a percentage of that number
18 that's allocated to a particular state.

19 Q: As a CPA, what importance do you place on
20 whether a state has a statute or regulation
21 that expressly allows a net operating loss
22 carryforward deduction?

23 A: I'd be required to follow the law.

24 Q: Okay. And if there's no statute or regulation
25 permitting an NOL carryforward deduction, what



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1 impact does that have?

2 A: Then I would have to rely on an analysis of the
3 state laws, the regulations, quite often use
4 the return instructions to provide some means
5 of determining how to handle that.

6 Q: So in your experience preparing returns in
7 South Carolina, could banks claim an NOL
8 carryforward deduction on their return?

9 A: No.

10 Q: Would this have been generally understood by
11 tax accountants or accountants in South
12 Carolina?

13 A: I believe so. I have -- at least returns that
14 were prepared by Elliott Davis were consistent
15 in that respect. Any years in which a federal
16 operating loss was utilized, there would be no
17 net operating loss benefit in commuting the
18 state tax base.

19 I've reviewed returns prepared by other CPA
20 firms in the course of acquisitions, or
21 whatever, and I've never seen a situation like
22 that being claimed by Synovus.

23 Q: Just to make sure it's clear for the record,
24 you were working at Elliott Davis during the
25 time period in which Synovus generating these



1 net operating losses, correct?

2 A: Yes.

3 Q: And that was during the economic downturn in
4 2008 and '09?

5 A: Correct.

6 Q: Where other banks also had NOLs?

7 A: Oh, yes.

8 Q: All right. I want to talk about ASC 740 for a
9 minute.

10 A: Okay.

11 Q: Can you explain to the Court what a temporary
12 difference is?

13 A: A temporary difference is the difference
14 between reporting income or expense items for
15 federal tax purposes compared to its reporting
16 amount on a -- for financial reporting
17 purposes. The temporary -- a temporary
18 difference would be one that would be expected
19 to reverse in a future year.

20 Q: So how are temporary differences relevant to
21 your analysis of ASC 740 in this case?

22 A: Well, there are several steps that you go
23 through in the process of determining income
24 tax expense and for the income statement and
25 for the deferred and current tax accounts for



1 balance sheet purposes.

2 The first step is you determine the amount of
3 tax that is expected to be shown on the federal
4 income tax return, federal and state income tax
5 return, which is based on federal or state law.
6 The next step is to accumulate all your
7 temporary differences either deductible in the
8 future or taxable in the future. So we refer
9 to those as deductible temporary differences or
10 taxable temporary differences, and you're
11 basically -- you do that by comparing balance
12 sheet, financial balance sheet items to the tax
13 balance sheet items.

14 Q: Okay.

15 A: And I'll take a sidetrack for a moment. When
16 I said that I worked with APB 11 back in years
17 before the FASB issued its pronouncements, APB
18 11 was a procedure that was based upon the
19 income statement. In other words, you computed
20 an income statement based tax amounts and then
21 figured out the balance sheet amounts after
22 that.

23 Under ASC 740 and FAS 109, its predecessor,
24 it's a balance sheet approach. So you compute
25 current tax and then you compute deferred tax



1 and add the income tax -- income statement
2 effect of those two together to get your total
3 income tax expense for the financial income
4 statement, so your second step is to determine
5 all your temporary differences.

6 Third step is to accumulate your net operating
7 losses and your tax credit carryovers and the
8 reason that those are separate from the second
9 step is because there's no financial balance
10 sheet, number two, referred to in determining
11 those. So you get all those together. You got
12 your temporary -- deductible temporary
13 differences, your taxable temporary
14 differences, you take them times the effective
15 rate. You would have to do this on a
16 jurisdiction by jurisdiction basis, by the way,
17 so for federal purposes, you take them times --
18 well, right now it's 21 percent. You know, for
19 state purposes you take them times actually
20 it's a tax-effected rate because those amounts
21 will be deductible for federal tax purposes and
22 you add those altogether and you've got the
23 total amount of -- or the net amount of
24 deferred tax assets.

25 Q: And you said you've got to look at the



1 different taxing jurisdictions?

2 A: Correct.

3 Q: So does it matter when you are looking at
4 whether to include a deferred tax asset on your
5 balance sheet does it matter whether a specific
6 taxing jurisdiction allows that particular tax
7 deduction?

8 A: Yes.

9 Q: And how so?

10 A: Well, to give you an example, North Carolina
11 allows a net operating loss deduction or a
12 carryover deduction. South Carolina does not.
13 So on the North Carolina determination of
14 temporary differences, you would have a net
15 operating loss. On the South Carolina deferred
16 taxes, you would have nothing because South
17 Carolina relies solely on net income and that
18 has no impact on the future years.

19 Q: Okay. So South Carolina does not allow an NOL
20 carryforward deduction. How would ASC 740
21 account for that?

22 A: It really wouldn't because in determining
23 temporary differences in South Carolina, you
24 would have none.

25 Q: So I guess you could place a deferred tax asset



1 but the value would be zero; is that fair?

2 A: You could say that, yeah. You might have a
3 schedule that lines up all of your states and
4 the net operating loss line would be blank or
5 zero for South Carolina.

6 Q: If an entity had listed a deferred tax asset on
7 its financial statement for a South Carolina
8 NOL carryforward deduction, but it was
9 determined that such a deduction did not exist,
10 what impact would it have on a deferred tax
11 asset?

12 A: Well, if the amount was material, the firm
13 would have had to have either requested the
14 entity to make an adjustment for the amount of
15 tax related to that, or they might have to
16 issue a qualified opinion because the financial
17 statements could not materially state the
18 position of the firm, or of the bank.

19 Q: Now, I understand you had prepared some
20 examples that were discussed in your deposition
21 about interplay between deferred tax assets and
22 net income; is that correct?

23 A: Right.

24 Q: And I want to go over those briefly for the
25 Court's benefit.



1 MR. LUTHER: If you could pull up Exhibit 35.

2 And Your Honor, if it's all right, I might also
3 have him come down and point on this. It's a
4 little bit easier for you to see.

5 Q: Mr. Beckwith, is it easier for you to walk
6 through this on the screen or using this thumb
7 board blow up?

8 A: It would probably be easier for me to go over
9 to the examples on the -- on the easel there.

10 I do want to take -- I do want to just bring
11 these along so I can kind of shortcut my
12 discussion.

13 Q: Are those just smaller copies of the same
14 thing?

15 A: Yes.

16 MR. LUTHER: Okay. Your Honor, may he approach?

17 THE COURT: Sure.

18 Q: And before we get started, can you just briefly
19 explain to the Court what you're trying to show
20 in these various examples?

21 A: I'm trying to show how the mechanics of ASC 740
22 operates in the normal course of business. I
23 made this simple enough that I can explain it
24 and hopefully other people understand it.

25 Q: Okay.



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1 A: And as you said, I just got my own printouts of
2 these.

3 Q: So this first example, I think, is Exhibit 35
4 in the consolidated exhibits.

5 A: I thought I saw some markers.

6 Q: You need a marker?

7 A: I'll just take the red one that will be enough,
8 and what I want to show here is a situation
9 where a bank -- we'll say it's a bank compares
10 its tax calculations for financial statement
11 purposes over a two-year period with the
12 beginning, the prior year shown as the
13 beginning balance for temporary differences.

14 THE COURT: All right. Hold on a second. Mr. von
15 Lehe, do you need to come around here?

16 MR. VON LEHE: I can see all right from here.

17 THE COURT: Well, you won't be able to see what he
18 marks.

19 MR. VON LEHE: Yes, so we'll come around.

20 A: From the example here, we have a bank that
21 starts out in year one. At the end of year
22 one, has \$200 of book loan loss deductions for
23 financial statement purposes an excess of
24 what's been allowed for tax purposes in prior
25 years.



1 In year two, the bank has \$900 of revenue, \$800
2 of expenses, which bring us to a \$100 of net
3 income before tax, \$10 of income taxes expense.
4 So they have a net income of \$90.

5 On the income tax return for that bank, it
6 shows \$90 of net income as a starting point,
7 adds back the \$10 expense for income taxes, so
8 we've got net income or loss before tax, again,
9 of \$100.

10 The bank also has \$50 of interest income from
11 exempt state and local securities, so that
12 reduced its taxable income by 50, and then he's
13 got, again, another \$100 of financial statement
14 book loan loss over tax and debt deductions of
15 a 100, that \$100 increases taxable income and
16 results in a net taxable income of \$150. I'm
17 using a 20 percent tax rate just for example
18 purposes because it's easy to do the math in my
19 head.

20 Q: Can I stop you right there ---

21 A: Yeah.

22 Q: --- just to clarify the record. When you talk
23 about the income tax return, you're talking
24 about the federal income tax return?

25 A: Yeah. So we've got a federal tax return



1 liability of \$30, which is our current account
2 -- current income tax liability on the balance
3 sheet and the current income tax expense on the
4 income statement.

5 For balance sheet purposes, you see we've got
6 a \$100 increase in temporary differences, which
7 computes to \$60 of deferred tax asset.

8 The difference between the beginning and the
9 ending deferred tax asset is our deferred tax
10 expense. So it's a debit on the balance sheet
11 to deferred tax asset and a credit on the
12 income statement of \$20 to give us a net income
13 tax for financial reporting purposes of \$10,
14 which is equal to the amount that was on the
15 books up there.

16 **THE COURT:** And this is all in the footnotes?

17 A: Yeah, from here on down is all on the tax
18 footnotes in general.

19 **THE COURT:** Okay.

20 A: So on the income statement, all you're going to
21 see on the income tax line is just a single
22 number and the footnote gives you all of the
23 details as to how that number has been
24 computed. So like I said before, you got a
25 statement that shows the components of tax



1 expense, the current and the deferred impact to
2 get to a net or a gross income tax expense, and
3 it shows the components of the deferred tax
4 asset or liability that goes to the balance
5 sheet. In the next year ---

6 **THE COURT:** Let me stop you there, so I can
7 understand it.

8 A: Okay.

9 **THE COURT:** Book loan loss ---

10 A: Yes.

11 **THE COURT:** --- is considered an asset?

12 A: Well, there's a book loan loss in the allowance
13 for loan and lease losses on the balance sheet.
14 This would be the increase or decrease on that
15 allowance account that is charged to income for
16 financial statement purposes.

17 **THE COURT:** For financial statement purposes?

18 A: Right. But then under the tax law, most banks,
19 at least those over five hundred million in
20 assets, deduct just the charge-offs that they
21 record during the year. So in this case, what
22 I'm saying is that the increase in the
23 allowance for loan losses exceeded the charge-
24 offs by a \$100. So the deduction on the bank
25 tax return is a \$100 less than the expense that



1 shows up for loan loss on the financial
2 statements.

3 **THE COURT:** Okay.

4 A: Should I proceed?

5 **THE COURT:** Proceed.

6 A: Next year I'm showing \$1100 of revenue, \$800 of
7 expenses for a \$300 net income before tax, \$50
8 of income tax expense. So there's a \$250 net
9 income line. Again, we take the net income,
10 add back the income tax expense to get net
11 income before taxes. The tax exempt income,
12 this is a permanent difference because that's
13 never taxed on the returns. I've left that the
14 same on all my examples, but now we've got \$250
15 after permanent differences and then, again, we
16 have another \$100 increase in the temporary
17 difference for loan losses. So that adds into
18 the 250 to give us \$350 of taxable income on
19 the return for a \$70 current income tax
20 expense. And similar to year two, we have a
21 \$100 increase in our temporary difference for
22 loan losses, gives us \$400 accumulative
23 temporary difference at 20 percent of the \$80.
24 The increase from year to year -- year over
25 year is 20, so that's our deferred tax benefit.



1 It's an increase of an asset, so it's a debit
2 on the balance sheet and a credit on the income
3 statement to balance our entry.

4 So we've got \$50 in net income tax expense,
5 which is composed of \$70 of current and \$20 of
6 deferred benefit, which is the number that
7 shows up on our financial statement.

8 Q: All right. So Mr. Beckwith, this first example
9 shows a scenario which in both year two and
10 year three, the bank is reporting net income,
11 no losses, correct?

12 A: Correct.

13 Q: All right. Did you have a second example that
14 you wanted to walk through?

15 A: Yes, part of Exhibit 4.

16 MR. LUTHER: Ms. Hogan, I think that's Exhibit 36 in
17 the consolidated list.

18 MS. HOGAN: Yes, sir.

19 Q: All right. And what does this Exhibit show?

20 A: This is basically the same as Exhibit 4, except
21 in year three, we have a \$50 decrease in our
22 temporary difference for loan loss. So in
23 other words, the bank charged off more loans
24 than it recorded for as provision for loan
25 losses on its financial statements. So that



1 decreases taxable income from the \$250 that we
2 had on the other exhibit down to \$200 for a \$40
3 current tax expense.

4 The \$50 decrease in our temporary difference
5 for loan losses changes our computation for
6 deferred tax asset to \$50, which is a decrease
7 from \$10, or back up \$10 from the beginning of
8 the year, 60 and that equals a deferred tax
9 expense because we used an asset, reduced our
10 asset, and got an expense related to that of
11 \$10.

12 So we got our components of income tax expense
13 is \$40 in current, \$10 of deferred for a total
14 of \$50 of expense, which again up here is the
15 amount on the income statement. And if we look
16 at Exhibit 3, we'll find out if that's the same
17 number that was on Exhibit 3.

18 The point of all this is that whether or not
19 deferred or temporary differences increase or
20 decrease, they do not impact a calculation of
21 net income tax on the income statement for
22 financial reporting purposes.

23 Q: Okay. And do you have one last example?

24 A: I do.

25 Q: Okay. I put up what I think is Exhibit 37.



1 And how does this exhibit compare to the other
2 two you just reviewed?

3 A: Okay. I've changed -- the only real change
4 I've made to the facts is that we now have a
5 \$1000 in year two of expense over \$900 of
6 income, so we have a net book loss before taxes
7 of a \$100, a \$30 tax benefit for financial
8 reporting purposes, which leads us to a net \$70
9 bottom line on the income statement.
10 Again, we adjust back up to taxable income, or
11 net income before taxes. We got our \$50
12 deduction for state and local income, which
13 gives us a loss of \$150 before the \$100 add
14 back for the increase in our temporary
15 difference back on the loan losses. So we got
16 a \$50 loss on the income statement that's a net
17 operating loss now.
18 On our deferred tax footnote, we see we still
19 got the same \$100 increase in our book loan
20 loss difference, but we now have the \$50 net
21 operating loss to be carried forward to future
22 years that is a \$70 final DTA, an increase of
23 a prior year of \$30.
24 So for financial statement purposes, our
25 footnote is going to show that we have zero



1 current tax because we had a loss, and we don't
2 get any benefit out of that loss in the year
3 it's created. We got a \$30 benefit, tax
4 benefit, for the creation of a net operating
5 loss, which we expect to be able to take
6 advantage of in the future to get a \$30 refund
7 sometime in the future. So we got a \$30
8 benefit in total, which is the number that was
9 on the financial statement. Then we have the
10 same reversal of \$50 in our book loan loss.
11 Year three numbers are the same as they were
12 for the other two exhibits down to this point,
13 and we've got the \$50 reduction for the loss,
14 loan loss reserve, and we got a \$50 NOL that's
15 being used in year three. So it reduces
16 taxable income to \$150. The return is going to
17 show \$30 of current income tax expense, which
18 comes down to here, again.
19 On our footnotes, we're going to show that the
20 temporary difference for loan losses is
21 decreased by \$50. The temporary difference for
22 net operating loss is decreased by \$50, so our
23 net temporary difference is \$50. That's an
24 increase of \$20 from the year before. We've
25 used the assets. We've used temporary



1 differences. We reduced assets by \$20, so
2 that's a deferred tax expense. Got a total of
3 \$50 of net income tax for financial reporting
4 purposes, which, again, is on the financial
5 statements.

6 If I may, I went ahead and summarized the
7 results for year three of all three exhibits.

8 Q: Okay. Let me pull that up for you. Okay. So
9 this is just a comparison of the year three
10 lines for each of those first three exhibits;
11 is that right?

12 A: Right.

13 Q: And what are you trying to show here?

14 A: Okay. I just want -- the point here is that
15 regardless of the changes in temporary
16 differences from year to year, there is no
17 impact upon the total tax expense shown on the
18 financial statements and the first example is
19 \$30 current and \$20 deferred for a \$50 total,
20 but the second one is a \$40 current, a \$10
21 expense for 50 and then the third example is a
22 \$70 current, a \$20 benefit, which reduces the
23 total to \$50.

24 All three exhibits show that they have the same
25 tax expense because for book purposes, there's



1 been no change in the total revenues and
2 expenses shown on the income statement.

3 Q: So even though there was a deferred tax asset
4 that was utilized in year three as a result of
5 an NOL generated in an earlier year, that
6 didn't affect the bottom line of net income on
7 the income statement?

8 A: Correct. It only affects the components that
9 reduces current taxes payable, reduces deferred
10 tax asset by similar numbers, so shareholder's
11 equity is unaffected. The components of tax
12 expense shown in the footnotes is still --
13 that's the same number.

14 Q: Okay. Thank you. I think you can have a seat.
15 You were present for Mr. Branch's testimony
16 earlier this morning, correct?

17 A: Yes.

18 Q: And you saw the example, the hypothetical that
19 they went through. Were you here for that?

20 A: Yes, actually there's a copy laying here.

21 Q: Okay. I'm going to put it up on the screen for
22 you. How does his hypothetical example that he
23 went over compare with what you just showed on
24 your example here?

25 A: Well, what it does is basically in the year two



1 -- the year one entry I agree with. The year
2 two entry excludes the impact of the net
3 operating loss claimed on the federal return.
4 It excludes the tax -- the impact on the income
5 statement, although, as I said before, the
6 number on the income statement itself doesn't
7 change but the components in the footnote would
8 be different. So for actual general ledger
9 accounting purposes, when you have a debit in
10 year two to taxes payable of \$300, you would
11 have a credit to current income tax expense on
12 the general ledger of \$300. The credit to
13 deferred tax asset of \$300 would also generate
14 a debit to deferred tax expense of 300. The
15 two would net out in determining net income.
16 So in terms of the presentation and the total
17 financial statements, there is an impact on the
18 income statement that nets out to zero.

19 Q: Okay. I want to take you -- we'll finish up
20 here. I want to take a look at an actual
21 return, one of the returns that Synovus filed
22 and let's look at 2012, which I think is
23 Exhibit 11 and 13 and let's start with 11,
24 please. And you can skip down to right there
25 (indicating).



1 Now, we looked at a blank version of this 1101
2 B form earlier, but on this specific example
3 for 2012, and I believe for the record this is
4 their original 2012 return, why is the number
5 on line one a negative number?

6 A: Because they would have shown a loss on their
7 financial statements, a net loss.

8 Q: Okay. And then what does the number on line
9 two represent?

10 A: That represents the net of schedules A and B,
11 essentially, the reversal of the Schedule M-3.

12 Q: Okay. And that's what we talked about earlier?

13 A: Right.

14 Q: Okay. And so then the line three would be the
15 entire net income of the bank?

16 A: Correct.

17 Q: Okay. How does that compare -- you mentioned
18 earlier that Schedule M-1 and Schedule M-3 on
19 the federal tax returns, how does that compare
20 to those line items?

21 A: I would expect that line three would agree to
22 the column A of the second page of the Schedule
23 M-3, which is basically the total of financial
24 statement revenues and expenses.

25 MR. LUTHER: Okay. Ms. Hogan. if you -- if you



1 would skip down to I think it's page 17 of that
2 Exhibit.

3 Q: So along with their 2012 returns, did they also
4 provide a copy of their federal return? Let me
5 ask you this. Let me back up. Have you had a
6 chance to review these before?

7 A: I have looked at them, yes.

8 Q: So we're now on that same return for 2012, what
9 is this that we're looking at? Scroll down to
10 the bottom please.

11 A: This is a schedule M-1, which reconciles net
12 income or loss per books to the income before
13 net operating losses and special deductions
14 that would be transferred to page one of the
15 return.

16 Q: And so if we take that line one of M-1 and
17 compare it to line three on the very beginning
18 of the return, that's what you're saying should
19 be fairly similar; is that correct?

20 A: I believe they were, yes.

21 Q: All right. If we go back to the first page of
22 the 2012 return, what does that line four
23 represent?

24 A: That represents the amount of line three that
25 is attributable to South Carolina through



1 apportionment, which basically would be the
2 South Carolina revenues divided by total
3 revenues.

4 Q: Okay. And for 2012 on their original return,
5 what was that amount?

6 A: 77,300,000 and change.

7 Q: Okay. Now, can you -- let's go to Exhibit 13.
8 This is the amended, second amended 2012
9 return. Have you had a chance to review this?

10 A: Yes.

11 Q: Okay. I just want to compare the difference
12 between these two returns. So on line one,
13 that number is a negative number, again,
14 correct?

15 A: Yes.

16 Q: Okay. And then what have they done with line
17 two on this amended return?

18 A: Well, they've changed Schedule A and B to equal
19 the amount of loss to get back to a zero total
20 net income.

21 Q: Okay. And you say they changed Schedule A and
22 B?

23 A: Yes.

24 **MR. LUTHER:** Can you flip down to the next page that
25 shows Schedule A and B?



1 Q: Okay. How have they done that?

2 A: This is identical to this -- this is identical
3 to the previous, the first return, except that
4 they have added an amount on line 12 as a
5 deduction for \$712 million of net operating
6 loss carryovers, whereas, the only place on the
7 return where a federal net operating loss is
8 supposed to be shown is up on line five as an
9 add back of any net operating loss that's been
10 claimed on the federal return.

11 Q: And I think it says there on that line, see
12 attachment one; is that correct ---

13 A: Yes.

14 Q: --- where they made the adjustments?

15 A: Yes.

16 MR. LUTHER: Can you skip over to attachment one?
17 Flip that over.

18 Q: Can you explain how they've done that here on
19 attachment one?

20 A: Yeah, they basically shown that they're
21 starting out with the same number for -- on
22 line one for federal income per the tax return
23 that negative 91 million. They've added back
24 the 804 million of adjustments on Schedule A
25 and B as represented to come to a total net



1 income, and the 804 excludes that line item for
2 net operating loss, so that would be equal to
3 the amount that was originally shown on line
4 two of the initial return.

5 Q: Okay.

6 A: But then they have deducted from the net on
7 line three total net income subject to
8 apportionment -- oh, okay, to show that they're
9 going to assert a deduction for the apportioned
10 NOL of 77 million.

11 Q: Does ASC 740 have anything to do with that line
12 8 calculation?

13 A: No.

14 Q: Do you know what the basis would be for
15 including that calculation in this attachment?

16 A: There was a four page explanation in the
17 amended returns to the basis for allowing that
18 deduction.

19 Q: Okay. Do you have an opinion on whether this
20 calculation for purposes of determining the
21 bank tax liability is correct?

22 A: I think it is wrong.

23 Q: Okay. And why is that?

24 A: Because they are trying to take a net operating
25 loss, which is a product of tax law and claim



1 it as a reduction in net income, which, again,
2 as we discussed earlier is a product of
3 financial accounting law, or financial
4 accounting principles and the two do not mesh.

5 Q: All right. Mr. Beck, I'm going to wrap it up
6 here. In your opinion, is book income as
7 determined by GAAP a reasonable proxy for
8 entire net income?

9 A: I believe it is. There's really no other
10 process by which a bank would determine net
11 income, and to interpret entire net income
12 meaning anything and all of the income plus
13 expenses that are shown on the financial
14 statements as anything else I think would be
15 beyond the way that ASC 740 works with -- for
16 financial recording purposes.

17 Q: Okay. In your opinion is GAAP a reasonable
18 standard for determining the tax base of a bank
19 for South Carolina bank tax purposes?

20 A: I think it is reasonable on the basis that
21 there is no other alternative that would, at
22 least in my opinion, be a better guide.

23 Q: In your experience as an accountant with banks
24 in South Carolina, were banks allowed to claim
25 a net operating loss deduction in calculating



1 their tax?

2 A: Not in my experience.

3 **THE COURT:** Whoa, whoa, say that again.

4 Q: Sure. In your experience as an accountant for
5 banks in South Carolina, were banks allowed to
6 claim an NOL deduction in calculating their
7 bank tax?

8 A: Not in my experience, no.

9 Q: In your opinion, does GAAP, or ASC 740 create
10 a tax deduction for NOL carryforwards that can
11 be used to reduce a bank's tax liability in
12 South Carolina?

13 A: No.

14 Q: Okay. So in your opinion, was it proper for
15 Synovus to reduce its entire net income to zero
16 by claiming an NOL carryforward deduction on
17 its return?

18 A: I do not believe so.

19 **MR. LUTHER:** Mr. Beckwith, I thank you. Those are
20 all the questions I've got for you. Thank you.

21 **MS. CUTTINO:** Your Honor, can we take a two minute
22 break.

23 **THE COURT:** Yep. Thank you.

24 **(A break was taken from 3:11 p.m. to 3:22 p.m.)**

25 **THE COURT:** Be seated.



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1 You're going to make all this clear?

2 **MS. CUTTINO:** Yes, sir. I will accept the
3 challenge.

4 **MR. BECKWITH - CROSS-EXAMINATION BY MS. CUTTINO:**

5 **Q:** All right. Mr. Beckwith, I have some questions
6 for you following your testimony. Now, you
7 testified that the books include the income
8 statement, the balance sheet, the cash flow,
9 and your changes to the shareholder form,
10 correct?

11 **A:** The financial statements, yes.

12 **Q:** Now, when we look at these four examples you've
13 given us, I see the income statement. Where's
14 the balance sheet on here?

15 **A:** The tax footnotes show the items in the balance
16 sheet for deferred tax assets, which is the
17 first section. I mean, to show all of those on
18 the same -- on the schedule would be very hard
19 to see, but the ---

20 **THE COURT:** Can you put that back up to on the
21 screen for me?

22 **MR. LUTHER:** This one here, the comparison?

23 **THE COURT:** Yeah.

24 **MS. CUTTINO:** I don't know which one that was,
25 Jason. It was the last one he did.



1 MR. LUTHER: I can put it up on the Elmo.

2 THE COURT: All right. Go ahead.

3 Q: So you've shown us what's going to happen to
4 the income statement, correct?

5 A: Correct.

6 Q: And your point was that the income statement
7 does not change after you take the deferred tax
8 asset, correct?

9 A: Correct so that the net income does not change.

10 Q: But don't you agree that the balance statement
11 does change?

12 A: The balance sheet will change to the extent
13 that deferred income taxes increase or
14 decrease, but at the same time the accounts --
15 the current income tax receivable or payable
16 will decrease or increase by any corresponding
17 amount ---

18 Q: And -- go ahead. I'll let you finish. I'm
19 sorry.

20 A: --- so I don't consider that necessarily
21 relevant to the point I was trying to make
22 there.

23 Q: All right. But the point we're trying to
24 determine in this hearing is whether or not net
25 income is an appropriate substitute -- whether



1 or not GAAP is an appropriate substitute for
2 net income, correct?

3 A: I think what we're trying to decide is if net
4 income is a GAAP based concept. It's not a
5 substitute. It is the compilation of rules
6 under which net income is computed.

7 Q: Do you believe that GAAP ---

8 **THE COURT:** You said net income is the compilation
9 of rules upon which GAAP is computed; is that
10 what you said?

11 A: Net income is a product of a compendium of
12 accounting rules that we refer to as GAAP.

13 **THE COURT:** Okay. I always thought it was the
14 opposite.

15 A: So GAAP is what determines the amounts of
16 revenues and expenses that show up on the
17 income statement.

18 **THE COURT:** Okay.

19 Q: Now, if we look at your example and how the
20 income statement is not impacted, if you have
21 expenses where you were not allowed to deduct
22 all of those expenses in year one ---

23 A: Correct.

24 Q: --- it's your opinion that you just lose those
25 expenses in future years?



1 A: I'm not sure exactly what you're getting at,
2 but you can see how the -- as far as the book
3 loan loss is concerned how those temporary
4 differences carry forward to the next year and
5 any increase or decrease impacts the current
6 tax calculation but also impacts the deferred
7 tax calculation so that overall income tax
8 expense for the financial statements does not
9 change.

10 Q: But if it's on a deferred tax asset, it's your
11 opinion that in South Carolina on the bank tax,
12 you cannot take those expenses in future years,
13 correct?

14 Q: Are you referring to the situation where you
15 created a net operating loss?

16 Q: Yes.

17 A: That is correct because a net loss on the
18 financial statements is used in the statement
19 of shareholder equity to reduce shareholder
20 equity which then becomes a basis for the next
21 year's change in shareholder equity statements.
22 See, to try to say that financial statement
23 income would take that net loss and apply it to
24 a future year would be just double counted in
25 shareholder equity.



1 Q: And you told me that the books include the
2 shareholder equity, the cash flow, the balance
3 statement and the income statement?

4 A: Correct.

5 Q: So it is an accurate statement to say that a
6 deferred tax asset does impact all of those
7 statements because you do see it in all of
8 those statements at some point in time,
9 correct?

10 A: I supposed I wouldn't object to that. I don't
11 know what you mean by it, but ...

12 Q: Now, in your statement when you're talking
13 about when you look at your compilations here
14 when you're talking about the South Carolina
15 bank tax, aren't you making the assumption that
16 net income only means the income statement?

17 A: I don't believe it's an assumption, I would say
18 it is a -- in my mind it's a fact but it is a
19 concept that is uniformly applied throughout
20 the accounting practice.

21 **THE COURT:** So that would be a fact based on
22 principles?

23 A: Yes, on GAAP.

24 Q: Based on GAAP?

25 A: Yes.



1 Q: All right. Now, the South Carolina statute
2 does not use the term "net income" in
3 isolation, does it?

4 A: The term "entire" is attached in the
5 legislation. As I said earlier, I think the
6 term "entire" is a descriptive term to the
7 concept of net income. It is in my estimation,
8 it's duplicative, I believe, because for GAAP
9 purposes all revenue and all expense is already
10 included in the determination of net income.

11 **THE COURT:** All right. So entire net income is
12 descriptive, but it is also duplicative; is
13 that what you're telling me?

14 A: Duplicative you mean by ---

15 **THE COURT:** No, I thought that's what you said.

16 A: Oh, I might have said that. Yes, I mean in the
17 ---

18 **THE COURT:** It doesn't describe a whole lot if it's
19 duplicative.

20 A: I believe the term was unnecessary in the final
21 determination of net income, but in -- I'm
22 trying to remember if it was a regulation or a
23 ruling, and it was pointed out that entire net
24 income meant income from all sources including
25 nontaxable income. So it's my belief, opinion,



1 whatever, that what the legislature would have
2 been getting at by adding the word "entire" is
3 to make sure that nontaxable income, for
4 example, and state and local bonds would be
5 included in the term net income.

6 **THE COURT:** Okay. Go ahead.

7 Q: Now, Mr. Beckwith, I believe you're referring
8 to the attorney general's opinion ID 189, and
9 if you want to refer to it, it's found in
10 Exhibit 25, Bates Number 1377.

11 A: Exhibit what again?

12 Q: Twenty-five.

13 A: Where is that again?

14 Q: It's on Bates number 1377 at the bottom, SC
15 1377.

16 A: SC 1377. Well, that's one place where I've
17 seen that, but there was a -- I'd have to refer
18 back to my notes to find the exact site, but I
19 believe it was 1500 dash or 1500 point -- I
20 think it was the regulation for a -- some kind
21 of an explanatory pronouncement from the
22 Department.

23 Q: All right. Well, let's start with this one.

24 A: Okay.

25 Q: Because what you just testified to was that you



1 believed entire net income meant all income,
2 but this opinion doesn't limit entire net
3 income to all income. It limits it and
4 construes it to mean all income from whatever
5 source derived less all expenses incurred,
6 correct?

7 A: Uh-huh, correct.

8 Q: So you also have to include all expenses that
9 have been incurred?

10 A: That's correct.

11 Q: All right. Now, in this same exhibit, let's
12 turn over to SC 1380.

13 A: Uh-huh.

14 Q: Are you looking at the -- this is the one
15 that's double Bates numbered. Are you looking
16 at the one that's the 1948 attorney general's
17 opinion?

18 A: Yes.

19 Q: And you agree with me that in the 1948 opinion,
20 and I'm looking at the bottom paragraph, it
21 says that banks are permitted to deduct all
22 expenses incurred in the operation of their
23 banks, correct?

24 A: Including federal and state income taxes.

25 Q: Correct.



1 A: So all of those items that are listed on the
2 income tax -- or income statement would be
3 deducted against the -- all income from
4 whatever source in that particular period.

5 Q: In your examples, do you have an example of
6 what happens if you have more expenses in one
7 year than you have income?

8 A: Yes, I do.

9 Q: Which one?

10 A: It would be number three, four, and five. It's
11 the one to your far left, I believe.

12 Q: This one, correct?

13 A: Oh, yeah -- no, yes. Yes, that one.

14 Q: Is this the right one?

15 A: Yes.

16 Q: Now, do you have more expenses than you have
17 income in the year incurred, correct?

18 A: Correct.

19 Q: What happens to those additional expenses that
20 you were not allowed to deduct in year one?

21 A: Well, for financial reporting purposes that's
22 not what happens. The income statement shows
23 the results of operation for a particular
24 period and as I said earlier, in the case where
25 it shows year two, where it has a \$1000 of



1 expenses against \$900 of revenue before income
2 taxes, the bottom line \$70 loss then goes to
3 the statement of shareholder's equity to reduce
4 shareholder's equity from the beginning to the
5 end of the year.

6 Q: And then you don't see that expense again on
7 the income statement, correct?

8 A: Correct. You never see it again.

9 Q: So you believe you're never allowed to take a
10 deduction for those additional expenses,
11 correct?

12 A: For financial accounting purposes, you do not
13 take expenses from one year and apply them
14 against net income for another year.

15 Q: And so that means ---

16 **THE COURT:** The thing that I never saw in here was
17 the NOL -- the carryforward.

18 A: Uh-huh.

19 **THE COURT:** It pretty well went away because the
20 reason it went away is it went to the
21 shareholder's equity and reduced that equity
22 and, therefore, made everything balanced and
23 then we moved forward.

24 A: Are you talking about the \$70 net loss?

25 **THE COURT:** Yeah.



1 A: That is not a net operating loss. That is a
2 net loss in financial accounting terms. Net
3 operating loss is a product of tax law.

4 **THE COURT:** All right.

5 A: Which is my point. There are two different
6 things. In the net loss ---

7 **THE COURT:** So you've never used net operating loss
8 in this, did you? Which one did you use?

9 A: I'm sorry. Could you ask that again?

10 **THE COURT:** Well which phrase did you use? You said
11 there's net operating loss which is ...

12 A: Tax.

13 **THE COURT:** Tax. And then there's net loss.

14 A: The net loss is used to show the reduction in
15 the equity available to shareholders at the end
16 of the year.

17 **THE COURT:** I don't mean to be interrupting you, but
18 how does net loss and net operating loss affect
19 one another, or do they?

20 A: They might not. They might not have any
21 relationship. You could have a net loss for
22 financial statement purposes, and have a net
23 income, net taxable income on your returns, or
24 vice versa. You could have a net loss for
25 financial reporting purposes -- or a net



1 income for financial reporting purposes and you
2 could have a net operating loss for tax
3 purposes. They are two different -- two
4 different animals.

5 **THE COURT:** All right.

6 Q: So your testimony is that under GAAP, NOLs
7 would not impact entire net income even if the
8 state bank tax explicitly allowed NOLs?

9 A: If the state bank law said you can take a net
10 operating loss, in however they defined it, and
11 include it in the computation of the tax base,
12 then I couldn't argue against that, but that's
13 not what it says.

14 Q: And you would not find it on the income
15 statement, correct?

16 A: It wouldn't show up on the income statement, it
17 would show up in the computation of tax expense
18 or benefit.

19 Q: Do you believe it's appropriate for a bank in
20 South Carolina -- now, the department has said
21 entire net income equals GAAP. I think I heard
22 you just say that GAAP is financial accounting,
23 and under financial accounting, you do not look
24 at income and expenses beyond one year; is that
25 what you said?



1 A: I think so.

2 Q: All right. Are banks in South Carolina allowed
3 to take certain credits?

4 A: Yes.

5 Q: And do they take those credits in years other
6 than those in which they are incurred?

7 A: If they're not used in the year in which they
8 are incurred, there is a specific provision
9 that allows for the carryover of those credits,
10 and the law -- I believe the law usually
11 indicates whether or not those credits are
12 available for personal purpose -- for usage
13 against the bank tax.

14 Q: Do you know if the Department believes that
15 those credits must specifically include the
16 bank tax?

17 A: You mean must be utilized against the bank tax?

18 Q: No, if there is a credit, do you believe the
19 Department's position is that those credits
20 must be affirmatively approved in the statute?

21 A: I'm sorry. I didn't hear the last couple ---

22 Q: Do you believe it's the Department's position
23 that those credits must be affirmatively
24 approved in the statute?

25 A: I assume that's correct having prepared returns



1 with credits that have had to be carried over.
2 Basically, we looked through the statute for
3 the -- I believe it's usually in the statute to
4 see whether or not those credits are
5 specifically allowed to offset the bank tax
6 liability.

7 Q: Now, I'm going to be looking at Exhibit 26.

8 A: Okay.

9 Q: This was the public draft we looked at earlier.

10 A: Uh-huh.

11 Q: This draft was never made final, was it?

12 A: To my knowledge, no.

13 Q: All right. And I'm looking at footnote 11 on
14 page 10.

15 A: Okay. Footnote 11. Okay.

16 Q: Yes. And this was published by the Department
17 -- well, the draft was put forth by the
18 Department, correct?

19 A: Yes.

20 **THE COURT:** You could blow that up, if you wish,
21 there's symbols of people on the top of the ...

22 Q: All right. And footnote 11 says, "Although the
23 bank tax is a franchise tax and not an income
24 tax, because the bank tax chapter is titled
25 income tax on banks, the Department believes



1 that the legislative intent was to allow income
2 tax credits against the bank tax if the
3 language of the credit does not limit the
4 credit to income taxes in Chapter 6," correct?

5 A: Right.

6 Q: Why would the intent of the legislature have
7 been to treat credits one way and deductions a
8 different way?

9 A: Well, credits are used to incentivize certain
10 behaviors. A big one for banks is the job tax
11 credit. So to include banks in the process of
12 being incentivized to hire additional full time
13 equivalents, they, apparently, wanted to design
14 the legislation so that that was allowable and
15 basically the same for the rest of the credits
16 that are -- that we were just looking at.

17 Q: But when we're looking at financial accounting,
18 you don't see those credits on the income
19 statement, do you?

20 A: You would see them to the extent that they were
21 earned and recorded as an income tax benefit in
22 the year that they were earned.

23 Q: But you wouldn't see them in the future years
24 that you have to take them, correct?

25 A: Only to the extent that they reduced current



1 taxes payable and increased -- and reduced
2 current -- I'm sorry. Only to the extent that
3 they would reduce current taxes payable and
4 reduce deferred tax assets.

5 Q: Which would not be reflected on the income
6 statement?

7 A: Correct, well, it would be reflected in the
8 footnotes like I've shown on these examples.

9 Q: And you testified that on the examples you
10 don't bring the footnotes over onto the bank
11 tax form. You only take the one line, correct?

12 A: Yes, but they do agree. The footnotes provide
13 additional information for the reader to
14 understand how those net amounts on the income
15 statement were computed.

16 Q: All right. Now, you also talked about the
17 Synovus forms that they actually filed with the
18 bank. If Synovus believed that net operating
19 losses were allowable in South Carolina, which
20 they do ---

21 A: Uh-huh.

22 Q: --- isn't putting them on that form the only
23 way to challenge the denial? Don't you
24 actually have to have a denial before it can be
25 challenged?



1 A: I believe they would have to file a return
2 reflecting that and then when the claim was
3 rejected by the Department, then they would
4 have to bring a court action to challenge that
5 result.

6 Q: And that's exactly what happened here, correct?

7 A: Yeah.

8 Q: All right. Let's assume that NOLs are allowed
9 in South Carolina for the banks ---

10 A: Okay.

11 Q: --- does the bank tax form work?

12 A: Not really.

13 Q: All right.

14 A: Because if you look at the Schedule A and B for
15 2012 that we looked at earlier, Synovus had to
16 create a separate line for the use of that net
17 operating loss they're saying is allowable in
18 South Carolina.

19 Q: And what if we're not under a GAAP NOL
20 carryforward, what if we just have additional
21 expenses that were incurred in one year that we
22 did not deduct that we would like to deduct in
23 year two when we have profits?

24 A: You would be disappointed.

25 Q: Is there a place on the form for that to be



1 allowed?

2 A: No.

3 Q: All right. So the form doesn't allow it,
4 correct?

5 A: Well, the form reflects the tax law and the tax
6 law does not allow any expenses incurred in one
7 year to be carried forward and offset against
8 another year.

9 Q: Where does the tax law say that?

10 A: Pardon me?

11 Q: Where does the tax law say that?

12 A: By adopting GAAP net income concept. The --
13 for GAAP purposes, the excess losses for
14 financial statement purposes are claimed, are
15 displayed in the year that they originate, and
16 as I said before, they're used to reduce
17 shareholder's -- the equity available to
18 shareholders at the end of the year. They do
19 not get pulled out of year two, in my example,
20 and used in year three for financial reporting
21 purposes.

22 Q: And for you to make that statement, haven't you
23 made the assumption of two of the ultimate
24 legal conclusions in this case that a Court
25 should decide?



1 Number one, aren't you assuming that GAAP
2 equals financial accounting under the bank tax?

3 A: Well, I suppose I am assuming it, but that is
4 common practice for as long as I understood.
5 Even for returns that were prepared prior to my
6 coming to South Carolina that I've reviewed in
7 the past.

8 Q: And aren't you assuming that this Court
9 determines that net operating loss
10 carryforwards are not allowed for the bank tax
11 under GAAP?

12 A: Right, but I don't know that I'm being asked to
13 make any opinion on the law -- on law to that
14 extent.

15 Q: I'm just making sure that we're all clear that
16 your answer assumes those conclusions are made?

17 A: Correct.

18 Q: Now ---

19 **THE COURT:** You said your answers and examples; is
20 that what you're talking about?

21 **MS. CUTTINO:** Yes.

22 Q: The bank tax form also doesn't work for state
23 tax credits, which the General Assembly
24 explicitly allows for banks, does it?

25 A: There are separate forms that are attached to



1 the bank tax return. I think it's TC 1120 or
2 something like that -- and, actually, there
3 were some in some of Synovus' returns that I
4 looked at, which compute and keep track of the
5 credits that are used and those credits that
6 have to be carried forward to future years.

7 Q: Does the state tax credit carryforward violate
8 GAAP?

9 A: The state tax credit carryforward has no impact
10 for GAAP because it's a product of state laws
11 as opposed to financial accounting principles.

12 Q: And you take it after you get your net income,
13 correct?

14 A: Well, you would use it in the determination of
15 the income tax expense for the year in which
16 those credits arise.

17 Q: Now, you repeatedly said in various ways that
18 in your experience, the bank tax bank -- the
19 banks in South Carolina use GAAP, correct?

20 A: Yes.

21 Q: Now, if those are publicly traded banks, they
22 must use GAAP, correct?

23 A: I believe all banks in South Carolina are now
24 required to use GAAP. In years past, and I
25 think this changed in the -- maybe the late 60s



1 or 70s. There were banks that were allowed to
2 report for regulatory purposes on a cash basis,
3 and they maintained their general ledgers on a
4 cash basis, but as I recall, the regulators
5 changed that policy probably because of the
6 advent of more available accounting programs to
7 require that all banks use accrual basis
8 accounting under GAAP to report for federal
9 purposes and for those banks that are SEC
10 filers, they are required to use GAAP.

11 Q: Now, the regulations that are on the books in
12 South Carolina say that you can use accrual or
13 cash based methods for your accounting in your
14 banks?

15 A: Yeah, I believe the cash method is kind of a
16 holdover from previous periods that would imply
17 that a bank could do an accrual to cash
18 conversion and report on that basis, but I've
19 never seen that in practice.

20 Q: So you believe the regulation is just wrong?

21 A: I believe there is some dead wood in the
22 regulations that probably needs to be cleaned
23 up.

24 Q: Do you agree that GAAP cannot be cash based
25 accounting?



1 A: Yes.

2 Q: Do you believe it would be improper for a bank
3 to have one set of books on GAAP and one set of
4 books on cash?

5 A: I think it would be very cumbersome to try to
6 manage both. I don't believe I've ever
7 encountered any that did. I don't know why
8 they would.

9 Q: But they could?

10 A: It's technically possible, I suppose.

11 Q: All right. Does the Internal Revenue Code
12 allow you to use cash based accounting?

13 A: Only for small companies. There's a gross
14 income limit on companies that can use cash
15 basis accounting. From my experience, I don't
16 know of any banks in South Carolina that would
17 be small enough to use cash basis accounting
18 for federal income tax purposes.

19 Q: Have you represented all of the banks in South
20 Carolina?

21 A: Of course not.

22 Q: Does the tax form ask a bank what method of
23 accounting it is using?

24 A: The Federal form does. I can't remember if the
25 state form does or not. I would have to look



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1 at it.

2 Q: I believe it is Exhibit ---

3 A: You know, I may have misspoke. A new bank that
4 is just starting up may be able to file on a
5 cash basis until they reach a certain gross
6 receipt level.

7 Q: And why is that?

8 A: Because like I said the ability to use cash
9 basis is limited to certain smaller companies
10 that have gross revenues under whatever the
11 limit is at that point in time.

12 Q: And when you're a start-up bank, you're allowed
13 to use a cash basis because when you're
14 starting up, it can take a while for your
15 profit to match your expenses, correct?

16 A: That provision is not specifically targeted
17 towards banks. It doesn't mean that they can
18 provide regulatory reports on the cash basis,
19 however, or financial statements on a cash
20 basis.

21 Q: Well, now, when Mr. Branch was testifying, and
22 I asked him what was the difference in cash and
23 accrual based accounting, he explained that
24 when you have cash-based accounting, you don't
25 actually count the money until you actually get



1 it in your hand. And so when you have new
2 startups, it takes a while for their income and
3 revenues to be higher than their expenses,
4 correct?

5 A: That is true in the banking industry.
6 Generally, the cash basis is supposed be
7 available to smaller companies for a longer
8 period of time that just happen to have very
9 small revenues and expenses.

10 Q: And so that under a cash basis, it does allow
11 you to take all expenses as a deduction in
12 multiple years until you're profitable,
13 correct?

14 A: All expenses paid. All expenditures would be
15 a better word for it and all revenues received.

16 Q: All right. Now -- now, I asked you this
17 question and I don't think you answered it.
18 Would you like to look at Exhibit 45?

19 And my question to you was, "Does the bank form
20 ask a bank if they are reporting on a cash or
21 accrual basis?"

22 "I will tell you I don't think that it does but
23 correct me if I'm wrong."

24 A: I don't see it on page one. I doubt if it's on
25 another page but the bank would attach a copy



1 of its federal form to the bank tax return when
2 it's filed and the federal form does ask the --
3 whether it's a cash basis, accrual basis, or I
4 think it's just other method of accounting used
5 for reporting taxable income.

6 Q: All right.

7 A: So in a way, it's going to show up some place
8 in all the paper or electronics that are
9 forwarded.

10 Q: And now in your testimony, the DOR asked you to
11 I think read line one.

12 Line one of the bank tax form, you begin with
13 your federal taxable income, correct?

14 A: Correct, for the federal return, correct.

15 Q: And you actually said that wasn't a very good
16 way of starting, didn't you?

17 A: Well, it's not required by the law. I assume
18 somebody when they were designing these forms
19 way back when they were first put together
20 wanted a way to tie the federal attachment into
21 the amount that was reported on line three and
22 you basically get that by starting with federal
23 taxable income and reversing all of your book
24 tax differences.

25 Q: Because these forms aren't the law, right?



1 A: Well, I think it's the law when you get to line
2 three.

3 Q: Oh, so part of it is the law and part of it is
4 not the law?

5 A: I mean, there are a lot of things that are
6 included in returns for the ability of the
7 Revenue Department or IRS to understand the way
8 the final taxable income is reported.

9 Q: And on line one, federal taxable income
10 includes your federal NOL, correct?

11 A: Includes a federal -- well, it could show a
12 federal NOL in the year that the federal NOL is
13 created so that would be a negative number
14 there, or it could be in a year that the
15 federal NOL is used it would be a reduced
16 number that came forward on line 30, I believe
17 it is, of the form 1120, which is after the NOL
18 deduction for federal purposes.

19 Q: And the federal tax law wants you to take out
20 the federal NOL, correct?

21 A: They have you -- are you talking about the year
22 in which it's utilized?

23 Q: Assuming there is one, a carryforward?

24 A: Okay. If there's a carryforward used?

25 Q: Yes.



1 A: Okay. The schedule A and B have you add back
2 the net operating loss that was deducted on the
3 federal return.

4 Q: All right. And then you add back several items
5 to taxable income, correct?

6 A: And subtract several items.

7 Q: All right. Let's talk about the ones you add
8 back. You add back income from federal
9 obligation bonds, correct?

10 A: Yes.

11 Q: As well as interest earned from state and local
12 debt that are not subject to ---

13 **THE COURT:** Hold up. What was your first question?

14 Q: Let's just start with the bond ones. You add
15 back income from federal obligation bonds,
16 correct?

17 A: Not federal.

18 Q: What bonds do you add back?

19 A: Just state and local. Federal -- federal
20 bonds, income on federal bonds is taxable for
21 federal tax purposes, so it's already recorded
22 in -- it's already included in federal taxable
23 income.

24 Q: And you add back those bonds?

25 A: No, you don't make any adjustment for those.



1 Q: For your state and local bonds, I'm sorry.

2 A: For state and local bonds they are -- the
3 interest on most state and local bonds,
4 although, there are some that are taxable --
5 the interest on state and local bonds is
6 nontaxable on the federal return, so they're
7 telling you to add it back here, so that you're
8 going to increase the number shown on line one
9 by the amount of the deduction that was shown
10 on Schedule M-3 of the federal return.

11 Q: And are you instructed to add back those state
12 and local bonds back on the bank tax because of
13 GAAP?

14 A: No, because all you're doing here is basically
15 working your way from federal taxable income
16 back to net income.

17 Q: All right. But you do add back those taxable
18 state and local bonds because the attorney
19 general opinion says it's a bank tax and you
20 tax all income, correct?

21 A: Uh-huh. I guess, you could say that, yeah.

22 Q: Then why on their form is there not a place to
23 also deduct all expenses?

24 A: Well, all deductible expenses are already
25 factored into the computation of federal



1 taxable income.

2 Q: Did the attorney general's opinion say all
3 deductible expenses, or did it just say all
4 expenses?

5 A: It did not address -- I think it said all
6 expenses including income taxes.

7 Q: So if we only add back additional income, and
8 we do not include all expenses as a deduction,
9 aren't we being inequitable because we're only
10 looking at profit, we're not also accounting
11 for losses?

12 A: No, if you look down to line 14, for example,
13 federal income tax which is not deductible in
14 computing federal taxable income is deducted in
15 the process of these schedules in getting from
16 federal taxable income to the net income. So
17 it's basically taking all of the deductions
18 that were not allowed for the federal return
19 and adding them and taking them here as a
20 deduction for state purposes, but like I said,
21 schedule -- line one on Schedule A and B are
22 not necessarily -- they're not required by the
23 law but they're a means by which I think the
24 Department can take that federal attachment and
25 reconcile it back to net income on the face of



1 the return.

2 Q: And so is it your belief that under line 14 you
3 could add back an expense that you incurred in
4 year one but could not take because you had no
5 profit?

6 A: No.

7 Q: Could you add it back in year two when you
8 actually had profit to be able to take a
9 deduction on?

10 A: No, you're only adding -- you're only taking a
11 deduction on line 14 for the federal income tax
12 that was not allowed on the federal return for
13 that year.

14 Q: Right. And I am asking you, do you believe
15 it's appropriate to be able to take a deduction
16 for all expenses regardless of whether or not
17 you take it in the year in which it is
18 incurred?

19 A: No, I think you have to take the expenses as an
20 expense for financial reporting purposes and
21 for South Carolina purposes in the year in
22 which they're incurred.

23 Q: So if you cannot take it in the year in which
24 it's incurred, you're just out of luck?

25 A: That tends to be the net effect. So if you



1 have a net loss on line three, your tax is
2 zero, and you have no ability to recover any
3 taxes based on that excess loss.

4 Q: Now, book income is not defined in GAAP,
5 correct?

6 A: Book income is not, net income is.

7 Q: Is entire net income defined?

8 A: Not in the -- the phrase "entire" is not
9 attached to net income in GAAP.

10 Q: And I thought it was interesting in your
11 testimony you were very careful to only use the
12 term "net income" when you referred to
13 financial accounting. You did not use the term
14 "entire net income" ---

15 A: Right.

16 Q: --- is that correct? Because you believe
17 there's a difference in the two terms?

18 A: Because financial reporting only uses the
19 phrase net income.

20 Q: And is your testimony dependent on entire net
21 income meaning financial income?

22 A: Meaning I would say that I believe entire net
23 income is the same as net income as determined
24 under GAAP for financial reporting purposes.

25 Q: With your bank tax clients in South Carolina,



1 did you allow them to take ordinary and
2 necessary business expenses?

3 A: I guess so, yeah.

4 Q: And is that a deduction?

5 A: Right, yes.

6 Q: Does the bank tax specifically state that you
7 can take an ordinary and necessary business
8 deduction in South Carolina?

9 A: By reference to comparing net income or as I
10 have equated net income that's implicit in the
11 return because net income includes a -- net
12 income includes a reduction of revenues for
13 expenses incurred during the period.

14 Q: And it's all right for that to be implicit?

15 A: I don't know why it wouldn't be.

16 Q: All right. How about charitable deductions?
17 Did your bank clients take charitable
18 deductions on the South Carolina state bank
19 return?

20 A: I believe that they did.

21 Q: Are charitable deductions specifically outlined
22 in the South Carolina bank tax?

23 A: In chapter 12, section 6, I believe it's going
24 to refer to it. Charitable deductions are, I
25 believe limited for regular corporate tax, but



1 there's no reference in section 12 to indicate
2 -- section 11 to indicate that banks cannot
3 take that deduction.

4 Q: And that's the same as a net operating loss
5 carryforward, which is also found on Chapter 6,
6 correct?

7 A: Chapter 6 would only allow the net operating
8 loss for non-bank corporations.

9 Q: But it's identical to the charitable deduction
10 that you allow your banks to take, correct?

11 A: No, I'm saying they're both -- well, the
12 charitable deduction that's allowed for bank
13 tax purposes implicitly by the reference to
14 entire net income is an amount that's already
15 expensed on the financial statements for that
16 period. The net operating loss is not an item
17 that is ever expensed on a financial statement.

18 Q: It's on the balance sheet, correct?

19 A: You may have a net loss in a year, but you
20 don't have a net operating loss. There's no
21 such thing. The only place where net operating
22 loss is relevant in ASC 740 is in the
23 determination of taxable income or income tax,
24 not in the determination of net income or
25 expenses on the financial statement. It only



1 relates to the termination of the income tax
2 expense or benefit.

3 Q: Which you find on the financial statements and
4 the balance sheet, correct?

5 A: And what?

6 Q: The balance sheet. That's where you see the
7 carryforward?

8 A: No, you see the deferred tax asset, which is
9 not the same as a net operating loss. The
10 deferred tax asset is the tax equivalent, the
11 tax effective amount of the net operating loss
12 to show the amount of taxes that the bank would
13 expect to recover in future years if that loss
14 is allowed on the federal return.

15 Q: But the net operating loss carryforward is a
16 deferred tax asset that you see on the balance
17 sheet, correct?

18 A: Net operating loss carryforward is a temporary
19 difference which converted to tax benefit is
20 part of your deferred tax assets.

21 Q: That you see on the balance sheet?

22 A: Yes.

23 Q: Which is part of your financial reporting?

24 A: Yes, but it's not a -- the deferred tax asset
25 gross is not any part of your financial



1 reporting except in the computation of income
2 tax expense, deferred income taxes and current
3 income taxes.

4 Q: Do publicly traded companies have an option as
5 to whether or not to follow GAAP?

6 A: Not to the extent that it creates a material
7 difference in the financial reports.

8 Q: And when you're a publicly traded company, you
9 don't get to pick and choose which portions of
10 GAAP you follow, do you?

11 A: Again, not to the extent that it would create
12 a material misstatement of a financial
13 position.

14 Q: And so you can't say to a client, I don't like
15 this GAAP section, it hurts you. Let's just
16 ignore it.

17 A: No, as a matter of fact, I've had to say the
18 exact opposite to a client one time. It was
19 very devastating.

20 Q: In fact, you would get in trouble with the SEC
21 if you told a publicly traded company to ignore
22 some section of GAAP, wouldn't you?

23 A: And with regulators.

24 Q: And now you testified earlier that you are
25 familiar with ASC 740, correct?



1 A: Uh-huh.

2 Q: And you agree that ASC 740 applies to the state
3 bank tax, correct?

4 A: To the extent that it is used to compute the
5 income tax, which is shown on the income
6 statement and used to reduce or increase net
7 income, I would agree with that.

8 Q: So you only believe you use part of ASC 740?

9 A: No, you use the whole thing.

10 Q: Because the bank tax is a tax based on income,
11 correct?

12 A: Because the bank tax is a tax based on net
13 income, entire net income, franchise tax based
14 on entire net income.

15 Q: And under ASC 740, the fact that we call it
16 franchise tax doesn't matter because we all
17 agree that the bank tax is based on income,
18 correct?

19 A: Any franchise tax that is based on income is
20 subject to accounting under section 740 as Mr.
21 Branch indicated.

22 Q: And the South Carolina bank tax, don't you
23 agree, it is based on income?

24 A: It is based on net income.

25 Q: And you agree, and I believe you testified in



1 your deposition today that banks in South
2 Carolina they can use the NOL in the year it's
3 created. It's your opinion that they cannot
4 use the NOL carryforward, correct?

5 A: Well, you say use the loss in the year it's
6 created. If the line three on the form 11 OMB
7 is a negative number, the bank tax is not a
8 negative number. It is just zero.

9 Q: All right.

10 A: And that loss that shows up on line three of
11 the 11 OMB for one year cannot be used on a
12 subsequent year's return to reduce that year's
13 net income.

14 Q: And you believe that to be true because there's
15 no specific South Carolina statute that says it
16 can be?

17 A: Correct.

18 Q: And you think that's different than your
19 charitable deductions that banks are allowed to
20 use?

21 A: Not different, because as I said, the
22 charitable deduction is an item that is
23 recorded as an expense on the financial
24 statements for the year in which they're
25 incurred, so it's already implicit in the net



1 income number.

2 Q: And you believe it's those expenses, all
3 expenses that you incurred, are greater than
4 your revenue ---

5 A: Uh-huh.

6 Q: --- that you lose all expenses in future years?

7 A: For bank income tax purposes, bank income tax
8 purpose that is the result.

9 Q: And there's no statute that says a bank can't
10 use an NOL carryforward, is there?

11 A: Not explicitly, the bank statutes do refer back
12 to the regular corporate income tax statutes,
13 but only for administrative other -- basically
14 giving the department the ability to administer
15 the bank tax.

16 Q: And there's no statute that says that you must
17 take all expenses in the year in which they are
18 incurred, correct?

19 A: Only through inference by the usage of the term
20 "net income".

21 Q: And, in fact, the attorney general's opinion
22 does not limit it to one year, correct?

23 A: I don't read it that way. What section was
24 that again? What example was that again?

25 Q: The 1948 attorney general's ---



1 A: Yeah.

2 Q: I think it's found in number -- in Exhibit 25.

3 A: Twenty-five, okay. And that was on ---

4 Q: 1380.

5 A: So what are you saying that the attorney
6 general's opinion says?

7 Q: In the bottom paragraph it says that banks are
8 permitted to deduct all expenses incurred in
9 the operation of their banks including federal
10 and state income taxes period.

11 A: Right. So all those expenses that are shown on
12 the financial statement net income -- financial
13 statement of net income are allowed for bank
14 income tax purposes as are all the revenues
15 that are shown on the income statement.

16 Q: And you're assuming that that means all of
17 those expenses can be taken in the year in
18 which they are incurred?

19 A: I'm not assuming. I'm saying that those
20 expenses are only reported in the year in which
21 they are incurred.

22 Q: Because if not, you believe that they are lost?

23 A: Well, for financial statement purposes, I've
24 said before, they're not really lost. They're
25 shown as a reduction in shareholder equity. In



1 other words, if the shareholders have
2 experienced a reduction in their net value of
3 the company because of the loss that was
4 incurred for that year for financial reporting
5 purposes.

6 Q: Now, would you agree with me that the word
7 "deduction", we're talking about a deduction on
8 taxes?

9 A: Yeah, federal and state taxes are part of the
10 -- are one of the expenses included in
11 determining that income.

12 Q: So if you can't take all expenses in year one,
13 you discount the use of the word "all" in the
14 attorney general's opinion like you discount
15 the use of the word "entire" in the bank tax
16 statute?

17 A: I don't think that's correct. Can you rephrase
18 that?

19 Q: Sure. What does entire mean?

20 A: All.

21 Q: All right. And you agree with me that the bank
22 tax statute says entire net income, correct?

23 A: Right.

24 Q: And you agree with me that net income means the
25 financial statements, correct?



1 A: I do.

2 Q: And all financial statements would include the
3 income statement, the balance sheet, the
4 shareholder's statement and the cash statement,
5 correct?

6 A: All financial statements, I suppose so, but the
7 only place where net income is determined is on
8 the income statement itself.

9 Q: All right. But we're not talking about net
10 income. We're talking about entire net income,
11 correct? The statute says entire?

12 A: Yes.

13 Q: And ---

14 A: So are you saying that there is income or
15 expenses recorded some place other than on the
16 income statement?

17 Q: I'm not saying anything.

18 A: Okay.

19 Q: And under the attorney general's opinion, it
20 says you're permitted to deduct all expenses
21 incurred in the operation of the banks?

22 A: Uh-huh.

23 Q: And you believe "all" there is somehow limited
24 only to the year in which that expense is
25 incurred?



1 A: Yes.

2 Q: Is your opinion essentially based exclusively
3 on the lack of a state statute authorizing
4 banks to take NOL carryforwards under GAAP?

5 A: I guess so.

6 Q: So your opinion doesn't really have anything to
7 do with GAAP or the FASB, does it?

8 A: It has everything to do with tax law as it's
9 applied in determining income tax expense under
10 GAAP and in the ASC 740.

11 **MS. CUTTINO:** Give me a moment. I'm checking off as
12 I go, Your Honor.

13 **THE COURT:** Okay.

14 Q: Now, you reviewed all of the Exhibit 25 in your
15 preparation, didn't you?

16 A: Actually, I can't say that I reviewed all of
17 it. I don't think as a packet of information,
18 I don't think I was provided that. I may have
19 reviewed it at some time in the past in context
20 of other engagements, but I don't think that I
21 reviewed the entire ...

22 Q: Isn't it true that you brought packet 25 to
23 your deposition as part of the file that you
24 reviewed in preparation for your opinion?

25 A: I don't remember that I did. This does not



1 look familiar to me except to the extent of
2 page SC 1377, which is the 1975 ruling that we
3 discussed earlier. I'm sorry. I don't
4 remember this explicit package except for that
5 one page I just remembered and -- oh, page SC
6 1382 I read before I believe.

7 Q: Well, that's all right. I can just keep going
8 and walk you through it.

9 A: I'm not sure I can answer that question.

10 Q: Did you review the Synovus 2014 financial
11 reports?

12 A: The financial statements or the returns?

13 Q: The annual report.

14 A: I believe I looked at it online from the SEC.
15 I don't think I have a copy of it.

16 Q: All right. Now, Mr. Branch testified that when
17 you look inside the 2014 financial report, you
18 see that the losses that we're actually talking
19 about in this case were primarily the result of
20 foreclosures that they incurred during that
21 financial downturn. Do you have any reason to
22 disagree with that?

23 A: No.

24 Q: Are those types of foreclosures the common
25 types of expenses that turn into NOLs?



1 A: Foreclosures and bad debt loan charge-offs
2 together in the year that the foreclosure is --
3 occurs in the year that the loans are charged
4 off are probably the largest piece of deduction
5 that would show up in the federal return that
6 created a net operating loss during the period
7 from let's say 2008 through 2012, '13, '14,
8 someplace in there.

9 Q: And do you agree with me that South Carolina is
10 generally a pro-business state in our policies,
11 taxes?

12 A: Yes, I think they are.

13 Q: And I'm going to point you to SC 1385 which is
14 contained within Exhibit 25.

15 A: Yep.

16 Q: So that Bates number at the bottom is 1385?

17 A: Yep.

18 Q: Are you aware that in 1983, a memorandum for
19 the record was issued by the Department in
20 which out-of-state banks who have mortgages in
21 South Carolina are allowed to file under
22 Chapter 6 of the income tax code instead of the
23 bank code?

24 A: I'm aware of that. I think that only applies
25 to banks that do not have banking operations



1 other than loans secured by real estate in the
2 state.

3 Q: So if one of these banks with mortgages in
4 South Carolina, suffered large losses and
5 foreclosures, they are allowed to file under
6 Chapter 6 and they are allowed to take a net
7 operating loss carryforward, correct?

8 A: To the extent that they're not considered to be
9 a bank in South Carolina, which would mean that
10 they would have to take deposits and make
11 loans. What you're talking about is probably
12 a loan production office, maybe, or just loans
13 for which a customer happened to own something
14 across the state line meaning a North Carolina
15 resident owns a piece of property in South
16 Carolina. To the extent that they're not
17 considered a bank, for South Carolina purposes
18 they were -- would be taxed under the regular
19 corporate law.

20 Q: But they are a bank?

21 A: Only in the states in which they conduct
22 banking operations as defined by law.

23 Q: All right. And these out-of-state banks,
24 foreign banks, they suffer foreclosure losses
25 ---



1 A: Uh-huh.

2 Q: --- exactly like Synovus did?

3 A: Okay.

4 Q: And the foreign banks are allowed to take a net
5 operating loss deduction under Chapter 6 but
6 your South Carolina banks are not?

7 A: Well, the South Carolina banks are allowed to
8 take the same deduction. It's just that if
9 that deduction causes net income to go
10 negative, there's no way for them to recover
11 that. Under Chapter 6, those banks would be
12 able to carry a net operating loss forward and
13 get a benefit out of those, but, again, as I
14 said it depends on whether those banks are
15 considered banks under South Carolina law.
16 Synovus, as I understand it, would have had
17 branches, physical presence in South Carolina
18 taking deposits, making loans, doing other
19 banking activities, so they are considered to
20 be a bank and subject to the bank income tax.

21 Q: But in one case the bank gets to take the NOL
22 carryforward and the other they don't, correct?

23 A: Correct.

24 **THE COURT:** You're doing okay over there?

25 **COURT REPORTER:** (Nods head.)



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1 MS. CUTTINO: I'm almost done, Your Honor.

2 THE COURT: No, I'm asking the court reporter.
3 You're fine.

4 Q: Now, when you were trying to determine what
5 entire net income means ---

6 A: Uh-huh.

7 Q: --- we all agree that there is no statute that
8 tells us what it means, correct?

9 A: Correct.

10 Q: Did you look at past Department determinations
11 to try to figure out what the Department does
12 when the statute is unclear?

13 A: I saw what the Department did as far as
14 determining -- as far as what their
15 determination was. I don't know what process
16 they went through. Are you talking about the
17 process or the end result?

18 Q: Well, let me ask you this. Would you agree
19 with me that on at least three prior occasions
20 that the Department has looked towards the
21 Internal Revenue Code when it is unclear what
22 the bank tax statute means?

23 A: I don't know how many times that's happened,
24 but I'm aware of at least one. If you have
25 references to those three, I can look at them.



1 Q: Yeah. That's what I'm doing. I've got too
2 many papers up here. Hold on one second.

3 MS. CUTTINO: Hold on one second. I'm sorry, Your
4 Honor.

5 THE COURT: I'm doing fine.

6 Q: Mr. Beckwith, I'm pulling -- the first one is
7 Exhibit 22, which is a private tax ruling 9510.

8 A: 9510.

9 Q: Yes, it's Exhibit 22.

10 A: Twenty two. I'm sorry. That's why it didn't
11 make any sense. I believe this one was cited
12 in the explanation, for the support that was
13 included with the 2012 amended return, so I
14 have looked at that.

15 Q: And so when the Department didn't know what to
16 do with the bank reorganization, they looked
17 towards the IRC?

18 A: Correct.

19 Q: And the next exhibit is Exhibit 23?

20 A: Okay.

21 Q: When the Department didn't know how to treat
22 banks that were operating in multiple states,
23 they looked to the IRC to determine how to
24 allocate and apportion, didn't they?

25 A: I doubt it. Allow me a second to read this,



1 would you please.

2 Q: Sure.

3 A: I don't see any reference to federal law in
4 this. I do see reference to ---

5 Q: And I may have misspoken.

6 A: --- the general tax law which as I recall, the
7 bank income tax sections, itself, do say that
8 they would look to Chapter 6 for purposes of
9 apportionment, and what this is talking about
10 is that they agreed that apportionment should
11 be done on the basis of essentially revenues
12 inside South Carolina and revenues everywhere.

13 Q: So they said that Chapter 7, which at that time
14 was a corporate income tax ---

15 A: Right.

16 Q: --- applies to multi-state banks for computing
17 the bank income tax under Chapter 11, correct?

18 A: Right. There was a specific provision under
19 Chapter 11 that indicates you look to Chapter
20 7 or 6, whatever it is.

21 Q: Do you know if that provision of Chapter 11 was
22 added before or after this opinion came out?

23 A: I don't. I don't.

24 Q: And the last one I want to direct you to is
25 Exhibit 24, which is ID 200.



1 A: Okay.

2 Q: And in this one, was it after a merger, did the
3 tax commission also look toward the IRC to
4 determine what to do?

5 And I'm looking at the statement that says the
6 South Carolina income tax has adopted the
7 reorganization provisions of, at that time,
8 Section 368 of the Internal Revenue Code.

9 A: Uh-huh.

10 Q: And so that's what they applied to a bank when
11 there was a problem, correct?

12 A: Yes, and as 9510 says, the ruling only applies
13 to reorganization transaction in question.

14 Q: So it's not unusual for the Department to look
15 toward the IRC or to the state corporate income
16 tax when the bank tax is not clear?

17 A: I don't know if it's usual, but it has been the
18 case if they determined it was appropriate to
19 use the nontaxable results found in the IRC
20 Section 368 when two banks merge.

21 Q: And it's your opinion that the bank tax is
22 based upon book income and book deductions,
23 correct?

24 A: The financial statements, revenue and expense,
25 yes.



1 Q: And you believe book refers to GAAP?

2 A: Yes, it's generally assumed that books will be
3 maintained on GAAP principles.

4 Q: And I believe you've already testified that
5 GAAP doesn't define book income?

6 A: Correct.

7 Q: And GAAP doesn't define entire net income?

8 A: Correct.

9 Q: Are there other accounting standards that are
10 appropriate to be followed?

11 A: For bank income tax purposes?

12 Q: Yes.

13 A: I guess if I understand the question I don't
14 think -- I can't think of any.

15 Q: If we have an international bank, can they
16 follow the international accounting standards?

17 A: You're getting a little bit out of my area for
18 -- I don't know if they can report on the
19 international standards when they're filing
20 their SEC reports or not. I suspect that they
21 cannot use international standards where they
22 disagree with the ASC. I suspect they cannot
23 use that for regulatory reporting purposes.

24 Q: But you don't know?

25 A: I do not know for certain. I couldn't point to



1 an authoritative who said that.

2 Q: Do you know what type of people make up the
3 financial accounting standards board, like who
4 sits on that board?

5 A: I haven't really paid a whole lot of attention
6 but I believe it's practitioners and academics.

7 Q: And do you agree with me that the financial
8 accounting standard boards have been
9 independent boards?

10 A: Yes.

11 Q: Do you agree with me that it's a private
12 nonprofit organization?

13 A: To the best of my knowledge.

14 Q: Now, do you agree with me that the corporate
15 income tax in South Carolina since conformity
16 is based on the federal tax code, the corporate
17 income tax in South Carolina?

18 A: The corporate income tax specifically says that
19 it uses federal taxable income as a starting
20 point and makes some adjustments such as
21 disallowance of accelerated depreciation.

22 Q: And the legislature does that each year by
23 formally adopting the portion of the federal
24 tax code that they believe are applicable and
25 then affirmatively excluding any parts that



1 they don't like, correct?

2 A: Yes, that's correct.

3 Q: And the legislature has to do that because they
4 cannot delegate away their taxing power without
5 affirmatively conforming to IRC each year,
6 correct?

7 A: I assume that's correct.

8 Q: Has the legislature ever formally adopted GAAP
9 like they do the federal code for the corporate
10 income statement?

11 A: Specifically, probably not because they're
12 working off of federal taxable income and not
13 adopting certain sections of federal taxable
14 income that they don't want to reflect in South
15 Carolina, corporate taxable income.

16 Q: Has the legislature ever adopted GAAP as the
17 interpretation of entire net income through
18 conformity with GAAP?

19 A: The legislature has been silent since the -- as
20 far as I know the legislature has been silent
21 since the original adoption of the bank income
22 tax law, so entire net income has been there,
23 as I understand it, from the very beginning.

24 Q: And at no point in time did the legislature
25 tell us to look to GAAP?



1 A: Right. I assume they did not believe it was
2 necessary to go beyond the vernacular of the
3 phrase.

4 Q: Even though GAAP is a third party nonprofit
5 organization?

6 A: I can't speak to that. I think you're getting
7 into areas of constitutional law.

8 Q: Do you know if the FASB today is -- can you --
9 do you have to be a member to access the FASB?

10 A: Typically you have to subscribe to some service
11 in order to log into the pronouncements and
12 everything.

13 Q: Do you know if the Department is a member of
14 any such service?

15 A: I have no idea.

16 Q: Would you agree with me that GAAP is a national
17 standard?

18 A: It's a US -- GAAP for US purposes is a national
19 standard, yes.

20 Q: And it's not limited to banks?

21 A: Not limited to banks, correct.

22 Q: Now the Department asked Mr. Branch about the
23 impact of any kind of court orders on the
24 application of the federal tax code on the bank
25 tax. Are you aware of this court or any other



1 court making any rulings whether or not the
2 income, the IRC is part of GAAP through ASC
3 740?

4 A: No.

5 Q: And in fact that's what we're here to figure
6 out, correct, at least partially?

7 A: I'm confused by the question, but I mean I
8 don't think -- I don't know whether or not the
9 court has ever addressed the concept of ASC 740
10 in terms of any type of tax.

11 Q: Hold on one second, Mr. Beckwith, I may be
12 done.

13 A: Can you rephrase -- can you reread that last
14 question to me?

15 Q: Sure. Are you aware of any court ever ruling
16 that ASC 740 does not include the IRC?

17 A: Oh, well, I -- 740 doesn't include the IRC it
18 only refers to it.

19 Q: And you're not aware of any court determining
20 that, correct?

21 A: No, but 740 does not incorporate federal tax
22 laws. It uses them to interpret the
23 calculations that are necessary under 740.

24 Q: So you don't believe that Mr. Branch was
25 correct?



1 A: I wouldn't say that. I just don't -- I guess
2 the way you phrased the question kind of ---

3 **THE COURT:** You can't pit witnesses in -- you cannot
4 pit witnesses in South Carolina anyway.

5 A: I'm sorry. What was that?

6 **MS. CUTTINO:** I'll withdraw that question.

7 A: Okay.

8 **MS. CUTTINO:** Hold on one second. Okay. I'm done.
9 Thank you, Your Honor.

10 **MR. LUTHER:** I will be very brief. If we need to
11 take a break, I'd be happy to do that.

12 **THE COURT:** Go ahead.

13 **MR. BECKWITH - REDIRECT EXAMINATION BY MR. LUTHER:**

14 Q: Mr. Beckwith, I think I asked Mr. Branch this
15 I want to clarify. Federal taxable income
16 starts with net income for the books, right?

17 A: Yes.

18 Q: So and to the extent most corporations use GAAP
19 as the accounting method, federal taxable
20 income begins with GAAP based net income,
21 correct?

22 A: Yes, Schedule M-3 requires a corporation to use
23 its applicable financial statement, which in
24 the case of the SEC would be the SEC report of
25 income.



1 Q: Okay. Let's just briefly look at M-3 just to
2 see that. If you could turn to Exhibit 47, I
3 believe.

4 A: Okay. Okay.

5 Q: And if you'll scroll down to line 4a you see
6 there it asks for your worldwide consolidated
7 net income from the income statement source,
8 right?

9 A: Right.

10 Q: And then it asks you on line 4b what your
11 accounting standard is?

12 A: Correct.

13 Q: And there are different options that you can
14 use, correct?

15 A: Uh-huh.

16 Q: And depending on which one you use, you're
17 still going to end up on line 11 with net
18 income per income statement, correct?

19 A: Right.

20 Q: So -- and ultimately I believe it's your
21 testimony that its net income that forms the
22 tax base for the South Carolina bank tax?

23 A: Correct.

24 Q: So you could use a different methodology but
25 most corporations in your experience and I



1 think other witnesses is that GAAP is what they
2 use?

3 A: Correct.

4 Q: And in fact if you look over at Exhibit 40 --
5 I'm sorry Exhibit 26, which is the draft that
6 Ms. Cuttino reviewed with you earlier and you
7 skip down to page 11, actually skip up a
8 second. I'm sorry. Let me look over your
9 shoulder real fast that would be easier.
10 Yeah, page four so question nine, which says,
11 in general, what is the tax base for
12 calculating the bank franchise tax and that
13 draft, if you skip down to the next page it
14 says the South Carolina bank tax is generally
15 computed using GAAP. Do you see that?

16 A: Uh-huh.

17 Q: Which is because most corporations use GAAP for
18 the methodology of calculating their net
19 income; is that fair?

20 A: Right.

21 Q: So to the extent you've been asked questions
22 for the Department's position you characterized
23 as net income must equal GAAP that's not
24 entirely accurate, correct?

25 A: I'm sorry?



1 Q: I'll withdraw that question.

2 All right. You were asked about the mortgage
3 issue, and the foreclosure issue on mortgages.

4 A: Yes.

5 Q: I just want to clarify, if you look at Exhibit
6 25, which is the 1948 AG opinion, and I think
7 it's is SC 1380, the Bates number. In the
8 second paragraph there the AG says that the
9 reason -- this is for the reason that the bank
10 tax is a franchise tax for the privilege of
11 operating or doing business in this state, do
12 you see that?

13 A: Uh-huh.

14 Q: And so the nature of the bank tax applies to
15 banks operating and doing business in this
16 state, correct?

17 A: I believe so.

18 Q: And so it's different than the situation you
19 were addressing where you had a bank not
20 operating and doing business in this state but
21 may have had mortgages secured by property in
22 this state?

23 A: Yes.

24 Q: All right. One last thing, I want to make sure
25 we clarify this because I think the Court has



1 some questions. I'm looking at your summary
2 exhibit here. Actually, no, let's look at
3 Exhibit -- I believe it's 37. Is that 37?

4 A: Yeah.

5 Q: Okay. This is the situation were you've got a
6 year two, a net loss, and then in year three
7 you have net income; is that correct?

8 A: Correct.

9 Q: Okay. And the question the Court asked you
10 earlier was what's the difference between net
11 losses and net operating losses, so I want to
12 make sure we clarify that. In year two, you
13 have a net loss. That's a financial accounting
14 term, correct?

15 A: Correct.

16 Q: Okay. As a result of that net loss with the --
17 before tax benefit and income tax expenses that
18 you have calculated in your example, the net
19 income is negative 70, correct?

20 A: It's a net loss of 70, yes.

21 Q: Okay. And so in that year if you forget about
22 NOL carryforwards for a second, what would be
23 the tax owed by the bank in year two?

24 A: For South Carolina bank income tax rules it
25 would be zero because the bank income tax only



1 taxes net income.

2 Q: So in year two, because there are a loss, the
3 benefit of the loss, so to speak, is that they
4 pay zero tax in year two, correct?

5 A: Correct.

6 Q: And for financial accounting purposes, would
7 you take that loss and use it in future years
8 for calculating entire net income?

9 A: No, because that would be double counting in
10 your financial statements.

11 Q: Right, because you're financial statements --
12 actually, I'm going to retract that. Your
13 income statement is based on, usually on, a 12-
14 month period, right?

15 A: Correct.

16 Q: It's an annual statement, correct?

17 A: Uh-huh.

18 Q: And your tax is also calculated annually,
19 correct?

20 A: Correct.

21 Q: So net operating loss, that term, I think your
22 testimony was it's a fiction of statute; is
23 that right?

24 A: Correct.

25 Q: Okay. And that's because the federal



1 government has said for federal tax purposes
2 we'll let you take that \$70 net loss and offset
3 your federal taxable income in future years,
4 correct?

5 A: Except to the extent that it may not be \$70.
6 Like in that example the net operating loss is
7 only \$50.

8 Q: Okay. But the ability to take that net loss
9 and use it to deduct your net income in future
10 years only comes by virtue of federal law,
11 correct?

12 A: And state law where applicable.

13 Q: And state law where applicable. And we don't
14 have that kind of state law, in your opinion,
15 in South Carolina, correct?

16 A: Correct.

17 Q: Okay. So the ability to offset net income in
18 future years doesn't arise from GAAP and ASC
19 740. It arises by creature of statute, right?

20 A: Right.

21 **MR. LUTHER:** Your Honor, I just want to, at that
22 point, to make sure I think it might be helpful
23 to enter the demonstrative exhibit, this
24 summary page, this -- the other three are in as
25 exhibits but this demonstrative was not, so I



1 just thought it might be helpful to mark it.

2 THE COURT: Do you have any objection to that?

3 MS. CUTTINO: No.

4 THE COURT: I assume it will be 48.

5 MR. LUTHER: Forty-eight.

6 (Joint Exhibit Number 48 was marked for
7 identification purposes.)

8 THE COURT: No objection?

9 MS. CUTTINO: No objection.

10 THE COURT: It's admitted.

11 (Joint Exhibit Number 48 was admitted into the
12 record.)

13 MR. LUTHER: That's all I have. Thank you.

14 THE COURT: You need ...

15 MS. CUTTINO: Very briefly.

16 THE COURT: Okay.

17 MR. BECKWITH - RECROSS-EXAMINATION BY MS. CUTTINO:

18 Q: Mr. Beckwith, you were also asked about Mr.
19 Branch's demonstrative exhibit during your
20 testimony, and so I'd also like to admit that
21 demonstrative into the record also.

22 MR. LUTHER: No objection.

23 Q: Mr. Beckwith ---

24 THE COURT: 49 is admitted without objection.

25 (Joint Exhibit Number 49 was marked and admitted into



1 the record.)

2 THE COURT: Go ahead.

3 Q: Mr. Beckwith, the Department asked you about
4 the public draft that was never made final by
5 the Department, correct?

6 A: Yes.

7 Q: And the public draft is actually 12 pages long
8 and goes through different issues that you
9 could have under the bank tax with GAAP,
10 correct?

11 A: I think that's a correct statement.

12 Q: And that's because GAAP is not intuitive. It
13 requires some type of interpretation, doesn't
14 it?

15 A: It requires -- I suppose it does require some
16 interpretation in the way it's applied.

17 Q: All right.

18 A: Generally you follow GAAP in applying -- you
19 follow the written word in applying GAAP, and
20 if there's any uncertainty there, then you have
21 to make an interpretation I guess.

22 Q: And while the Department started to give us
23 some guidance, they never actually made it
24 final, did they?

25 A: That's my understanding.



1 Q: And I just want to make clear that I understand
2 your testimony. You testified that entire
3 means all and entire net income means the
4 entire financial books and those books include
5 the income statement, the balance sheet, the
6 cash flow, and the fourth one that has to do
7 with the investors, correct?

8 A: The statement of shareholder equity.

9 Q: Yes.

10 A: They all intertwine.

11 Q: So when you look at entire net income, you
12 would admit it is all four financial
13 statements, but yet when you want to apply the
14 definition to the tax base, you want to limit
15 it to only net income, which you deem to be the
16 income statement, correct?

17 A: For South Carolina purposes?

18 Q: Yes.

19 A: For bank tax purposes, yes.

20 **MS. CUTTINO:** That's all I have, Your Honor.

21 **THE COURT:** All right. You may step down.

22 **MR. LUTHER:** I'm done. We have no further
23 witnesses.

24 **THE COURT:** I wondered how late we were going to go
25 and I think I just got my answer.



1 So do you want to take a break and give closing
2 arguments or do you want to just utilize your
3 proposed orders?

4 **MR. LUTHER:** I think we're fine just utilizing
5 proposed orders.

6 **MS. CUTTINO:** Same thing. We're okay doing the same
7 thing, Your Honor.

8 **THE COURT:** All right. The rule I normally exercise
9 is the proposed orders are due in 30 days from
10 today from the conclusion of this hearing or 30
11 days to the date that the transcript is made
12 available to you. Are y'all okay with that?

13 **MR. LUTHER:** You said 30 days from the day that the
14 transcript is made available?

15 **THE COURT:** Yeah, because you're already assuming
16 you're going to ask for a transcript.

17 **MS. CUTTINO:** I think we're all going to need one
18 after today.

19 **THE COURT:** All right. Anything else?

20 **MS. CUTTINO:** Thank you, Your Honor.

21 **THE COURT:** And I reserve the right to after I get
22 your proposed orders to call you and ask
23 further questions.

24 **MR. LUTHER:** You can call Mr. Beckwith, that would
25 be much appreciated.



1 MS. CUTTINO: We all reserve the right, Your Honor.

2 THE COURT: Anything else we need to do?

3 All right. Thank you. The hearing is
4 adjourned.

5 (There being no further questions, the deposition
6 concluded at 4:58 p.m.)
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South Carolina Administrative Law Court (SC ALC)
Request for Contested Case Hearing FORM
Mail to: 1205 Pendleton St., Suite 224, Columbia, SC 29201

Last Name: Synovus Bank		First:	Middle:	☐ Mr. ☐ Mrs.	☐ Miss ☐ Ms.	Docket No. (To Be Completed by ALC)
Mailing Address: 1111 Bay Avenue, Suite 200			City: Columbus		State and Zip: GA 31901	
Home Number:	Work Number:	Cell Number:		*E-Mail Address:		

*By providing your e-mail address, you consent to receive court orders and notices via electronic transmission

REPRESENTATION

Are you representing yourself? ☐ Yes ☒ No

Are you represented by an Attorney? ☒ Yes ☐ No

Name of Attorney: Ashley P. Cuttino (lead) (see Attachment A)

Attorney Mailing Address:
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CASE INFORMATION

Name of Agency that Issued the Decision: Department of Revenue
 (Example – Dept. of Revenue, Dept. of Insurance, DHEC)

In order to have your case processed, **you must attach the agency decision.** Is it attached?:
☒ Yes ☐ No

If no, please explain:

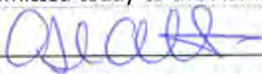
Date the decision was issued: October 17, 2017

Date the decision was received: October 20, 2017

Please provide a brief statement regarding why the hearing is being requested and the relief sought:

Novel issue for Court's determination. Please see Attachment B.

Payment via ☒ Check ☐ Money Order ☐ Cash for \$ 500.00 (applicable **filing fee pursuant to** ALC Rule 71) is being submitted today to the Administrative Law Court via ☐ U.S. Postal Service ☒ Hand-delivery


X Your Signature or Signature of Attorney

11/16/17

Date

PROOF OF SERVICE (MUST BE COMPLETED)

Your Name: Ashley P. Cuttino

Date: 11/16/17

City: Greenville

State: SC

I hereby certify that on the date and place listed above, I served a copy of the foregoing Request for Contested Case Hearing **on all other parties** to this matter by depositing the same in the United States Mail, postage paid, and addressed as follows (use the reverse side for any additional names):

SC Dept. of Revenue	PO Box 12265	Columbia, SC 29211-9979
Name and/or Agency Name	Address	City, State and Zip

Name and/or Agency Name	Address	City, State and Zip


X Your Signature or Signature of Attorney

11/16/17

Date

Attention: All cases filed in the Administrative Law Court are subject to the Rules of Procedure found at the Court's website www.scalc.net or from the Clerk of Court. Failure to follow these rules may result in dismissal of your case.

ATTACHMENT A

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ATTACHMENT B

Introduction

Synovus Bank (“Synovus”) timely filed claims for refund with the South Carolina Department of Revenue (“Department” or “DOR”) for tax years 2012, 2013, and 2014. The refunds arose because Synovus asserted in the refund claims it was entitled to Net Operating Loss (“NOL”) carryforward deductions for each of the tax years 2012 through 2014.

For all three tax years, the Department granted the refunds. However, the Department paid to Synovus the requested refund amounts only for 2013 and 2014, not for 2012. As to 2012, even though the refund was approved, it was not paid due to a procedural problem requiring the 2012 refund amount be “held for verification.”

Thus, Synovus believed—and was told by the Department—the refund requests were approved. However, such a conclusion was short-lived.

Despite the refunds being approved, the Department made a subsequent decision to audit the tax years 2012, 2013, and 2014. Following the audit, in March and April, 2016, the Department reversed its prior decision approving the refunds. Instead, the Audit concluded the refunds were incorrectly granted. Solely on statutory grounds, DOR concluded NOLs are not allowed in computing a Bank Tax liability.

Following the Audit, DOR issued the attached seventeen-page Department Determination. Synovus disagrees with DOR’s determination and files this appeal.

Basis for Synovus’ Appeal

Synovus in this appeal does not attempt to address all of the seventeen pages of positions advanced by the Department. Synovus will do so at a later stage of this matter. However, to more accurately place before this Court the context of this controversy, Synovus feels compelled to address in a general fashion the three primary arguments presented by the Department Determination.

First, DOR concludes banks are subject to a “franchise tax” with a tax base relying on an accounting principle known as “book income” for which NOL deductions are not allowed. Second, DOR concludes the South Carolina General Assembly has not granted banks any statutory authority in either Chapter 11 or Chapter 6 to deduct NOLs on their South Carolina tax returns. Third, while DOR agrees the Internal Revenue Code conformity statute of S.C. Code Ann. §12-6-50 allows NOL deductions, DOR argues such deductions are adopted only for the corporate income tax imposed by S.C. Code Ann. §12-60-580. As explained below, the Department is incorrect on each of its three arguments.

1. Each of the Three Arguments Presented by the Department Raises an Issue of Statutory Construction

Each of DOR's three arguments are incorrect as shown under a standard statutory construction analysis.¹

A. The Bank Tax is Not a Franchise Tax Measured by Book Income

First, as a foundational premise, the Court must be aware no Court has determined NOL deductions are not an allowable deduction for a bank in South Carolina. Rather, the issue has simply never been presented in a litigation setting.

Against the backdrop of no litigated decision, a standard statutory analysis directs the Court to seek the intent of the General Assembly. *Sloan v. Hardee*, 371 S.C. 495, 498, 640 S.E.2d 457, 459 (2007) (“The cardinal rule of statutory interpretation is to ascertain and effectuate the intention of the legislature.”). The intent is best found by applying the plain language used by the legislature. *Sloan*, 371 S.C. at 499, 640 S.E.2d at 459 (“Words must be given their plain and ordinary meaning without resort to subtle or forced construction to limit or expand the statute's operation.”).

Nothing in the plain language of the bank tax sections (Chapter 11) (“bank tax”) or in the corporate tax sections (Chapter 6) of the South Carolina tax code (Title 12) demonstrates a legislative intent to deny NOL deductions to the bank tax. On the contrary, the General Assembly's legislative intent to grant NOL deductions to banks is seen in the plain language used in taxing banks.

For example, never once does the General Assembly call the tax on banks in Chapter 11 a “franchise tax.” Instead, no less than three statutes—fully fifty percent of the statutes in all of Chapter 11—labels the tax on banks an “income tax.” See S.C. Code §§12-11-30, 12-11-50, 12-11-60.

Further, the Department's entire case rises and falls on DOR's assertion the tax imposed in Chapter 11 is a tax on a bank's “book income.” At no point in any section of Chapter 11 does the General Assembly use the term “book income” to define the tax on banks. In fact, the term “book income” never appears in Chapter 11. “Book income” is a term employed in financial accounting parlance; it is not a term employed for imposing an income tax on banks.

Seeking to bolster its position, DOR displays the depth of the legal contortions it is willing to apply to justify its “book income” and “franchise tax” scenario. In a telling statement in its Department Determination, DOR states:

The tax base for the bank tax has been the “entire net income” of the bank since the bank tax's inception in 1937. 1937 S.C. Acts page no. 565. Although the 1926 Act also used “entire net income” to define the tax base for corporate income tax purposes, from

¹ The question here is straight-forward: is a bank entitled to an NOL deduction. DOR does not disagree on the question before the Court. In its Department Determination, DOR states “the Department does not dispute that the Taxpayer incurred losses in tax years 2009 and 2010 [such that t]he sole issue addressed in this Determination is whether the Taxpayer can deduct those losses in the form of NOLs to offset its bank tax liability.” See Department Determination, p. 2, fn. 2

1937 to 1985 the tax base of “entire net income” for bank tax purposes has been calculated differently from the tax base of “entire net income” for corporate income tax purposes. If the General Assembly had intended to change the tax base for the bank tax from “entire net income,” like it did for the corporate income tax, it would have explicitly done so in 1985. For the corporate income tax, in 1985 the General Assembly changed the tax base from “entire net income” to “taxable income as determined under the [IRC] with modifications specified.” The General Assembly did not change the tax base for the bank tax in 1985, or at any other time, from how it has been written and interpreted since 1937.

Department Determination, p. 9.

By its statement, DOR asserts the bank tax base in 1937 was—and remains today—the bank’s “entire net income.” Then, in its explicit statement, the Department agrees the corporate income tax base in 1937 “also used ‘entire net income’ to define the tax base for corporate income tax purposes.” The Department then states “[f]or the corporate income tax, in 1985 the General Assembly changed the tax base from ‘entire net income’ to ‘taxable income as determined under the [IRC] with modifications specified.’”

Thus, the Department finds both the bank tax and the corporate income tax used the same base—entire net income—in 1937. The Department finds that identical base—entire net income—continued as the tax base for both the bank tax and the corporate income tax until 1985. Then, in 1985, DOR concludes the tax base for taxing corporate income changed.

Logically, the above all being true based on admitted statements by DOR, for the period from 1937 to 1985, with both taxes being statutorily labeled income taxes and with both taxes relying on the identical tax base, how can a 1985 change ONLY to the corporate income tax base cause a transformational metamorphosis converting the bank tax into a “franchise tax” measured by “book income”? Clearly, it cannot.

Indeed, for DOR to maintain any semblance of logic for its argument, given that both the bank tax and the corporate income tax used the identical tax base of “entire net income,” DOR must assert for the time frame from 1937 until 1985, both the corporate income tax and the bank tax were franchise taxes based on book income with the General Assembly in 1985 freeing the corporate income tax from the franchise tax when “the General Assembly changed the tax base from ‘entire net income’ to ‘taxable income as determined under the [IRC] with modifications specified.’” Such is certainly not the case.

If the Department is being forthright with the Court, the Department knows the corporate income tax has never been a franchise tax based on book income. Accordingly, as a matter of logic, given both the bank tax and the corporate income tax employed the identical tax base from 1937 to 1985 and given the undisputed view the corporate income tax has never been a franchise tax based on book income, the change made by the General Assembly in 1985 simply

reidentified the tax base for both taxes as “taxable income as determined under the [IRC] with modifications specified.”

B. By Statute, the General Assembly Grants Banks NOL Deductions.

The Department claims no statutes grant NOL deductions to banks. The Department is incorrect.

S.C. Code Ann. § 12-11-40 adopts “all of the provisions of Chapter 6 of this title [12] that may be appropriate or applicable.” All agree, Chapter 6 grants NOL deductions. *See* S.C. Code Ann. § 12-6-40(A)(1)(a) and § 12-6-50(6). Nothing is more “appropriate or applicable” to the taxation of banks in Chapter 11 than Chapter 6’s means for computing the amount upon which the bank tax is imposed. After all, from 1937 to 1985, both the bank tax and the corporate income tax employed the identical tax base such that the change made by the General Assembly in 1985 in Chapter 6 was simply to reidentify the tax base for both taxes as “taxable income as determined under the [IRC] with modifications specified.” Therefore, NOLs are allowed for banks just as they are allowed for corporate income taxpayers.

C. The Conformity Statutes of S.C. Code Ann. §§12-6-40 and 12-6-50 Allow NOL Deductions to Banks

The Department agrees the General Assembly, for all years here in dispute, adopted the Internal Revenue Code as applicable on December 31 of the year preceding the tax year; i.e., December 31, 2011 for the 2012 tax year, etc. *See* S.C. Code §12-6-40(A)(1)(a). The adoption section takes in all of the IRC—nothing is omitted. However, the General Assembly in a separate section identifies specific provisions of the IRC it excludes from its adoption of the IRC. *See* S.C. Code §12-6-50.

The Department argues the adoption of the IRC does not apply to banks. However, if that were an accurate statement, the General Assembly would have no reason to “leave in” provisions of the IRC applicable to taxing banks. In other words, if the General Assembly believed the IRC were inapplicable to South Carolina’s taxation of banks, the General Assembly would have specifically excluded from the adoption of the IRC any provisions addressing the taxation of banks. But, such an exclusion did not occur.

Instead, for all of the tax years in dispute, the adoption of the IRC by the General Assembly included all of “Subchapter H” of the IRC, the IRC statutes explicitly governing Banks. If the Department’s position were correct that the IRC were inapplicable to banks, the General Assembly would then promptly exclude all of IRC Subchapter H. The General Assembly did not do so. Instead, the General Assembly “left in,” therefore adopted, IRC section 584.

Under IRC §584, a “common trust fund” is defined as “fund[s] maintained by a bank . . . as a trustee, executor, administrator, or guardian, or . . . a custodian of accounts . . . which the Secretary determines are established pursuant to a State law . . . similar to the Uniform Gifts to Minors Act.”

The statute then explains how a bank's common trust fund is to be taxed. The relevant section states:

The benefit of the deduction for net operating losses provided by section 172 shall not be allowed to a common trust fund, but shall be allowed to the participants in the common trust fund under regulations prescribed by the Secretary. (Emphasis added).

26 U.S.C. §584(g)

In other words, by adopting IRC §584, the General Assembly expresses its intent to grant banks NOL deductions under IRC §172. If the General Assembly had no intention of allowing NOL deductions to banks, no reason would exist to tell banks they are not entitled to NOL deductions for their common trust funds. The denial of the deduction for a limited activity proves the granting of the deduction for the broader activity of operating a bank. If the deduction is not allowed at all to banks, the General Assembly's denial of the deduction to a limited activity amounts to a futile act. The General Assembly does not engage in futile acts. *Duvall v. S.C. Budget and Control Bd.*, 377 S.C. 36, 42, 659 S.E.2d 125, 128 (2008) (one "must presume the legislature intended to accomplish something with an enacted statute and did not intend for a section or provision to be purposeless or futile."). Accordingly, while a bank's common trust fund is not entitled to NOL deductions, the bank is entitled to NOL deductions for its normal bank operations. This case involves the latter, not the former—Synovus is entitled to the NOL deductions it claims.

Based on the above, none of the three reasons offered by the Department to deny Synovus' NOL deductions are valid. The case Synovus will present to this Court will further support Synovus' basis for the deductions and provide additional arguments establishing the errors committed by DOR in denying the claimed NOL deductions.

2. General Overview of Synovus' Statutory Support for the Taking of NOLs in Summary

In or around 1985, the General Assembly, through tax reform, revised the South Carolina Tax Code to conform to the Internal Revenue Code (I.R.C). In 2005, the Tax Code was further revised. SC Code § 12-6-40 (Conformity Statute). Prior to 2005, S.C. Code § 12-6-50 provided the list of I.R.C. provisions the South Carolina General Assembly did not want to adopt. This list was arguably only applicable for corporate income tax purposes based on the language of S.C. Code § 12-6-40. In 2005, the General Assembly took affirmative action to change the language used in S.C. Code Ann. § 12-6-40. The General Assembly changed the language and broadened its application to apply to the entire "title and all other titles which provide for taxes administered by the Department". The change in language clarified that conformity applies to all "taxes administered by the Department." See 2005 Act No. 145, § 8 (H.B., 3768). The application of the conformity statute to *all* taxes administered by the Department, including banks, removed any ambiguity that existed prior to 2005 regarding the applicability of conformity to banks. The 2005 amendment also clarified any confusion over the ability of banks in South Carolina to take the NOL deductions specifically proscribed by the General Assembly in Chapter 6 of the tax code. See S.C. Code § 12-6-1130(4).

The General Assembly made clear what taxpayers are subject to the provisions of Chapter 6. Chapter 6 defines the “taxpayer” subject to its provisions as:

(1) "Taxpayer" includes an individual, trust, estate, partnership, association; company, corporation, or any other entity subject to the tax imposed by this chapter *or required to file a return*.

SC Code § 12-6-30(1) (emphasis added).

Further, DOR has historically agreed that the conformity statute applies to banks in South Carolina. On at least two (2) separate occasions since conformity DOR has confirmed in writing its opinion that the I.R.C. applies to banks and has taken an inconsistent position to the Determination Letter from which this appeal originates.

1. PLR 95-10. PLR 95-10 issued by DOR in 1995 does not label the bank tax as a franchise tax. Instead, PLR 95-10 refers to the bank tax as an income tax on banks. PLR- 95-10 instructs that the taxpayer/bank “will report its South Carolina taxable income each year based upon its taxable income calculated and reported for federal income purposes.”
2. Tax Commission Information Letter # 94-35. Tax Commission Information Letter # 94-35 issued by DOR in 1995 determined the substantive allocation and apportionment provisions applicable to multi-state taxpayers in Chapter 6 also applied to banks.

DOR has also confirmed that the Use of Net Operating Losses Following a Change in Ownership, like that between NBSC and Synovus are allowed for “*taxpayers*”, with no limitation as to the type of taxpayer. See SC Revenue ruling #16-7.

Similarly, the former Tax Commission also took the position that the I.R.C. applied to banks prior to conformity. The Tax Commission applied I.R.C. § 368 in a reorganization case between two banks. Following reorganization, the Tax Commission applied I.R.C. § 368 to the newly formed bank to ensure full taxation. See Income Tax Decision I-D-200 (1975).

These actions are consistent with the repeal of many of the bank tax regulations that gave instructions to banks on how to calculate and conform to the bank tax code following conformity. Prior to conformity, the former tax commission adopted 117-92.4 containing sixteen (16) income tax regulations for purposes of instruction on the bank tax. The regulations provided very specific tax guidance on tax procedures for banks, including those areas also covered by the I.R.C. Following conformity, in 1988-9, the Tax Commission repealed 117-92.4. The reason for the regulatory repeal is simple: additional regulation specific to banks was no longer needed because of conformity.

3. DOR’s Lack of Authority to Deny NOL Deductions

DOR’s reliance on “book income” as opposed to “taxable income” raises a constitutional concern. South Carolina’s constitution prevents the legislature from delegating away its

legislative power, especially its power to tax. *See Eastern Federal Corp. v. Wasson*, 281 S.C. 450, 316 S.E. 2d 373 (1984). If “book income” is that upon which the bank tax is imposed, no definition of book income is set by the General Assembly. Rather, “book income” is that which a varying range of accountants, financial advisors, and a host of consultants may wish to establish. In all events, DOR’s imposition of a tax on “book income” is an unconstitutional delegation of the taxing power of the legislature to private parties. Such an interpretation must be rejected.

As a corollary to “book income” is DOR’s assertion the bank tax is a “franchise tax.” DOR points to no statutory or legal precedent for this position. The South Carolina legislature is familiar with the term “franchise tax” and uses the term “franchise tax” in other sections of the tax code. *See* SC Code Ann. §§ 12-6-2210; 12-6-2290; 12-6-1130; 12-8-550. The General Assembly does not, however, use the term “franchise tax” in the bank tax section.

DOR bases its “franchise tax / book income” position on its interpretation of the term “entire net income” found in S.C. Code Ann. § 12-11-20. However, “entire net income” is not defined by the legislature and DOR’s application of the term “entire net income” is inconsistent and illogical when Title 12 is reviewed in total. Indeed, DOR’s entire argument relies on a single attorney general’s opinion from 1948, an interpretation given approximately seventy (70) years ago, decades prior to the General Assembly adopting conformity with the IRC.

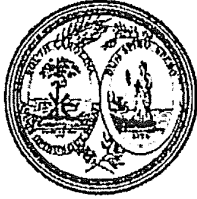
Because the General Assembly did not define the base for the bank tax, the intent of the General Assembly must be gained from the context of the plain meaning of the words used in the surrounding statutes. Such statutes, all within the bank tax chapter of the tax code, explicitly classify the tax as an income tax – not a franchise tax. *See* SC Code Ann. § 12-11-30 (“The *income tax* provided in this chapter is instead of all other taxes on banks”) (emphasis added); S.C. Code Ann. § 12-11-50 (“[T]he *income tax* paid under the provisions of this chapter must be deposited to the credit of the grand fund of the State.”) (emphasis added).

Finally, DOR disregards the impact conformity with the IRC has had on the bank tax. The bank tax primarily serves one purpose—provide a different tax rate to banks, 4.5%, than that provided to corporate taxpayers. *See* S.C. Code Ann. § 12-11-20. For all substantive provisions computing the amount upon which the tax is imposed, the General Assembly instructs DOR and banks to refer to Chapter 6 (the income tax chapter) for:

. . . purposes of administration, allocation and apportionment, enforcement, collection, liens, penalties *and other similar provisions, all of provisions of Chapter 6 of this title that may be appropriate or applicable are adopted and made part of this chapter . . .*

S.C. Code Ann. § 12-11-40(emphasis added)

Based on the summary of arguments above, Synovus appeals the determination of DOR denying the Bank’s ability to take NOL carryforward deductions.



STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE

300A Outlet Pointe Blvd., Columbia, South Carolina 29210
P.O. Box 12265, Columbia, South Carolina 29211-9979
803-898-5130 FAX: 803-896-0171

October 17, 2017

Lewis T. Smoak, Esquire
Ogletree Deakins Nash Smoak & Stewart, PC
P.O. Box 2757
Greenville, SC 29602

Re: Department Determination
Synovus Bank
Bank Tax for the Years Ended December 31, 2011, 2012, 2013, and 2014

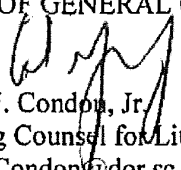
Dear Mr. Smoak:

Enclosed is the South Carolina Department of Revenue's Determination in the above-referenced matter. If you disagree with the Determination, you may request a contested case hearing before an Administrative Law Judge. If you choose to pursue such remedy, you must do so within thirty (30) days of the date of this letter. If you fail to respond within this time limitation, you will lose your right to appeal the Department Determination and your protest will be ended. Should you desire a contested case hearing, you must complete the enclosed request form and mail it, along with a \$500.00 filing fee, to the Administrative Law Court at the address stated on the form's instruction sheet.

The Administrative Law Court rules require that you also send me a copy of your request.
My address is as follows: P.O. Box 12265, Columbia, SC 29211-9979.

Sincerely,

OFFICE OF GENERAL COUNSEL FOR LITIGATION


William J. Condon, Jr.
Managing Counsel for Litigation
William.Condon@dor.sc.gov
803-898-5278

c: Ray N. Stevens, Esquire
Burnet R. Maybank, III, Esquire
Enclosures
WJC: tm

DEPARTMENT DETERMINATION

Taxpayer:

Synovus Bank
1111 Bay Avenue, Suite 200
Columbus, GA 31901

Periods Involved:

Bank Tax for the Years Ended December 31, 2011, 2012, 2013, and 2014

Matter in Dispute:

Was Synovus Bank (Taxpayer) entitled to deduct net operating loss carryforwards when computing its bank tax liability for bank tax years 2011 through 2014?

Amount in Dispute:

<u>Tax Years</u>	<u>Disputed Bank Tax</u>	<u>Disputed Interest</u>	<u>Disputed Total</u>
12/31/11	\$ 0 ¹	\$ 0	\$ 0
12/31/12	387,856	67,194.07	455,050.07
12/31/13	420,784	58,334.99	479,118.99
12/31/14	562,076	58,991.80	621,067.80
Total	\$ 1,370,716	\$ 184,520.86	\$1,555,236.86

The Department has calculated the above-assessed interest through November 20, 2017. Interest continues to accrue, as appropriate.

Determination:

The Taxpayer is required to pay the disputed total to the Department because, under South Carolina law, the Taxpayer was not entitled to deduct net operating loss carryforwards when computing its bank tax liability for bank tax years 2011 through 2014.

Relevant Facts:

1. On May 6, 2010, the National Bank of South Carolina (NBSC) merged into Synovus Bank (which was formerly known as Columbus Bank and Trust Company (CB&T)). Each of these entities are organized as corporations.

¹As part of the Department's audit, the Department disallowed the use of net operating loss carryforwards in 2011; however, available tax credits eliminated any bank tax liability in 2011 for the Taxpayer.

2. On or after December 19, 2014, Taxpayer filed amended South Carolina Bank Tax Returns for 2011, 2012, and 2013. In these amended returns, Taxpayer claimed it was entitled to deduct losses that Taxpayer (or NBSC and CB&T) had incurred in 2009 and 2010 in the form of net operating loss ("NOL") carryforwards.² Accordingly, for tax years 2011–2013, Taxpayer offset its South Carolina net taxable income for bank tax purposes by deducting these NOL carryforwards from 2009 and 2010. As a result, the Taxpayer reported no bank tax liability for tax years 2011, 2012, and 2013.
3. In its second amended bank tax return for 2013, the Taxpayer also claimed that even after applying a portion of its NOL carryforwards to tax years 2011–2013, the Taxpayer had remaining NOLs of \$291,331,561 that could be carried forward to 2014.
4. On its original Bank Tax Return for 2014, the Taxpayer offset its South Carolina net taxable income by a portion of these remaining NOLs, resulting in no bank tax liability in South Carolina. As a result, the Taxpayer claimed a refund of \$968,585 from South Carolina.
5. On March 14, 2016, the Department issued two Proposed Notices of Adjustment with related "Reports of Field Audit" (PNOA). The Department issued one PNOA to NBSC and labeled it as a valuation adjustment. In this PNOA, the Department made an adjustment that increased the loss that NBSC incurred in South Carolina for 2009 from \$157,505,037 to \$248,505,037. The Department also issued a PNOA to the Taxpayer. In this PNOA, the Department disallowed the Taxpayer's claims for NOL deductions in 2011 through 2014. In this PNOA, the Department assessed penalties and interest through April 15, 2016. On or about April 6, 2016, the Department revised the PNOA to the Taxpayer deleting the penalties that it had originally assessed and updating the interest amount.
6. The total assessment on the revised PNOA to the Taxpayer is \$2,076,325. In this Department Determination, the Department reduced the 2012 bank tax assessment by \$566,471 for bank taxes the Taxpayer previously paid for 2012.

²An NOL is the amount for income tax purposes by which deductions exceed income in a particular income tax year. For federal income tax purposes, NOLs may be carried back to each of the two taxable years preceding the taxable year in which the NOL was incurred and carried forward to each of the twenty taxable years following the taxable year in which the NOL was incurred. I.R.C. § 172(b)(1)(A) (West 2016).

For purposes of this Department Determination, the Department does not dispute that the Taxpayer incurred losses in tax years 2009 and 2010. The sole issue addressed in this Determination is whether the Taxpayer can deduct those losses in the form of NOLs to offset its bank tax liability. The Department retains its right to examine the specific details and amounts of the claimed NOLs in the event a court determines the Taxpayer is entitled to deduct NOL carryforwards from its bank tax liability.

7. The Taxpayer filed a written protest on both PNOAs on June 7, 2016.

Discussion:

The Taxpayer may not deduct NOLs on its South Carolina bank tax returns for three primary reasons. First, since the inception of the bank tax in 1937, the Department and others have interpreted and applied the bank tax to be a franchise tax - not an income tax - whose tax base is calculated differently than the corporate income tax and from which NOLs are not deductible.

Second, deductions are a matter of legislative grace, and the South Carolina General Assembly has not granted banks any statutory authority in either Chapter 11 or Chapter 6 to deduct NOLs on their South Carolina tax returns.

Third, the 1985 Internal Revenue Code ("IRC") conformity provisions do not apply to the bank tax, so the IRC conformity provisions in section 12-6-50 on which the Taxpayer primarily relies do not apply to banks. The IRC was adopted for corporate income tax in section 12-60-580, and banks are exempt from the corporate income tax under section 12-6-550(1). Further, the General Assembly explicitly exempted banks from taxation under the IRC in section 12-6-630.

Before focusing on the non-deductibility of NOLs by banks in South Carolina, the Department must provide a brief legislative history concerning the corporate income tax and the bank tax. This legislative history will assist in understanding the Department's Determination and in addressing the Taxpayer's arguments.

Legislative History of the Corporate Income Tax.

In 1927, the South Carolina General Assembly adopted the Income Tax Act of 1926 (1926 Act), which included a corporate income tax but did not include a separate bank tax. Income Tax Act of 1926, 1927 S.C. Acts page no. 1, 3. The corporate income tax has gone through several changes over the years, such as excluding banks from the corporate income tax in 1937 and redefining the tax base for the corporate income tax in 1985, when the General Assembly conformed certain income tax calculations to a partially adopted IRC.

In the 1926 Act, the General Assembly imposed an income tax on corporations organized in South Carolina and foreign corporations doing business in South Carolina. Income Tax Act of 1926, 1927 S.C. Acts page no. 3. This corporate income tax applied to for-profit banks. *See* Income Tax Act of 1926, 1927 S.C. Acts page no. 5-6. The corporate income tax was 4% of "entire net income"; the corporate income tax was not based on the IRC. *See* Income Tax Act of 1926, 1927 S.C. Acts page no. 3. For corporate income tax purposes, the 1926 Act defined "net income" as "gross income" less allowed deductions. Income Tax Act of 1926, 1927 S.C. Acts page no. 6. The 1926 Act also stated, "The net income of a taxpayer shall be computed in accordance with the method of accounting regularly employed in keeping the books of such taxpayer." Income Tax Act of 1926, 1927 S.C. Acts page no. 7. Until 1985, the corporate income tax remained a tax on

“entire net income,” although the General Assembly increased the tax rate to 5%. S.C. Code Ann. § 12-7-230 (1976); S.C. Code Ann. § 65-222 (1962).

In 1985, the General Assembly repealed the 1926 Act and completely changed the tax base on which the corporate income tax and certain other income taxes were based. This framework still exists today.³ Specifically, the General Assembly changed the tax base for various income taxes, including the corporate income tax but not the bank tax, from “entire net income” to taxable income based on a partially adopted IRC with certain other modifications. *See* S.C. Income Tax Federal Conforming Amendments of 1985, Act No. 101, 106th Session § 7 (1985); *see* S.C. Code Ann. § 12-6-580 (2014). Additionally, the corporate income tax rate, which the General Assembly had increased to 5%, remained at 5% under the IRC conformity provisions of 1985. S.C. Code Ann. § 12-6-530 (2014).

The General Assembly did not adopt the entire IRC for corporate income tax and other income tax purposes; hence, the General Assembly conformed the applicable taxes to a partially adopted IRC. To determine what portions of the IRC South Carolina adopted, one must read sections 12-6-40 and 12-6-50 together. First, the General Assembly has defined the IRC as “the Internal Revenue Code of 1986, as amended through December 31, 2015,” “[e]xcept as otherwise provided.” S.C. Code Ann. § 12-6-40 (Supp. 2016). Then, the General Assembly listed the non-adopted portions of the IRC for South Carolina purposes in section 12-6-50. S.C. Code Ann. § 12-6-50 (2014). The relevant non-adopted portion of the IRC here is “[s]ection 172(b)(1) relating to net operating loss carrybacks.” S.C. Code Ann. § 12-6-50(6) (2014). One must read these sections together to identify the partially adopted IRC for South Carolina corporate income tax purposes.

Legislative History of the Bank Tax.

In 1937, the General Assembly enacted a separate tax on banks and excluded banks from the corporate income tax. 1937 S.C. Acts page no. 565-66. This 1937 Act imposed a bank tax on “the entire net income of the taxpayer doing a banking business within this State.” 1937 S.C. Acts page no. 565. The bank tax rate was 4.5% of the entire net income of the bank. *Id.* Additionally, unlike corporations subject to the corporate income tax, this 1937 Act exempted banks from all other taxes, except taxes on real property. *Id.* Since 1937, banks have remained exempt from the corporate income tax. *See e.g.*, S.C. Code Ann. § 12-6-550(1) (2014).

Further, the General Assembly adopted certain provisions for enforcement and administration of the bank tax. The 1937 Act included the following provision:

³In 1985, the General Assembly, through Act No. 101, titled the South Carolina Income Tax Federal Conforming Amendments of 1985, made a portion of the IRC the starting point for determining taxable income for individuals, corporations, partnerships, estates, and trusts. S.C. Code Ann. §§ 12-7-410, 12-7-415, 12-7-420, 12-7-425 (Supp. 1985). In 1995, the General Assembly recodified the provisions in Chapter 7 of Title 12 into Chapter 6 of Title 12.

That for the purpose of administration, enforcement, collection, liens, penalties, and other provisions of enforcement, all provisions of Sections 2435-2479, inclusive, Code of Laws of South Carolina, 1932, that may be appropriate or applicable are hereby adopted and made part of this Section for the enforcement and administration of this Act.⁴

Id. A similar provision has remained in South Carolina's bank tax laws since 1937. *See e.g.*, S.C. Code Ann. § 12-11-40 (2014).

The General Assembly has allowed the adoption of regulations, which existed prior to 1985 and still exist, that define the bank tax as a franchise tax that is still based on entire net income, not on taxable income based on a partially adopted IRC. *See* S.C. Code Ann. Regs. 117-15-00, 117-1500.1, 117-1500.3 (West 2017); *see also* S.C. Reg. BA-R-1 (December 6, 1967).

General Differences between the Corporate Income Tax and the Bank Tax.

Since 1937, the corporate income tax and the bank tax have remained separate taxes and have existed in separate chapters in South Carolina's taxation laws. In the Code of Laws of South Carolina, 1962, the Income Tax Act of 1926 was in Chapter 5 of Title 65, while the Bank Tax was in Chapter 7 of Title 65. Currently, in the Code of Laws of South Carolina, 1976, the South Carolina Income Tax Act is in Chapter 6 of Title 12, while the Bank Tax is in Chapter 11 of Title 12.

Banks determine their South Carolina tax base for purposes of the bank tax based on their book income,⁵ and they may not deduct NOLs. Since 1985, taxpayers subject to the corporate income tax have determined their South Carolina taxable income based on a partially adopted Internal

⁴Sections 2435-2479 include the entire income tax article in the 1942 Code of Laws of South Carolina. These sections include many statutes related to administration and enforcement of taxes, including section 2558, Collection and Enforcement of Tax; section 2459, Examination of Returns; section 2464, Action for Recovery of Taxes; and section 2466, Penalties.

⁵To calculate the bank tax, a bank multiplies the bank tax rate of 4.5% by its tax base, which is called "entire net income." S.C. Code Ann. § 12-11-20 (2014). While taxable income as defined by the Internal Revenue Code excludes certain income from taxation (e.g., interest income on government obligations) and disallows a deduction for certain expenses (e.g., federal income taxes), "book income" is different. It is a synonymous term to "entire net income." *See e.g.*, Final Report of S.C. Taxation Realignment Commission, pp. 75-76, 140-41 (Dec. 2010) (stating that the entire net income of a bank is based on its book income). Book income means that a bank may deduct all of its expenses from all of its revenues to calculate entire net income. *See* S.C. Code Ann. Regs. 117-1500.1, 117-1500.3 (West 2017); *see also* I-D-189 (Jan. 24, 1975) (stating that the bank tax has a special tax base that is economic income rather than taxable income). A bank may use either the cash or accrual method of accounting. S.C. Code Ann. Regs. 117-1500.2 (West 2017).

Revenue Code⁶ and may deduct NOL carryforwards. *See* S.C. Code Ann. § 12-6-50(6) (2014). However, the 1985 IRC conformity statutes, which include section 12-6-50(6), do not apply to the bank tax, so banks are required to determine their bank tax liability based on the original 1937 bank tax concepts - without deducting NOLs.

I. Banks Have No Statutory or Other Authority to Deduct Net Operating Losses on Their South Carolina Bank Tax Returns.

Since the General Assembly adopted the bank tax in 1937, banks have had no statutory authority to deduct NOLs on their South Carolina bank tax returns. This has not changed over the decades. The provisions of Chapter 11 of Title 12 regarding the bank tax have not changed in any meaningful way since 1937 that would allow a bank to deduct NOLs, and the IRC conformity provisions adopted into Chapter 6 of Title 12 do not apply to banks.

In this section, we demonstrate that banks have no statutory authority to deduct NOLs in their South Carolina bank tax returns. First, the General Assembly has not granted any authority in Chapter 6 or Chapter 11 authorizing banks to deduct NOLs. Such a grant of authority would be necessary because deductions are a matter of legislative grace. Second, when the General Assembly amended Chapter 6 - the South Carolina Income Tax Act - to adopt the IRC conformity provisions, the General Assembly did not change the provisions of Chapter 11 - the Bank Tax under which a deduction for NOLs has not been allowed. Third, the 2005 amendment to section 12-6-50, one of the IRC conformity provisions, did not extend the deduction for NOLs to the bank tax. Fourth, even though the General Assembly adopted I.R.C. section 584 which mentions NOLs by enacting section 12-6-50(9), section 12-6-50(9) applies to common trust funds, not to banks, so section 12-6-50(9) does not grant banks the authority to deduct NOLs. Fifth, section 12-11-40 of the bank tax chapter adopts certain provisions of Chapter 6; however, it adopted provisions in Chapter 6 for only enforcement and administration purposes, not for purposes of applying the IRC conformity provisions of Chapter 6 to the bank tax in Chapter 11.

A. The South Carolina General Assembly Has Not Given Banks Any Legislative Authority to Deduct Net Operating Losses.

At no time before or after 1985 has the General Assembly granted banks the statutory authority to deduct NOLs on their South Carolina bank tax returns. Since 1937, the bank tax has remained a tax on “entire net income,” which does not allow a deduction for NOL carryforwards. Although the 1985 IRC conformity provisions allow taxpayers subject to the corporate income tax to deduct NOL carryforwards, the IRC conformity provisions do not apply to banks.

No entity, including a bank, is inherently granted a deduction for NOLs (carrybacks or carryforwards). For a taxpayer to claim a tax deduction lawfully, the governing law must

⁶Taxable income for corporations is based on a partially adopted IRC, while taxable income for banks is based on book income. Therefore, the term “taxable income” in this document, when used related to the bank tax, does not imply conformity to the IRC.

specifically allow the tax deduction. *Davis Mechanical Contractors, Inc. v. Wasson*, 268 S.C. 26, 29, 231 S.E.2d 300, 301 (1977) (stating that “[t]ax deductions are a matter of legislative grace”).

Accordingly, for the Taxpayer to prevail in this matter, it must prove that the General Assembly has specifically allowed banks the authority to deduct NOL carryforwards. Deductions for net operating losses - both carrybacks and carryforwards - are a creature of section 172 of the Internal Revenue Code, I.R.C. § 172(a), (b) (West 2016), not a creature of South Carolina law. However, in 1985 when the General Assembly adopted the IRC conformity provisions, it adopted a provision regarding NOLs. S.C. Code Ann. § 12-6-50(6) (2014) (prohibiting NOL carrybacks under I.R.C. § 172). By adopting the Internal Revenue Code but prohibiting a deduction for NOL carrybacks, the General Assembly allowed NOL carryforwards for entities (e.g., corporations) that are taxed in South Carolina under the IRC conformity provisions. The Taxpayer relies almost entirely on the adoption of section 12-6-50(6) to claim that it can deduct NOL carryforwards on its South Carolina bank tax returns. However, South Carolina does not tax banks like the Taxpayer under the IRC conformity provisions, *see* S.C. Code Ann. §§ 12-6-550(1) (2014), 12-6-580 (2014), so the Taxpayer’s reliance on section 12-6-50(6) is erroneous.

Here, the Taxpayer will be unable to meet its burden to show that the General Assembly has statutorily granted authority to banks to deduct NOL carryforwards. No applicable South Carolina law – either in Chapter 6 or Chapter 11 – grants banks a deduction for NOL carryforwards, and, as demonstrated herein, the General Assembly did not adopt any portion of the IRC, including I.R.C. § 172 regarding NOL deductions, for bank tax purposes.

First, no provision in Chapter 11 of Title 12 authorizes a bank to deduct NOL carryforwards. *See* S.C. Code Ann. §§ 12-11-10 – 12-11-60 (2014). In fact, the provisions of Chapter 11 never mention NOLs or IRC conformity. Since 1937, the bank tax has been based on “entire net income.” *See* S.C. Code Ann. § 12-11-20 (2014); 1937 S.C. Acts page no. 565. Although the IRC conformity amendments of 1985 changed the tax base for corporate income tax purposes from “entire net income” to taxable income based on a partially adopted IRC, the General Assembly did not change the tax base of “entire net income” in the bank tax laws. *See* S.C. Code Ann. § 12-11-20 (2014). Further, section 12-11-40 adopted certain provisions of Chapter 6 for bank tax purposes, but it did not adopt the IRC conformity provisions for bank tax purposes. *See* S.C. Code Ann. § 12-11-40 (2014). Section 12-11-40 specifically adopted certain provisions of Chapter 6 for only “enforcement and administration” purposes. *Id.*

Second, the Taxpayer relies on the current statutory framework in Chapter 6 of Title 12 (i.e., the IRC conformity provisions) to argue that the Taxpayer may deduct NOLs on its South Carolina bank tax returns, but the Taxpayer’s argument is flawed. The General Assembly adopted the IRC for only certain categories of taxpayers, and banks do not fit into any of the categories of taxpayers for which the General Assembly adopted the IRC.

The IRC conformity provisions apply to the corporate income tax, S.C. Code Ann. § 12-6-580 (2014), the individual income tax of a resident, S.C. Code Ann. § 12-6-560 (2014), the gross income and taxable income of S Corporations and their shareholders, S.C. Code Ann. § 12-6-590

(2014), the gross income and taxable income of partnerships and their partners, S.C. Code Ann. § 12-6-600 (2014), and resident estates and trusts, S.C. Code Ann. § 12-6-610 (2014). The General Assembly also partially adopted the IRC for all other entities, except those entities specifically excluded from the corporate income tax by section 12-6-550. S.C. Code Ann. § 12-6-630 (2014).

Here, banks, including the Taxpayer, do not fall into any of the categories of taxpayers for which the General Assembly adopted the IRC. First, banks generally are organized as corporations in South Carolina, *see* S.C. Code Ann. §§ 34-3-10(A), 34-3-210 (West 2017), so they are not subject to the IRC conformity provisions related to residents filing individual income taxes, partnerships, and resident estates and trusts. Second, the Taxpayer has not elected to be taxed as an S Corporation, so it is not subject to the IRC conformity provisions related to S Corporations. Third, although the Taxpayer, a bank, is organized as a corporation, the General Assembly specifically excluded banks from the corporate income tax. S.C. Code Ann. § 12-6-550(1) (2014). Therefore, when the General Assembly applied the IRC to the corporate income tax under section 12-6-580, the General Assembly did not apply the IRC to banks. Fourth, section 12-6-630 applies the IRC to all other entities but specifically excludes entities, including banks that the General Assembly excluded from the corporate income tax by section 12-6-550. Therefore, this catchall provision specifically excluded banks from IRC adoption.

Because banks do not fall into any of the categories of taxpayers for which the General Assembly adopted the IRC, the IRC conformity provisions of Chapter 6 are not applicable to banks; hence, banks do not use the IRC to determine their South Carolina tax base. Accordingly, the Taxpayer's reliance on the IRC conformity provisions in Chapter 6, especially section 12-6-50(6) regarding NOLs, is misguided.

In summary, the General Assembly in Chapter 11 did not grant banks the authority to deduct NOL carryforwards on their South Carolina bank tax returns. S.C. Code Ann. §§ 12-11-10 to 12-11-60 (2014). Further, the General Assembly has not adopted the IRC conformity provisions, including section 12-6-50(6), which mentions NOLs, for South Carolina bank tax purposes. Therefore, despite the fact that corporations may deduct NOL carryforwards for purposes of the corporate income tax, banks have no statutory authority to deduct NOL carryforwards when calculating their tax base for South Carolina bank tax purposes. The Taxpayer is unable to satisfy its burden of proof to show otherwise.

B. When The General Assembly Adopted IRC Conformity With Respect to the Corporate Income Tax, The General Assembly Made No Changes to the Bank Tax.

Although it was clear that the tax base for the bank tax was calculated differently than the tax base for the corporate income tax for many decades, the General Assembly did not amend the bank tax provisions in Chapter 11 of Title 12 when it adopted the IRC conformity provisions in Chapter 6 in 1985. Instead, by leaving the tax base for bank tax purposes as the "entire net income" while changing the tax base for the corporate income tax to the taxable income based on a partially adopted IRC, the General Assembly confirmed that the tax base for the bank tax differs from the tax base for the corporate income tax.

The 1985 IRC conformity provisions added section 12-7-415 (now section 12-6-580), which made “taxable income as determined under the [IRC] with the modifications specified” as the tax base for the corporate income tax. S.C. Income Tax Federal Conforming Amendments of 1985, Act No. 101, 106th Session § 7 (1985). This essentially replaced the previous corporate income tax base of “entire net income.” S.C. Code Ann. § 12-7-230 (1976); S.C. Code Ann. § 65-222 (1962).

The tax base for the bank tax has been the “entire net income” of the bank since the bank tax’s inception in 1937. 1937 S.C. Acts page no. 565. Although the 1926 Act also used “entire net income” to define the tax base for corporate income tax purposes, from 1937 to 1985 the tax base of “entire net income” for bank tax purposes has been calculated differently from the tax base of “entire net income” for corporate income tax purposes. If the General Assembly had intended to change the tax base for the bank tax from “entire net income,” like it did for the corporate income tax, it would have explicitly done so in 1985. For the corporate income tax, in 1985 the General Assembly changed the tax base from “entire net income” to “taxable income as determined under the [IRC] with modifications specified.” The General Assembly did not change the tax base for the bank tax in 1985, or at any other time, from how it has been written and interpreted since 1937. *See infra* Part II. Further, S.C. Code Ann. Regs. 117-1500 and 117-1500.1, which define the bank tax as a franchise tax, not an income tax, and define “entire net income” for bank tax purposes, were not repealed in 1985, and these regulations remain in force today. The General Assembly had knowledge of these regulations in 1985 and the fact that entire net income was applied differently for bank tax purposes and corporate income tax purposes, yet the General Assembly chose not to amend Chapter 11 regarding the bank tax or to repeal the bank tax regulations that support this Department Determination.

Therefore, the 1985 IRC conformity provisions did not change the application of the bank tax as a franchise tax that imposes a 4.5% tax on the entire net income of a bank based on its book income and as a tax that has no statutory authority to permit deductions for NOLs. Without any statutory or regulatory changes in 1985 or thereafter regarding the bank tax, banks are still statutorily unable to deduct NOLs.

C. Later in its 2005 Amendment to Section 12-6-50, the General Assembly Did Not Extend the Internal Revenue Code Conformity Provisions to the Bank Tax.

As discussed above, the 1985 IRC conformity provisions are not applicable to the bank tax. The Taxpayer asserts that, even if that is true, an amendment to section 12-6-50 in 2005 extended the applicability of the 1985 IRC conformity provisions to the bank tax; however, the 2005 amendment did not extend the applicability of the IRC conformity provisions in general, nor subsection 12-6-50(6) specifically, to the bank tax.

Section 12-6-50 is the IRC conformity statute that lists the IRC provisions that South Carolina did not adopt. This statute exists in Chapter 6 of Title 12, while the bank tax statutes exist in Chapter 11 of Title 12. The Taxpayer incorrectly argues that amending the introduction of section 12-6-50 from “[f]or purposes of this chapter” to “[f]or purposes of this title” extends the applicability

of section 12-6-50, including the NOL carryback provision of subsection 12-6-50(6), to the bank tax. The Taxpayer's argument fails because, as explained above, the General Assembly did not adopt the IRC conformity provisions for bank tax purposes, so amending an IRC conformity provision would not affect the bank tax.

In 2005, the General Assembly amended section 12-6-50 to say the following:

For purposes *of this title* and all other titles which provide for taxes administered by the department, except as otherwise specifically provided, the following Internal Revenue Code Sections are specifically not adopted by the State:

(6) Section 172(b)(1) relating to net operating loss carrybacks.

Act No. 145, 116th Session § 8 (2005) (emphasis added).

Prior to the above 2005 amendment, section 12-6-50 read as follows:

For purposes *of this chapter*, except as otherwise specifically provided, the following Internal Revenue Code Sections are specifically not adopted by this State:

(6) Section 172(b)(1) relating to net operating loss carrybacks.

S.C. Code Ann. § 12-6-50 (Supp. 1999) (emphasis added).

The Taxpayer asserts that even if it could not deduct NOL carryforwards before 2005, this amendment permits it to deduct NOL carryforwards in 2011 through 2014. The Taxpayer asserts that the new introductory language in section 12-6-50 (i.e., “[f]or purposes of this title”) means that section 12-6-50 was adopted for all taxes in Title 12 that are administered by the Department, which includes the bank tax. Here, the Taxpayer's argument is that the 2005 amendment expanded the scope of the IRC conformity provisions in section 12-6-50 from only Chapter 6 regarding income taxes to other chapters in Title 12 including Chapter 11 regarding the bank tax.

However, the Taxpayer's argument assumes that the General Assembly adopted the IRC for bank tax purposes, which it did not. For the Taxpayer's argument to prevail, it must prove that the General Assembly adopted the IRC for bank tax purposes. Only if the IRC conformity provisions apply to the bank tax would the non-adoption statute of section 12-6-50, and specifically subsection 12-6-50(6) that mentions NOLs, be applicable to banks. Although the bank tax is included in Title 12, the South Carolina statutory framework does not adopt the IRC for purposes of the bank tax.

As explained above in Part I(A), the General Assembly adopted the IRC for the corporate income tax, S.C. Code Ann. § 12-6-580 (2014), and for other taxes, S.C. Code Ann. §§ 12-6-560, 12-6-590, 12-6-600, 12-6-610, 12-6-630 (2014), but banks are specifically excluded from sections 12-6-580 and 12-6-630 and do not fit into the other categories of taxpayers for which the IRC was adopted. In fact, amended section 12-6-50 acknowledges that it will not apply to all taxes administered by the Department when it included language saying “except as otherwise specifically provided.” Here, the General Assembly specifically excluded banks from the income taxes to which it applied the IRC.

Further, the General Assembly had a reason to change the provision’s language to “[f]or purposes of this title.” In many chapters other than Chapter 6 in Title 12, it had used the term “Internal Revenue Code” referring to other taxes administered by the Department. *See e.g.*, S.C. Code Ann. § 12-13-20 (2014) (using the term “Internal Revenue Code” when addressing the South Carolina income tax on building and loan associations).

Because the General Assembly did not adopt the IRC for banks and it had a reason to change the language in section 12-6-50 that did not affect the bank tax, the 2005 amendment to section 12-6-50 did not extend section 12-6-50(6) to the bank tax.

D. The General Assembly Did Not Adopt All of Subchapter H of the Internal Revenue Code. It Instead Adopted Only I.R.C. § 584, Which Does Not Permit Banks to Deduct Net Operating Losses.

As stated above, the General Assembly in 1985 established a partially adopted IRC as the starting point for calculating the South Carolina corporate income tax and certain other taxes, but it did not establish the IRC as the starting point for calculating the bank tax. The Taxpayer wrongly asserts that as part of the 1985 IRC conformity provisions the General Assembly adopted the entirety of Subchapter H of the IRC, which is titled “Banking Institution,” and that I.R.C. § 584, which was adopted in South Carolina, permits banks to deduct NOLs.

Subchapter H of the IRC includes IRC sections 581-582, 584-585, 591, 593-594, and 597, but, in the 1985 conformity provisions, the General Assembly did not adopt IRC sections 581, 582, and 585 through 597.⁷ Act No. 101, 106th Session § 12(h) (1985); *see also* S.C. Code Ann. § 12-6-50(9) (2014). Therefore, when reading sections 12-6-40 and 12-6-50 together, the General Assembly adopted only I.R.C. § 584 for IRC conformity purposes, not the entirety of Subchapter H.

The only provision from Subchapter H of the IRC that the General Assembly adopted was section 584 regarding common trust funds. The IRC defines a “common trust fund” as follows:

[A] fund maintained by a bank

⁷Today, South Carolina law has also adopted I.R.C. § 597; however, it is not relevant to this matter. *See* S.C. Code Ann. § 12-6-50(9) (2014).

(1) exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity:

(A) as a trustee, executor, administrator, or guardian, or

(B) as a custodian of accounts

and

(2) in conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System or the Comptroller of the Currency pertaining to the collective investment of trust funds by national banks.

I.R.C. § 584(a) (West 2017).

A common trust fund is not a bank. The IRC defines a common trust fund differently than it defines a bank. *Compare* I.R.C. § 584(a) (West 2017) (defining a common trust fund) *and* I.R.C. § 581 (West 2017) (defining a bank). A common trust fund is a “fund maintained by a bank”; it is not a bank itself. *See* I.R.C. § 584(a) (West 2017). A common trust fund is a collective investment vehicle in which a bank acts as a trustee, custodian, or similar position for the benefit of the collective investment vehicle. *See* I.R.C. § 584(a)(1) (West 2017). A common trust fund is not considered a corporation. I.R.C. § 584(b) (West 2017). Common trust funds are not subject to federal and state income tax; like a partnership, each participant in the common trust fund includes its own share of the tax attributes of the common trust fund on its own tax return. *See* I.R.C. §§ 584(c), (d), (g) (West 2017). Finally, a common trust fund is a separate entity from the bank, which acts as the fund’s trustee or in a similar position, and common trust funds issue their own audited financial statements that are separate and apart from the respective bank’s financial statements. *See* Audited Financial Statements of Wells Fargo Bank Common Trust Funds for Personal Trusts at Dec. 31, 2015, [https:// www.08.wellsfargomedia.com/assets/pdf/personal/the-private-bank/ucm_prd_216897.pdf](https://www.08.wellsfargomedia.com/assets/pdf/personal/the-private-bank/ucm_prd_216897.pdf) (last visited June 27, 2017).

Despite the facts that banks are entirely different from common trust funds and the General Assembly included only the IRC statute concerning common trust funds in the South Carolina partially adopted IRC, the Taxpayer wrongly asserts that I.R.C. § 584(g) allows NOL deductions for banks while denying them for common trust funds. That subsection has nothing at all to do with banks. *See* I.R.C. § 584(g) (West 2017). In fact, the subsection allows NOL deductions by the participants in the common trust fund, as permitted under Treasury regulations. *Id.* Therefore, I.R.C. § 584(g) does not permit the Taxpayer, a bank, to deduct NOL carryforwards in this matter.

The Taxpayer’s argument here fails for two primary reasons. First, the General Assembly did not adopt the entirety of Subchapter H of the IRC. When reading sections 12-6-40 and 12-6-50 together, the partially adopted IRC included only I.R.C. § 584. However, the Taxpayer wrongly asserts that by adopting the entirety of Subchapter H regarding banking institutions, the General Assembly implied that the IRC conformity provisions apply to the bank tax in Chapter 11 of Title

12. The Taxpayer's position is in error because the General Assembly did not adopt the entirety of Subchapter H but adopted only I.R.C. § 584 regarding common trust funds. Second, I.R.C. § 584 applies to common trust funds, not to banks, so the adoption of I.R.C. § 584 has no impact on whether banks may deduct NOL carryforwards on their South Carolina bank tax returns.

E. In Chapter 11, The General Assembly Adopted Portions of Chapter 6 Only for Enforcement and Administration Purposes. This Bank Tax Statute Did Not Adopt The Internal Revenue Code or Permit Deductions of Net Operating Losses for Bank Tax Purposes.

Since the inception of the bank tax in 1937, the General Assembly has ensured that a statute existed in the bank tax chapter allowing for the adoption of certain income tax provisions (currently from Chapter 6 of Title 12) as appropriate for the administration and enforcement of the bank tax. However, this statute is a limited adoption of some provisions of the South Carolina Income Tax Act and does adopt the IRC conformity provisions or permit banks to deduct NOL carryforwards.

The bank-tax statute that was applicable during the years at issue in this case was as follows:

For the purpose of administration, allocation and apportionment, enforcement, collection, liens, penalties, and other similar provisions, all of the provisions of Chapter 6 of this title that may be appropriate or applicable are adopted and made a part of this chapter for the enforcement and administration of this chapter, including the requirement to make declarations of estimate tax and make estimated tax payments.

S.C. Code Ann. § 12-11-40 (2014). As this statute says, the income tax statutes adopted from Chapter 6 are for only "enforcement and administration" purposes. *Id.* The calculation of the tax base for the bank tax (i.e., the IRC conformity provisions of Chapter 6) is not related to enforcement or administration of the bank tax.

Section 12-11-40 does not adopt the provisions of Chapter 6 that calculate gross income or taxable income or that impose the tax or the tax rate upon a taxpayer. It addresses only some provisions of Chapter 6 "that may be appropriate or applicable . . . for the enforcement and administration" of the bank tax. *Id.* Administration activities would include such activities as payment of the bank tax, *see* S.C. Code Ann. § 12-11-50 (2014), and the deadlines for filing a bank tax return. Enforcement activities would include activities such as making and publishing rules and regulations. S.C. Code Ann. § 12-6-20 (2014). The other Chapter 6 activities adopted by this bank-tax statute include collection, liens, penalties, and other similar provisions. For bank tax purposes, the General Assembly did not adopt provisions of Chapter 6 used to define or calculate the tax base. Finally, in 1996 the General Assembly amended section 12-11-40 to adopt the "allocation and apportionment" provisions of Chapter 6 for purposes of the bank tax. Act No. 248, 111th Session § 1 (1996). Although this adoption does affect the calculation of South Carolina net income to which the bank tax rate of 4.5% is applied, it does not adopt the IRC conformity

provisions, which would be necessary for the Taxpayer to prevail in this matter. It merely imposes the allocation and apportionment provisions of Chapter 6 on whatever multistate tax base that a bank must apportion to South Carolina. It was reasonable for the General Assembly to ensure in 1996 that banks operating in South Carolina could use the allocation and apportionment provisions because that is the period in which banks were being de-regulated and commencing multi-state banking operations. Additionally, if section 12-11-40 or its predecessor statutes were a broad adoption of the Chapter 6 income-tax provisions for bank tax purposes, there would have been no need to adopt in 1996 the allocation or apportionment provisions of Article 17 of Chapter 6 for bank tax purposes.

Section 12-11-40 and its predecessor statutes are an adoption of certain provisions of Chapter 6 that are necessary only for enforcement and administrative purposes. Section 12-11-40 is not an adoption of the IRC conformity provisions or of section 12-6-50(6) that mentions NOLs; hence, the General Assembly through section 12-11-40 did not adopt the IRC conformity provisions of Chapter 6, including the NOL provision of section 12-6-50(6), for bank tax purposes.

In summary, tax deductions are matter of legislative grace, and South Carolina law does not provide any statutory authority for a bank to deduct NOLs as part of the bank tax. Further, the General Assembly did not impose the IRC conformity provisions on banks, so all of the Taxpayer's arguments that rely on IRC conformity provisions to justify an NOL deduction for banks must fail. Accordingly, the Taxpayer is unable to prove that the General Assembly has granted it the authority to deduct NOLs on its South Carolina bank tax returns.

II. Since its Inception in 1937, the Bank Tax Has Been Different from the Corporate Income Tax Such that Net Operating Losses that May Be Available to Reduce Corporate Income Taxes Are Not Available to Reduce Bank Taxes.

The legislative history, longstanding Department policy, and other activities indicate that once the General Assembly enacted the bank tax in 1937, that the corporate income tax and the bank tax were distinct and separate taxes that had different tax bases, such that net operating losses have never been deductible under the bank tax.

In addition to being in separate chapters of the South Carolina Code of Laws, the Department and others have recognized for decades that the corporate income tax and the bank tax differ in critical areas. We address some these differences below.

In 1948, the South Carolina Attorney General issued an opinion that differentiated the bank tax from the corporate income tax. The Attorney General stated that the bank tax "was a franchise tax for the privilege of operating, or doing business, in this State, the amount thereof being measured by the entire net income." 1948 S.C. Op. Atty. Gen. No. BA-OAG-1 (March 12, 1948). The Attorney General also stated that the bank tax imposes a tax on "all income from whatever source derived, even income from non-taxable securities." *Id.* This is a difference between the bank tax and the corporate income tax because a state may not impose a direct income tax (e.g., the corporate income tax) on interest income earned from government obligations. The Attorney

General identified another item in which the calculation of the tax base for the bank tax differs from the calculation of the tax base for corporate income tax purposes when it recognized that for bank tax purposes federal and state income taxes are deductible. *Id.*

By 1967, a regulation existed that mirrored the 1948 Attorney General's Opinion. That regulation defined "entire net income" for bank tax purposes to "include income derived from any source whatsoever including interest on obligations of the United States, the United States Government or its possessions or of any state and any political subdivision thereof."⁸ S.C. Reg. BA-R-1 (December 6, 1967). South Carolina continuously has had such a regulation since then. *See* S.C. Code Ann. Regs. 117-1500.1 (West 2017). Current regulations also state that the bank tax is a franchise tax on banks, not an income tax on banks. *See* S.C. Code Ann. Reg. 117-1500 (West 2017).

At least one decision of the South Carolina Tax Commission (SCTC), the predecessor of the Department, also has differentiated the bank tax from the corporate income tax and even stated that the bank tax was a franchise tax that has a "special" tax base. In a matter concerning First National Bank of South Carolina regarding its 1971 to 1973 bank taxes, the SCTC stated that the bank tax "has always been construed to be a franchise tax measured by the bank's entire net income" and referenced the 1948 Attorney General's Opinion saying that entire net income includes "all income from whatever source derived, less all expenses incurred." I-D-189 (Jan. 24, 1975). The SCTC concluded that all expenditures incurred during a tax year of a bank are deductible because "[t]he *special base of this [bank] tax* is, therefore, economic income rather than taxable income." *Id.* (emphasis added).

Allowing a bank to record and offset its income by "all expenses incurred" is entirely different from the corporate income tax and identifies a critical and longstanding difference between the bank tax and the corporate income tax. While the 1975 SCTC decision and the 1948 Attorney General's Opinion support a bank's ability to deduct all of its expenses, both the 1926 Act and the IRC place limitations on the amount of deductions that a corporation (or other taxpayer) may claim, even though the actual cash outlay of a greater amount was made. First, under the 1926 Act, the General Assembly limited deductions that a corporation could take. For example, under the 1926 Act, a corporation may not deduct state and federal income taxes, Income Tax Act of 1926, 1927 S.C. Acts page no. 10, and may deduct only ordinary and necessary business expenses, Income Tax Act of 1926, 1927 S.C. Acts page no. 9. Further, under the IRC conformity provisions, the IRC imposes limitations on deductions that apply to corporations but not to banks. For example, the IRC still limits business deductions to those that are ordinary and necessary, I.R.C. § 162(a) (West 2017), and limits the deduction for corporate charitable contributions to only those that are substantiated and to only 10% of the corporation's taxable income, I.R.C. § 170(a), (b)(2) (West 2017). Therefore, while a bank and a corporation may incur the same expense for \$100, income tax laws primarily originating from the Internal Revenue Code may limit the amount the corporation may deduct - or entirely disallow any deduction - on its corporate income tax return,

⁸Professor Richard Pomp, in his state and local government textbook, identifies this difference between a franchise tax that is based on income and a direct income tax. Richard D. Pomp, *State and Local Taxation*, vol. 2, 10-12 (8th ed. 2015).

but South Carolina bank tax laws will allow a deduction for the entire \$100. Accordingly, book income of a bank and taxable income of a corporation pursuant to IRC conformity provisions may be different despite the exact same transactions occurring in each entity.

Further, Departmental policy documents also differentiate the bank tax from the corporate income tax. For example, the Department has recognized the bank tax to be a franchise tax based on the entire net income of the bank. S.C. Rev. Rul. #92-9. Additionally and specifically related to NOL deductions, the Department-issued instructions to Form SC 1101 B, the South Carolina Bank Tax Return, state that banks are not allowed a NOL deduction for South Carolina bank tax purposes.

As has been demonstrated above, the bank tax and the corporate income tax are distinctly different taxes with different tax bases and exist for different purposes. Since 1937, South Carolina law has excluded banks from the corporate income tax. The corporate income tax is a traditional income tax and, under the General Assembly's 1985 amendments conforming the income tax to the Internal Revenue Code, NOL carryforwards are deductible for corporate income tax purposes. *See* S.C. Code Ann. § 12-6-50(6) (2014). However, as the Attorney General recognized, the bank tax is an annual tax on the privilege of doing banking business in South Carolina. The legislative and other history of the bank tax demonstrate that generally all income and all expenses are deductible when calculating the tax base for bank tax purposes, while we know that for corporate income tax purposes certain income is not taxable and certain expenses are not deductible.

No statutory provision or history of allowing a deduction for NOLs for bank tax purposes in South Carolina has existed. In fact, it has been the longstanding policy of the Department, and previously the SCTC, that the bank tax is an annual privilege tax, which calculates its tax base differently from the corporate income tax and which does not allow deductions for NOLs. This longstanding policy is demonstrated by the 1948 Attorney General's Opinion, the 1975 SCTC decision regarding First National Bank of South Carolina, bank tax regulations, and the instructions to Form SC 1101 B.

In addition, testimony to and the final report of the South Carolina Taxation Realignment Commission (TRAC) – a statutorily created body – in 2010 supports the Department's longstanding policy. First, in its final report, TRAC stated that banks “are exempt from South Carolina income taxes” but instead pay “a franchise tax based upon the ‘entire net income’ of banks,” which is based on “net book income.” Final Report of S.C. Taxation Realignment Commission, pp. 75-76, 140-41 (Dec. 2010). Second, the President and CEO of the South Carolina Bankers Association testified as follows:

In South Carolina, banks pay an income tax that is not calculated in the same manner as for a C corporation. The bank tax is a franchise tax. Banks are taxed pursuant to Chapter 11 of Title 12. S.C. Code § 12-11-20 provides that the entire net income of a bank in South Carolina is to be taxed at 4 1/2% rate annually. This income is “book income” not “taxable income” which is what C Corps are taxed on. As a result all income and expenses are included in the tax

calculation for a bank. And the entire net income is calculated without regard to the majority of the book/tax differences considered for federal income tax purposes, including the NOL carryforward.

Lloyd Hendricks, Bank Tax – TRAC Testimony Give[n] by Lloyd Hendricks (June 8, 2010), last accessed on June 1, 2017 at www.scstatehouse.gov/Archives/CitizensInterestPage/TRAC/060810Meeting/Bank%20Tax.pdf.

Because legislative history supports the non-deductibility of NOLs by banks and because courts should give deference to the Department's longstanding policy regarding the bank tax, Synovus may not deduct NOL carryforwards in its 2011 through 2014 bank tax returns.

Conclusion:

Since the inception of the bank tax in 1937, the Department and others have interpreted and applied the bank tax to be a franchise tax, not an income tax, whose tax base is calculated differently than the corporate income tax and for which NOLs are not deductible. Courts should give deference to the legislative history and to the Department's longstanding policy.

Further, deductions are a matter of legislative grace, and the General Assembly has not granted banks any statutory authority in either Chapter 11 or Chapter 6 to deduct NOLs on their South Carolina bank tax returns. Additionally, the 1985 IRC conformity provisions do not apply to the bank tax, so the IRC conformity provisions in section 12-6-50 on which the Taxpayer primarily relies do not apply to banks. First, the IRC was adopted for the corporate income tax in section 12-6-580, but banks are exempt under section 12-6-550(1) from the corporate income tax. Second, the General Assembly explicitly exempted banks from taxation under the IRC under section 12-6-630.

Banks have no authority to deduct NOL carryforwards, so the Taxpayer may not deduct NOL carryforwards in bank tax years 2011 through 2014.

October 17, 2017

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January 2, 2018

Via Hand Delivery

The Honorable Ralph King Anderson, III
Chief Administrative Law Judge
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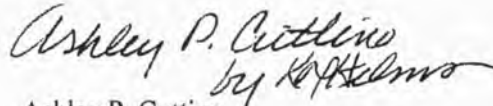
RE: *Synovus Bank v. South Carolina Department of Revenue*
Docket No. 17-ALJ-17-0418-CC

Dear Judge Anderson:

Please find enclosed Synovus Bank's Prehearing Statement and Proof of Service in the above referenced matter.

Should you have any questions or need additional information, please let us know.

Sincerely,


Ashley P. Cuttino

APC:tla

Attachment

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**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Synovus Bank,

Petitioner,

v.

South Carolina Department of Revenue,

Respondent.

Docket No. 17-ALJ-17-0418-CC

**PETITIONER'S PRE-HEARING
STATEMENT**

1. The Nature of This Proceeding;

Appeal from a determination issued by the South Carolina Department of Revenue ("DOR" or "Department") contending a bank in South Carolina may not apply Net Operating Loss carryforwards ("NOL" carryforwards) on South Carolina tax returns despite the fact that NOL carryforwards are allowed under the federal tax code and have been adopted by the South Carolina legislature through tax conformity. This is an issue of first impression as the issue of the application of NOL carryforwards to banks has never been presented in a litigation setting.

2. Statutory Provision(s) Conferring Subject Matter Jurisdiction to the Agency and Other Applicable Statutes and Regulations

Taxpayer May Request a Contested Case Hearing Following a Department Determination: S.C. Code Ann. §12-60-450(e).

Administrative Law Court (ALC) Shall Preside Over Contested Case Hearing: S.C. Code Ann. §1-23-600

3. The Issues Presented for Determination Set Forth with Particularity, Including Any Claims or Defenses Expected to be Raised

Synovus Bank ("Synovus") asks this Court to determine if the South Carolina legislature, through conformity or otherwise, allows a bank to take a NOL carryforward deduction. The answer to this question is rooted in the DOR's contention that the bank tax is a franchise tax, thus applying the accounting principal of book income to the tax calculation. Synovus disagrees with the DOR and affirmatively alleges that there is no legislative authority to support an interpretation that the bank tax is a franchise tax. In addition, Synovus asks this Court to determine that, through conformity with the federal tax code, the South Carolina General Assembly granted corporations, including banks, the ability to deduct NOL carryforwards on

their South Carolina tax returns. In short, the issues raised for this Court to determine are as follows:

- Is the bank tax in South Carolina a franchise tax?
- Even if the bank tax in South Carolina could be classified as a franchise tax, is the tax measured on “book income” or “taxable income?”
- Did the DOR overreach its legislative authority by determining the bank tax to be a franchise tax?
- Is a bank a corporation subject to the provisions of the corporate tax code other than taxable rate as set forth in the bank tax?
- Did the legislature adopt NOL carryforwards through conformity?
- If NOL carryforwards were adopted through conformity, are NOL carryforwards allowable for banks in South Carolina?

4. The Action Requested of the Court and a Detailed Statement of the Law Which Supports that Requested Action, Including Statutory and/or Case Citations

Synovus requests the Court order the DOR to refund to Synovus all applicable taxes for the 2012, 2013 and 2014 tax years, dismiss DOR’s Audit Adjustments directed to Synovus as Audit Numbers 00/36/7603 and 00/36/7604, and issue an order clarifying the use of NOL carryforwards by banks in South Carolina in subsequent years.

5. A Brief Summary of the Facts to be Presented at the Hearing

A. Procedural History

Synovus timely filed claims for refunds with the DOR for tax years 2012, 2013, and 2014. The refunds arose because Synovus asserted in the refund claims it was entitled to NOL carryforward deductions for each of the tax years 2012 through 2014.

For all three tax years, the Department granted the refunds. However, the Department paid to Synovus the requested refund amounts only for 2013 and 2014, not for 2012. As to 2012, even though the refund was approved, it was not paid due to a procedural problem requiring the 2012 refund amount be “held for verification.”

Despite the refunds being approved, the Department made a subsequent decision to audit the tax years 2012, 2013 and 2014. Following the audit, in March and April, 2016, the Department reversed its prior decision approving the refunds. Instead, the audit concluded the refunds were incorrectly granted. During the audit, DOR concluded NOLs are not allowed in computing a bank’s tax liability.

Following the audit, DOR issued a Department Determination. Synovus disagrees with DOR’s determination and timely filed this appeal.

B. Substantive Facts

The substantive facts in this case are, largely, not in dispute. The parties expect to stipulate to some, if not all of the facts in this case after a period of limited discovery.

i. Synovus is a Regional Bank

Synovus' initial South Carolina bank tax filing obligations occurred as a result of the merger between the National Bank of South Carolina (NBSC) and Synovus Bank in 1995.

ii. The Bank Tax

There is no dispute that a bank tax (Chapter 11, Title 12) exists in South Carolina. The bank tax was originally passed in 1937. The bank tax instructs that banks in South Carolina are to compute their taxes at a rate of four and one half per cent of the entire net income of a bank. Nothing in the plain language of the bank tax sections or in the corporate tax sections (Chapter 6) of the South Carolina tax code (Title 12) demonstrates a legislative intent to deny NOL deductions to the bank tax. The General Assembly never uses the term "franchise tax" in relation to the bank tax. To the contrary — fifty percent of the statutes in all of Chapter 11—labels the tax on banks an "income tax." See S.C. Code §§12-11-30, 12-11-50, 12-11-60. Similarly, at no point in any section of Chapter 11 does the General Assembly use the term "book income" to define the tax on banks. In fact, the term "book income" never appears in Chapter 11.

DOR has admitted in its Determination Letter that the bank tax base in 1937 was—and remains today—the bank's "entire net income." The DOR further agrees and admits that the corporate income tax base in 1937 "also used 'entire net income' to define the tax base for corporate income tax purposes."

iii. The Conformity Statutes of S.C. Code Ann. §§12-6-40 and 12-6-50 Included the Bank Tax

In or around 1985, the General Assembly, through tax reform, revised the South Carolina Tax Code to conform to the Internal Revenue Code (I.R.C.). In 2005, the Tax Code was further revised. SC Code § 12-6-40 (Conformity Statute). In 1985 the General Assembly changed the tax base in the corporate tax section (Chapter 6) from "entire net income" to "taxable income as determined under the [IRC] with modifications specified," thus conforming the South Carolina tax code with the federal tax code. Prior to 2005, S.C. Code § 12-6-50 provided the list of I.R.C. provisions the South Carolina General Assembly did not want to adopt. This list was arguably only applicable for corporate income tax purposes based on the language of S.C. Code § 12-6-40. In 2005, the General Assembly took affirmative action to change the language used in S.C. Code Ann. § 12-6-40. The General Assembly changed the language and broadened its application to apply to the entire "title and all other titles which provide for taxes administered by the Department". The change in language clarified that conformity applies to all "taxes administered by the Department." See 2005 Act No. 145, § 8 (H.B., 3768). The application of the conformity statute to *all* taxes administered by the Department, including banks, removed any ambiguity that existed prior to 2005 regarding the applicability of conformity to banks. The 2005 amendment also clarified any confusion over the ability of banks in South Carolina to take the NOL

carryforward deductions specifically proscribed by the General Assembly in Chapter 6 of the tax code. See S.C. Code § 12-6-1130(4).

The General Assembly made clear what taxpayers are subject to the provisions of Chapter 6. Chapter 6 defines the “taxpayer” subject to its provisions as:

- (1) “Taxpayer” includes an individual, trust, estate, partnership, association; company, corporation, or any other entity subject to the tax imposed by this chapter *or required to file a return*.

SC Code § 12-6-30(1) (emphasis added).

Further, DOR has historically agreed that the conformity statute applies to banks in South Carolina. On at least two (2) separate occasions since conformity DOR has confirmed in writing its opinion that the I.R.C. applies to banks and has taken an inconsistent position to the Determination Letter from which this appeal originates.

- A. PLR 95-10. PLR 95-10 issued by DOR in 1995 does not label the bank tax as a franchise tax. Instead, PLR 95-10 refers to the bank tax as an income tax on banks. PLR- 95-10 instructs that the taxpayer/bank “will report its South Carolina taxable income each year based upon its taxable income calculated and reported for federal income purposes.”
- B. Tax Commission Information Letter # 94-35. Tax Commission Information Letter # 94-35 issued by DOR in 1995 determined the substantive allocation and apportionment provisions applicable to multi-state taxpayers in Chapter 6 also applied to banks.

DOR has also confirmed that the Use of Net Operating Losses Following a Change in Ownership, like that between NBSC and Synovus are allowed for “taxpayers”, with no limitation as to the type of taxpayer. See SC Revenue ruling #16-7.

Similarly, the former Tax Commission also took the position that the I.R.C. applied to banks prior to conformity. The Tax Commission applied I.R.C. § 368 in a reorganization case between two banks. Following reorganization, the Tax Commission applied I.R.C. § 368 to the newly formed bank to ensure full taxation. See Income Tax Decision I-D-200 (1975).

iv. The Conformity Statutes of S.C. Code Ann. §§12-6-40 and 12-6-50 Allow NOL Deductions to Banks

The Department agrees the General Assembly, for all years here in dispute, adopted the Internal Revenue Code as applicable on December 31 of the year preceding the tax year; i.e., December 31, 2011 for the 2012 tax year, etc. See S.C. Code §12-6-40(A)(1)(a). The adoption section takes in all of the IRC—nothing is omitted. In fact, the General Assembly included all of “Subchapter H” of the IRC, the IRC statutes explicitly governing Banks. However, the General Assembly in a separate section identifies specific provisions of the IRC it excludes from its adoption of the IRC. See S.C. Code §12-6-50. The General Assembly did not specifically

exclude from the adoption of the IRC all provisions addressing the taxation of banks. Instead, for all of the tax years in dispute, the adoption of the IRC by the General Assembly “left in,” and therefore adopted, IRC section 584.

Under IRC §584, a bank “common trust fund” is defined as “fund[s] maintained by a bank . . . as a trustee, executor, administrator, or guardian, or . . . a custodian of accounts . . . which the Secretary determines are established pursuant to a State law . . . similar to the Uniform Gifts to Minors Act.”

The statute then explains how a bank’s common trust fund is to be taxed. The relevant section states:

The benefit of the deduction for net operating losses provided by section 172 shall not be allowed to a common trust fund, but shall be allowed to the participants in the common trust fund under regulations prescribed by the Secretary. (Emphasis added).

26 U.S.C. §584(g)

By adopting IRC §584, the General Assembly expresses its intent to grant banks NOL deductions under IRC §172. If the General Assembly had no intention of allowing NOL deductions to banks, no reason would exist to tell banks they are not entitled to NOL deductions for their common trust funds.

These actions are consistent with the repeal of many of the bank tax regulations that gave instructions to banks on how to calculate and conform to the bank tax code following conformity. Prior to conformity, the former tax commission adopted 117-92.4 containing sixteen (16) income tax regulations for purposes of instruction on the bank tax. The regulations provided very specific tax guidance on tax procedures for banks, including those areas also covered by the I.R.C. Following conformity, in 1988-9, the Tax Commission repealed 117-92.4. The reason for the regulatory repeal is simple: additional regulation specific to banks was no longer needed because of conformity.

v. DOR’s Lack of Authority to Deny NOL Deductions

DOR’s reliance on “book income” as opposed to “taxable income” based on its assertion that the bank tax is a “franchise tax” raises a constitutional concern. DOR points to no statutory or legal precedent for this position. The South Carolina legislature is familiar with the term “franchise tax” and uses the term “franchise tax” in other sections of the tax code. *See* SC Code Ann. §§ 12-6-2210; 12-6-2290; 12-6-1130; 12-8-550. The General Assembly does not, however, use the term “franchise tax” in the bank tax section.

DOR bases its “franchise tax / book income” position on its interpretation of the term “entire net income” found in S.C. Code Ann. § 12-11-20. However, “entire net income” is not defined by the legislature and DOR’s application of the term “entire net income” is inconsistent and illogical when Title 12 is reviewed in total. DOR relies on a single attorney general’s

opinion from 1948, an interpretation given approximately seventy (70) years ago, decades prior to conformity with the IRC.

Because the General Assembly did not define the base for the bank tax, the intent of the General Assembly must be gained from the context of the plain meaning of the words used in the surrounding statutes. Such statutes, all within the bank tax chapter of the tax code, explicitly classify the tax as an income tax – not a franchise tax. *See* SC Code Ann. § 12-11-30 (“The *income tax* provided in this chapter is instead of all other taxes on banks”) (emphasis added); S.C. Code Ann. § 12-11-50 (“[T]he *income tax* paid under the provisions of this chapter must be deposited to the credit of the grand fund of the State.”) (emphasis added).

6. A Summary of Any Motions Expected to be Raised at the Hearing and the Appropriate Authority Underlying the Motion

The parties have contemplated limited discovery followed by a stipulation of some, if not all of the facts. Either party may subsequently file a Motion for Summary Judgment.

7. A List of Proposed Witnesses and Exhibits

The parties are working jointly on a consent scheduling order which will be presented to the Court on or before January 16, 2018. The disclosure of witnesses and exhibits shall be produced to the opposing party pursuant to the scheduling order.

8. A Statement Regarding the Necessity for Discovery, if any

Both parties agree limited discovery is needed in this matter. A consent scheduling order will be presented to the Court on or before January 16, 2018.

9. The Estimated Length of the Hearing

2 days

10. Any Dates in the Next One Hundred Twenty (120) Days when You Will Not be Available for a Hearing;

Synovus Counsel is unavailable on the following dates:

January 8; 10-12; 25-26

February 7-9; 16

March 13; 19; 30

April 2-6; 11-13

Of note, a consent scheduling order which will be presented to the Court on or before January 16, 2018. The consent scheduling order anticipates requesting a trial date outside of the 120-day window identified above.

11. An Email Address Where You Can be Reached

Emails for Synovus counsel:

Ashley Cuttino – ashley.cuttino@odnss.com

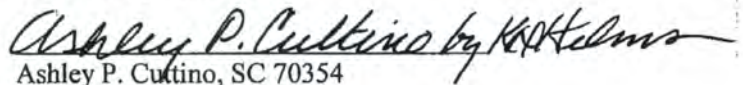
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Respectfully submitted this 2nd day of January 2018.

Respectfully submitted,

 Ashley P. Cuttino, SC 70354

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Attorneys for Petitioner, Synovus Bank

PROOF OF SERVICE

I hereby certify that the foregoing was served upon the following persons on January 2, 2018, by U.S. First Class Mail, properly addressed, and with the correct amount of postage affixed thereto:

William J. Condon, Jr., Esq.
South Carolina Department of Revenue
PO Box 12265
Columbia, SC 29211-9979



32457722.1

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Synovus Bank,

Petitioner,

v.

South Carolina Department of Revenue,

Respondent.

Docket No. 17-ALJ-17-0418-CC

PETITIONER'S MOTION FOR SUMMARY JUDGMENT

COMES NOW Petitioner Synovus Bank ("Synovus"), by and through its undersigned counsel, and hereby moves for summary judgment on its claims against Respondent South Carolina Department of Revenue ("DOR" or "Department").

This matter is the result of an appeal filed by Synovus Bank from a determination issued by the South Carolina Department of Revenue. The parties stipulate that no facts are at issue and the sole issue in this appeal is whether a bank can deduct losses in the form of net operating losses ("NOLs") to reduce its bank tax liability. DOR contends that a bank in South Carolina may not apply NOL carryforwards on South Carolina tax returns because South Carolina taxes banks as a franchise tax on book income rather than taxable income; banks have allegedly not been specifically granted an NOL carryforward deduction; and the 1985 tax conformity passed by the General Assembly does not apply to the bank tax. The DOR made this determination despite the fact that NOL carryforwards are allowed under the federal tax code and have been adopted by the South Carolina legislature through tax conformity for all taxpayers, including banks, as of at least 2005.

This is an issue of first impression and one of statutory construction. The application of NOL carryforwards to a bank has never been presented to any court in South Carolina. Synovus

asks this Court to determine that, through a significant legislative change in the tax conformity statute in 2005, the South Carolina General Assembly granted corporations, including banks, the ability to deduct NOL carryforwards on their South Carolina tax returns and this is true, regardless of whether or not the bank tax is a franchise tax.

Dated this 25 day of July, 2018.

Respectfully submitted,



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Attorneys for Petitioner Synovus Bank

CERTIFICATE OF SERVICE

I hereby certify that on the 25 day of July, 2018, the foregoing PETITIONER'S MOTION FOR SUMMARY JUDGMENT has been served upon the following persons by U.S. First Class Mail, and with the correct amount of postage affixed thereto:

Jason P. Luther, Esq.
South Carolina Department of Revenue
PO Box 12265
Columbia, SC 29211-9979



**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Synovus Bank,	)	
	)	
Petitioner,	)	
	)	
v.	)	Docket No. 17-ALJ-17-0418-CC
	)	
South Carolina Department of Revenue,	)	
	)	
Respondent.	)	

**PETITIONER’S MEMORANDUM IN SUPPORT
OF ITS MOTION FOR SUMMARY JUDGMENT**

COMES NOW Petitioner Synovus Bank (“Synovus”), by and through its undersigned counsel, and hereby moves for summary judgment on its claims against Respondent South Carolina Department of Revenue (“DOR” or “Department”).

I. INTRODUCTION

This matter is the result of an appeal filed by Synovus Bank from a determination issued by the South Carolina Department of Revenue. The parties stipulate that no facts are at issue and the sole issue in this appeal is whether a bank can deduct losses in the form of net operating losses (“NOLs”) to reduce its bank tax liability. DOR contends that a bank in South Carolina may not apply NOL carryforwards on South Carolina tax returns because South Carolina taxes banks as a franchise tax on book income rather than taxable income; banks have allegedly not been specifically granted an NOL carryforward deduction; and the 1985 tax conformity passed by the General Assembly does not apply to the bank tax. The DOR made this determination despite the fact that NOL carryforwards are allowed under the federal tax code and have been adopted by the South Carolina legislature through tax conformity for all taxpayers, including banks, as of at least 2005.

This is an issue of first impression and one of statutory construction. The application of NOL carryforwards to a bank has never been presented to any court in South Carolina. Synovus asks this Court to determine that, through a significant legislative change in the tax conformity statute in 2005, the South Carolina General Assembly granted corporations, including banks, the ability to deduct NOL carryforwards on their South Carolina tax returns and this is true, regardless of whether or not the bank tax is a franchise tax.

II. FACTS

No fact is at issue in this appeal and the parties have stipulated to the following. Exhibit 1, Stipulation of Facts.

On February 28, 1995, Synovus Financial Corp. acquired NBSC Corporation, the parent company of National Bank of South Carolina (NBSC). Exhibit 1, Stip. ¶ 10. Subsequently, on May 6, 2010, NBSC was merged into Columbus Bank & Trust Company and was renamed Synovus Bank. Exhibit 1, Stip. ¶ 6. Each of these entities is or was, as the case may be, organized as a corporation. Exhibit 1, Stip. ¶ 6.

As a result of the economic downturn suffered by many banks during the relevant time period, Synovus incurred NOLs and reported those losses on its federal tax returns for the years at issue. Synovus timely filed returns with the DOR for tax years 2011, 2012, and 2013. Exhibit 1, Stip. ¶ 13. For each tax year, 2011, 2012 and 2013, Synovus subsequently filed an amended tax return and claimed a portion of the NOLs on its state tax returns. Exhibit 1, Stip. ¶¶ 13-22. As a result of the filing on the amended return, Synovus claimed a tax refund for 2011, 2012, and 2013. Exhibit 1, Stip. ¶¶ 18, 20, 23-25. Synovus also filed a 2014 tax return that claimed NOLs. Exhibit 1, Stip. ¶¶ 22, 25. Each amended tax return on which a refund was requested was filed based on book income as instructed by DOR. The NOL carryforward deduction was applied based on a book income calculation for each year. Exhibit 2, Mark Robinson Aff. 7-13.

For tax years, 2012, 2013 and 2014 the Department granted the refunds. However, the Department paid to Synovus the requested refund amounts only for 2013 and 2014, not for 2012. As to 2012, even though the refund was approved, it was not paid due to a procedural problem requiring the 2012 refund amount be “held for verification.” Exhibit 1, Stip. ¶¶ 23-25.

Despite the refunds being approved, the Department made a subsequent decision to audit the tax years 2012, 2013 and 2014. Following the audit, the Department reversed its prior decision approving the refunds. Instead, the audit concluded the refunds were incorrectly granted after having increased the amount of NOL deductions reported. During the audit, DOR concluded NOLs are not allowed in computing a bank’s tax liability. Exhibit 1, Stip. ¶ 26. Following the audit, DOR issued a Department Determination. Synovus disagreed with DOR’s determination and timely filed this appeal. Exhibit 1, Stip. ¶ 27.

III. LEGISLATIVE AND OTHER HISTORY OF THE BANK TAX AND INCOME TAX

A. Federal NOLs

While there is no dispute that Synovus has generated and taken NOLs on its federal income tax returns, a very brief discussion of NOLs may be helpful. As stated in 539-3rd TMP, *Net Operating Losses*:

Under § 172, a net operating loss (also known as an NOL) incurred by a taxpayer in a taxable year can be carried back and deducted from the taxable income of specified preceding taxable years and carried forward and deducted from the taxable income of specified succeeding taxable years. The net operating loss deduction responds to a potential unfairness resulting from the fact that the income tax is computed based on an annual accounting period. Under this system, businesses with steady income that consistently exceeds their expenses are able fully to utilize all their deductions. In contrast, without the ability to deduct net operating losses, businesses with fluctuating incomes would lose the benefit of their deductions in taxable years in which expenses exceeded income. A business with alternating profits and losses would pay higher taxes

over a period of years than a business with stable profits, even though the average incomes of the two businesses were equivalent.

The net operating loss deduction minimizes the disparity that would otherwise result between the tax treatment of businesses with relatively constant income and businesses with fluctuating income. As stated by the U.S. Supreme Court:

[The net operating loss rules] were enacted to ameliorate the unduly drastic consequences of taxing income strictly on an annual basis. They were designed to permit a taxpayer to set off its lean years against its lush years, and to strike something like an average taxable income computed over a period longer than one year.

By emphasizing the ability to carry losses forward, Congress also intended to assist new businesses, whose formative losses can be used to offset income in subsequent more profitable years.

See Tax Mgmt. (BNA) (Series 539-3rd, Net Operating Losses).

In fact, almost *all* taxes on net income allow for the use of NOLs. The federal government and most states impose taxes on net income, and in virtually every case the tax base allows for a deduction for NOLs¹.

Since 1955, South Carolina has included a provision permitting taxpayers to deduct NOLs. The original NOL provision allowed a deduction for taxpayers that “established a new business or industry” in the state during the tax year. *See* 1955 (49) 437, § 6 (adding S.C. Code § 65-259(13)). In 1979, the Legislature extended the NOL deduction to “all taxpayers.” *See* 1976 S.C. Code Ann. § 12-7-700(12A) (Supp. 1979) (providing that the state’s NOL deduction “shall be allowed to all

¹ *See, e.g.*, 30 Del. Code § 1903; N.Y. Tax Law § 1503; R.I. Reg. CT 94-06. Courts have recognized that NOLs provide reasonable equitable relief from the potentially harsh consequences of levying an income tax based on a yearly accounting period. *See, e.g., Richard’s Auto City, Inc. v. Dir., Div. of Taxation*, 12 N.J. Tax 619, 626 (1992), *rev’d* on other grounds (“The [New Jersey] Legislature recognized that [] not permitting a net operating loss to be carried over to a subsequent tax accounting period [] would produce harsh results for many businesses whose yearly income may fluctuate from a loss in one year to a profit the next.”); *United Technologies Corp. v. Groppo*, 600 A.2d 1350, 1358 (Conn. 1991) (“An inequitable tax burden would result if companies were taxed during profitable periods without receiving any relief during periods of net operating losses.”) (citation omitted).

taxpayers”). The General Assembly repealed the standalone South Carolina NOL section when it adopted conformity, instead relying on the IRC and S.C. Code § 12-6-1130.

B. History of the Bank Tax in South Carolina

In 1926, the South Carolina General Assembly passed a state income tax that defined the type of tax on which income was to be based as “entire net income.” S.C. Code Ann. § 2451 (1932). In 1937, the General Assembly, for the first time, passed a tax specific to banks (the “bank tax”). The terminology used by the General Assembly in 1937 to identify the type of income to be taxed on banks was also “entire net income.” 1937 S.C. Acts § 563(2). Both the income tax and bank tax sections of the South Carolina Code continued to use the term “entire net income” until 1985 when the income tax terminology changed to conform to the federal tax code. *See* Tax Reform Act of 1986 PL 99–514 (HR 3838), PL 99–514, October 22, 1986, 100 Stat 2085. The term “entire net income” continues to be used in the bank tax section and has not changed since 1937. S.C. Code Ann. § 12-11-20.

The 1937 version of the bank tax contained eight (8) Code sections. Exhibit 3. The 1937 version of the bank tax made clear that the bank tax was applicable to banks and that banks would be charged at a different tax rate than other corporations. 1937 S.C. Acts 563(2). In addition, the 1937 bank tax addressed the payment of property taxes. 1937 S.C. Acts 563(3). The 1937 bank tax did no more and no less. 1937 S.C. Acts 563.

Despite the use of identical terminology “entire net income” in both the bank tax and income tax sections of the South Carolina Code, in 1948, the South Carolina Attorney General issued a short opinion that the bank tax was a franchise tax based on his interpretation of the term “entire net income.” The Attorney General differentiated the intent of the General Assembly and its use of the term “entire net income” in the bank tax from the General Assembly’s use of the

same term in the income tax without explanation. 1947-48 OP. S.C. Att’y Gen. 294 (March 12, 1948). Exhibit 4.

The bank tax has remained essentially unchanged since the initial version passed in 1937. Today, and at all times applicable to the NOL carryforward deductions taken in this matter, the bank tax has contained only six (6) sections. Throughout, the bank tax is described as an “income tax.”

Title 12 - Taxation
CHAPTER 11
Income Tax on Banks

SECTION 12-11-10. “Banks” and “taxpayers” defined.

For the purpose of this chapter and unless otherwise required by the context, the words “banks” and “taxpayers”, whenever used in this chapter, shall mean any person engaged in a banking business, whether incorporated under the laws of this State, any other state or the United States or whether unincorporated, except cash depositories.

SECTION 12-11-20. Tax on **income of banks**; rate.

A tax is imposed upon every bank engaged in business in the State which shall be levied, collected and paid annually with respect to the entire net income of the taxpayer doing a banking business within this State or from the sales or rentals of property within this State, computed at the rate of four and one half per cent of the entire net income of such bank or taxpayer.

SECTION 12-11-30. **Income tax** to be instead of other taxes; exceptions.

The **income tax** provided for in this chapter is instead of all other taxes on banks, except the use tax, the deed recording fee, and taxes on real property. The real property of a bank is taxed in the place where it is located.

SECTION 12-11-40. Appropriate Chapter 6 provisions shall govern enforcement, administration, allocation and apportionment of **income tax on banks**.

For the purpose of administration, allocation and apportionment, enforcement, collection, liens, penalties, and other similar provisions, **all of the provisions of Chapter 6 [income tax] of this title that may be appropriate or applicable are adopted and made a part of this chapter** for the enforcement and administration of this chapter, including the requirement to make declarations of estimated tax and make estimated tax payments.

SECTION 12-11-50. Payment of tax; deposit into general fund.

The taxes provided for in this chapter must be paid to the department as provided in Section 12-11-40 and the **income tax** paid under the provisions of this chapter must be deposited to the credit of the general fund of the State.

SECTION 12-11-60. Conditions rendering this chapter ineffective.

In case the first sentence of Section 12-11-30 should for any reason be declared to be invalid by a court of competent jurisdiction, the provisions of Sections 2663 through 2675, 2677 and paragraphs (33), (34) and (53) of Section 2578 of the Code of 1942 shall be and remain in full force and effect and the income tax provided in this chapter shall not be effective.

See S.C. Code §12-11-10 et al (emphasis added).

B. History of the South Carolina Income Tax and its Application to the Bank Tax and Conformity

1. The Conformity and Decoupling Statutes Were Originally Passed in 1985 and Revised in 2005

Prior to 1985, South Carolina had its own statutory definitions for enforcing tax laws—its own statutes defining the tax base, deductions, credits, etc. *See* S.C. Code § 12-7-415. In 1985, the General Assembly, through tax reform, revised the South Carolina Tax Code to conform to the Internal Revenue Code (“IRC”). S.C. Code § 12-4-415. The General Assembly has historically chosen to adopt the entire IRC and then provide specific IRC sections for exclusion.

The statutory provisions adopting a specific version of the IRC on a certain date (the “Conformity Statute”) is codified in § 12-6-40 and the statutory provisions specifically NOT adopting certain portions of the IRC (the “Decoupling Statute”) is codified in § 12-6-50.^{2 3 4}

In 2005, the Tax Code was further revised and clarified. In 2005, the General Assembly again adopted the conformity language which adopts the entire IRC. *See* S.C. Code § 12-6-40. In 2005, the General Assembly took affirmative action to significantly change the language used in

² 1985-1994:

- The Conformity Statutes were §§12-7-410 (for individuals), 12-7-415 (for corporations), 12-7-420 (for partnerships), and 12-7-425 (for estates or trusts)
- The Decoupling Statute for all taxpayers was §12-7-430
- From 1985-1994, the Conformity Statute of §12-7-415 for corporations:
 - Adopted the IRC’s definitions of gross income and taxable income outright except for modifications made in the Decoupling Statute
 - Therefore, all of the intermediate steps in calculating gross income and taxable income (such as deductions, credits, etc.) were adopted by South Carolina unless specifically modified in the Decoupling Statute

³1985-1994:

- From 1985-1994, the Decoupling Statute of §12-7-430:
 - addressed taxable income of “individuals, estates, trusts, partnerships, and corporations”; and provided the following regarding net operating losses:
Section 12-7-430. “The South Carolina taxable income of individuals, estates, trusts, partnerships and corporations is modified as provided in this section.

- (d) The deductions used in computing adjusted gross income and taxable income are modified as follows:
 - (1) The deduction permitted by the Internal Revenue Code Section 164 must be computed in the same manner except there is no deduction for state and local income taxes, or state and local franchise taxes measured by net income, or any income taxes, or any taxes measured by or with respect to net income.
 - (2) Any net operating loss deduction is computed in accordance with the internal Revenue Code Section 172, except that all items of income and deductions used in computing the net operating loss deduction are adjusted as provided in this section and in Section 12-7-435 and no carrybacks allowed.”

Banks are required by law to be corporations and, under S.C. Code Ann. §12-11-40, are subject to “all provisions of chapter 7 of this Title that may be appropriate or applicable.

⁴ 1995-2004:

- The Conformity Statute was a single statute found in §12-6-40
- The Decoupling Statute was a single statute found in §12-6-50
- From 1995 -2004, the Conformity Statute
 - adopted the Internal Revenue Code outright as of a certain date except as provided in the Decoupling Statute
- From 1995-2004, the Decoupling Statute
 - only addressed modifications to the Internal Revenue Code “for purposes of this chapter [6]”

the Decoupling Statute. *See* S.C. Code §12-6-50. Immediately prior to 2005, the Decoupling Statute, stated “For purposes of *this chapter*” “This Chapter” was Chapter 6, which contains income tax sections and not bank tax statutes which are contained in Chapter 11. Following the 2005 amendment to SC Code § 12-6-50, the Decoupling Statute was expanded to *all of Title 12*. In 2005 the Decoupling statute was amended to state:

SECTION 12-6-50. Internal Revenue Code sections specifically not adopted by State.

For purposes of this title and all other titles that provide for taxes administered by the department, except as otherwise specifically provided, the following Internal Revenue Code Sections are specifically not adopted by this State:

S.C. Code 12-6-50 (emphasis added).

The General Assembly changed the language and broadened its application to apply to the entire “title and all other titles which provide for taxes administered by the Department.” This “Title” is of course, Title 12. The change in language clarified that conformity applies to all of Title 12 and all other “taxes administered by the Department.” *See* 2005 Act No. 145, § 8 (H.B., 3768) (“To amend Sections 12-6-40 and 12-6-50, both as amended, relating to definitions and conformity provisions for purposes of the South Carolina Income Tax Act, so as to update the reference date by which this state adopts various provisions of the Internal Revenue Code of 1986 and clarify those provisions not adopted”). Exhibit 5.

Note that while this brief focuses on the 2005 Legislative change, the former Tax Commissions obviously thought the 1985 conformity statute applied to banks. Prior to conformity, the former Tax Commission adopted in Reg. 117-92.4 (Exhibit 6) some 16 income tax regulations governing the bank tax. These regulations gave specific Tax Guidance for Banks. As may be seen in S.C. Tax Commission Information Letter 88-14 (Exhibit 7), the Tax Commission in 1988, post

conformity, noted the repeal of eighty (80) Income Tax Regulations, including Regulation 117-92.4, Banking Regulations. The repealed regulations, which were no longer necessary due to conformity, dealt with such issues as depreciation obsolesce, accumulation of depreciation, gain or loss from demolished property, and gain or loss from exchanges with the federal income tax code. Not a single repealed – or current – regulation cites to book income.

2. The General Assembly Defined Taxpayers and the Intended Application and Reach of the Income Tax Chapter of Title 12 of the South Carolina Code

The General Assembly defined which taxpayers are subject to the provisions of Chapter 6 (Income Tax). Chapter 6 (Income Tax) defines the “taxpayer” subject to its provisions as:

- (1) **“Taxpayer”** includes an individual, trust, estate, partnership, association; company, **corporation, or any other entity** subject to the tax imposed by this chapter or **required to file a return.**

SC Code § 12-6-30(1) (emphasis added).

Inclusion of a bank as a “taxpayer” under Title 12, Chapter 6 is consistent with the General Assembly’s instructions that the bank tax be administered, allocated, apportioned and enforced pursuant to the provisions of Chapter 6 (Income Tax). *See* § 12-11-40.

SECTION 12-11-40. Appropriate Chapter 6 provisions shall govern enforcement, administration, allocation and apportionment of **income tax on banks.**

For the purpose of administration, allocation and apportionment, enforcement, collection, liens, penalties, and other similar provisions, **all of the provisions of Chapter 6 [income tax] of this title that may be appropriate or applicable are adopted and made a part of this chapter** for the enforcement and administration of this chapter, including the requirement to make declarations of estimated tax and make estimated tax payments.

SC Code § 12-11-40 (emphasis added).

3. The General Assembly Specifically Adopts NOL Carryforwards, but not Carryback Deductions

The General Assembly has further specifically addressed the applicability of NOL carryforward deductions to all taxpayers. The General Assembly specifically states that carryforward deductions are allowed for taxpayers in South Carolina, and specifically denies NOL carryback deductions.

SECTION 12-6-1130. Taxable income; computation; modifications

South Carolina taxable income is computed by making modifications to deductions provided in the Internal Revenue Code as follows:

- (2) The deduction for taxes permitted by Internal Revenue Code Section 164 is computed in the same manner as provided in Section 164 except there is no deduction for ... state and local franchise taxes measured by net income,

- (4) A net operating loss deduction is computed in accordance with the Internal Revenue Code except that:
 - (a) All items of income and deductions used in computing the net operating loss deduction are adjusted as provided in this article.
 - (b) No carrybacks are allowed.
 - (c) A federal election to carryback a net operating loss deduction does not affect the computation of this deduction for South Carolina income tax purposes.
 - (d) A net operating loss is subject to allocation and apportionment under Article 17 of this chapter in the year the loss is incurred.

S.C. Code §12-6-1130.

4. The General Assembly Addressed the Applicability of IRC Provisions, Including NOLs, to Banks in the Decoupling Statute

Through conformity, the General Assembly specifically chose to adopt all of “Subchapter H” of the IRC. 26 U.S.C.A. § 581 (West). Subchapter H of the IRC contains the statutes explicitly governing banks. The General Assembly then decoupled and affirmatively chose not to adopt certain IRC, Subchapter H sections:

SECTION 12-6-50. Internal Revenue Code sections specifically not adopted by State.

For purposes of this title and all other titles that provide for taxes administered by the department, except as otherwise specifically provided, the following Internal Revenue Code Sections are specifically not adopted by this State:

- (9) Sections 581, 582, and 585 through 596 relating to the taxation of banking institutions;

S.C. Code § 12-6-50(9).

The General Assembly did not decouple and, therefore, adopted IRC § 584. *See* 26 U.S.C. § 584. IRC § 584 provides instruction to the common trust funds of banks. IRC § 584 specifically denies the use of NOL carryforwards for a bank’s common trust fund. The relevant section states:

The benefit of the deduction for net operating losses provided by section 172 shall not be allowed to a common trust fund, but shall be allowed to the participants in the common trust fund under regulations prescribed by the Secretary.

26 U.S.C. § 584(g).

The General Assembly did not decouple or exclude NOL carryforwards for banks, only the bank’s common trust fund.

C. DOR has Previously Agreed that the IRC and S.C. Income Tax Laws Apply to Banks in South Carolina and that NOL Carryforwards are Allowed for All Taxpayers

On at least two (2) separate occasions since conformity, DOR has confirmed in writing its opinion that the IRC and/or S.C. income tax laws apply to banks. In addition, the former Tax Commission also took the position that the IRC applied to banks prior to conformity. DOR has also taken the written position that NOL carryforwards are applicable to taxpayers, without regard or limitation to the type of taxpayer. These are inconsistent positions to the Determination Letter from which this appeal originates. Further, these DOR opinions align with Synovus' request to apply NOL carryforwards to a bank.

1. PLR 95-10. PLR 95-10 issued by DOR in 1995 does not label the bank tax as a franchise tax. Instead, PLR 95-10 refers to the bank tax as an income tax on banks. Exhibit 8, p. 2. SC PLR 95-10 dealt with a bank reorganization. The question was whether South Carolina would follow the federal treatment of the IRC Reorganization sections under the Bank Tax. The PLR first notes:

In adopting the Internal Revenue Code, South Carolina, in Section 12 of 1985 Act. No. 101, as amended by Section 25P of 1987 Act. No. 170, specifically did not adopt certain federal code sections. None of the IRC code sections cited in the Facts above are specifically excluded from the South Carolina law. The question is whether the principles embodied in the Internal Revenue Code sections listed in the Facts which apply to corporations taxed under Chapter 7, Title 12 of the Code should apply to transactions involving banks taxed under Chapter 11, Title 12 of the South Carolina Code of Laws. (Emp added).

Exhibit 8, p. 2. The PLR adopted the IRC reorganization sections notwithstanding that the Bank Tax Act did not specifically include them.

The same policy reasons that encouraged the adoption by South Carolina of the Internal Revenue Code sections listed in the Facts to corporations taxed under Chapter 7 of Title 12 encourage the extension of these provisions to transactions that occur among

taxpayers subject to tax under Chapter 11, Title 12 [banks]. Thus, in this case, South Carolina will follow the federal tax treatment of the reorganization.

Exhibit 8, p. 3.

2. Tax Commission Information Letter # 94-35. Exhibit 9. In Tax Commission Information Letter # 94-35, the Tax Commission adopted the substantive allocation and apportionment provisions found in today's Chapter 6 (which includes conformity).

The Information Letter states:

The general corporate income tax in Chapter 7 [now Chapter 6] directs corporations that conduct their businesses within and without this State to pay tax upon an income base that reasonably represents the proportion of the trade or business carried on within this State. There has been some confusion as to whether these provisions of Chapter 7 [now Chapter 6] apply to multistate banks for purposes of computing the bank income tax under Chapter 11.

For returns filed for year ending before 1997, the Department will accept multistate bank returns which are based upon the proportion of the bank's entire net income that reasonably represents the proportion of the bank's trade or business carried on within this State in the same manner as required of those corporations subject to the corporate income tax of Chapter 7.

Exhibit 9, pp. 1-2. S.C. Code § 12-11-40 was subsequently amended to statutorily take this position.

3. Income Tax Decision I-D-200 (1975). Exhibit 10. Similarly, the former Tax Commission took the position that the IRC applied to banks prior to conformity. Two banks merged and the assets of Bank A were transferred to Bank B and the new entity was renamed Bank A. At issue was the income of former Bank B. The new entity filed a tax return in accordance with the bank tax statutes which were silent on this issue which excluded the income of former Bank B. Although the Bank Tax did not include IRC § 368, the Tax Commission applied it to

ensure that the income of Bank B did not escape taxation. See Income Tax Decision I-D-200 (1975)⁵.

Further, DOR has issued an opinion regarding NOL carryforwards without limitation as to what type of taxpayer was allowed to take the NOL carryforward.

4. SC Revenue Ruling #16-7. Exhibit 12. DOR confirmed that the use of net operating losses following a change in ownership are allowed for “taxpayers,” with no limitation as to the type of taxpayer.

III. LEGAL ARGUMENT

A. **The Legal Standard to be Used to Determine the Applicability of NOL Carryforwards to a Bank in South Carolina is an Issue of Equity to be Liberally Interpreted in Favor of the Taxpayer.**

A determination of whether or not NOL carryforwards can be taken by a bank in South Carolina is a question of equity that should be construed in favor of the taxpayer. Equity lies at the heart of a tax carryover concept. *Fieldcrest Mills, Inc. v. Coble*, 290 N.C. 586, 590–91, 227 S.E.2d 562, 565 (1976) (quoting Columbia Law Review, “the fundamental proposition underlying the carryover concept is one of tax equity. Comment, 66 Colum. L. Rev. at 339); *Hosp. Tr. Leasing Corp. v. Norberg*, 491 A.2d 982, 987 (R.I. 1985) (stating that failing to apply NOL would be “completely inimical to the equitable goals of income averaging”). Moreover, a carryover concept effectuates fairness and equity. *United States v. Foster Lumber Co.*, 429 U.S. 32, 52, 97 S. Ct. 204, 215, 50 L. Ed. 2d 199 (1976) (concluding that an NOL effectuates fairness). Given the equitable and remedial nature of carryover statutes, the issue of NOL carryforwards should be liberally construed in favor of the taxpayer. *Id.* (quoting *Lewyt Corp. v. C.I.R.*, 349 U.S. 237, 240, 75 S. Ct. 736, 739, 99 L. Ed. 1029 (1955) (“where the benefit claimed by the taxpayer is fairly within the

⁵ Also of interest is Tax Commission Decision I-D-5 (1960) (Exhibit 11) which applied the former state NOL statute to an insurance company taxed under the former Insurance Tax provisions.

statutory language and the construction sought is in harmony with the statute as an organic whole, the benefits will not be withheld from the taxpayer’’)). Therefore, where the aims of justice and equity can be achieved by furthering a tax carryover scheme, then the Court should be apt to do so. *See United States v. Foster Lumber Co.*, 429 U.S. 32, 52, 97 S. Ct. 204, 215, 50 L. Ed. 2d 199 (1976) (quoting *Lewyt Corp.*, 349 U.S. at 240).

B. This case is a Matter of Statutory Construction

This case rests on the statutory interpretation of Title 12, Chapter 11 (bank tax) and Title 12, Chapter 6 (income tax) of the South Carolina Code. The cardinal rule of statutory construction is to ascertain and effectuate the intent of the legislature. *Charleston County Sch. Dist. v. State Budget and Control Bd.*, 313 S.C. 1, 437 S.E.2d 6 (1993). Under the plain meaning rule, it is not the Court’s place to change the meaning of a clear and unambiguous statute. *In re Vincent J.*, 333 S.C. 233, 509 S.E.2d 261 (1998) (citations omitted). Where the statute’s language is plain and unambiguous, and conveys a clear and definite meaning, the rules of statutory interpretation are not needed and the Court has no right to impose another meaning. *Id.* at 233, 509 S.E.2d at 262 (citing *Paschal v. State Election Comm’n*, 317 S.C. 434, 454 S.E.2d 890 (1995)). “What a legislature says in the text of a statute is considered the best evidence of the legislative intent or will. Therefore, the courts are bound to give effect to the expressed intent of the legislature.” *Norman J. Singer, Sutherland Statutory Construction* § 46.03 at 94 (5th ed. 1992).

In the context of a tax statute, it is a settled rule that ambiguities are resolved “against the government and in favor of the taxpayer.” *See Fairfield Waverly, LLC v. Dorchester Cnty. Assessor*, Docket No. 14-ALJ-17-0602-CC (filed February 1, 2017) (citing *Mead v. Beaufort Cnty. Assessor*, Docket No. 13-ALJ-17-0585-CC (filed Aug. 19, 2014)) and *Hadden v. S.C. Tax Comm’n*, 183 S.C. 38, 46-47, 190 S.E. 249, 251 (1937) (noting that “where a tax statute is ambiguous or is reasonably susceptible of an interpretation that would exclude the person or subject

sought to be taxed, any substantial doubt must be resolved against the government in favor of the taxpayer”); *see also Clark v. S.C. Tax Comm’n*, 259 S.C. 161, 169, 191 S.E.2d 23, 26 (1972) (“Revenue laws are generally construed in favor of the taxpayer and against the taxing authority.”); and *Sutherland Statutory Construction* § 66:1 (6th ed.).

“In the enforcement of tax statutes, the taxpayer should receive the benefit in cases of doubt.” *Alltel Commc’ns v. S.C. Dep’t of Rev.*, 399 S.C. 313, 321, 731 S.E.2d 869, 872 (2012) (citing *S.C. Nat’l Bank v. S.C. Tax Comm’n*, 297 S.C. 279, 281, 376 S.E.2d 512, 513 (1989)). “[W]here the language relied upon to bring a particular person within a tax law is ambiguous or is reasonably susceptible of an interpretation that will exclude such person, then the person will be excluded, any substantial doubt being resolved in his favor.” *Cooper River Bridge, Inc. v. S.C. Tax Comm’n*, 182 S.C. 72, 76, 188 S.E. 508, 509–510; *see also SCANA Corp. v. S.C. Dep’t of Revenue*, 384 S.C. 388, 394 n. 3, 683 S.E.2d 468, 471 (2009) (Beatty, J., dissenting) (noting general rule that where substantial doubt exists as to the construction of tax statutes, the doubt must be resolved against the government).

C. In 2005 the General Assembly, Through Conformity, Made Clear that a Bank Can Utilize a Net Operating Loss Carryforward

In or around 1985, the General Assembly, through tax reform, revised the South Carolina Tax Code to conform to the Internal Revenue Code (IRC). In 2005, the General Assembly took affirmative action to expand the language used in the decoupling statute. The General Assembly changed the language and broadened its application from “*this chapter*” (Chapter 6) to the entire “**title [Title 12] and all other titles which provide for taxes administered by the Department.**” *See S.C. Code Ann. § 12-6-50.* The change in language clarified that conformity applies to all “taxes administered by the Department,” including the bank tax. *See also* 2005 Act No. 145, § 8

(H.B., 3768). The affirmative expansion of the decoupling statute was consistent with the rest of the tax code which already made clear the bank tax is subject to conformity and the IRC.

1. NOL Carryforward Deductions are Allowed for All Taxpayers, Including Banks.

There is no dispute that NOL carryforwards are allowed under Chapter 6 of Title 12. *See* S.C. Code § 12-6-1130(4)(specifically allows NOL carryforward deductions). Once it is determined that conformity applies to banks, there is no longer a question as to the applicability of an NOL carryforward deduction. There is also no argument to be made that the Legislature did not intend Section 12-6-1130(4) to apply to a bank if the bank tax is a franchise tax.

There is no exception identified in Section 12-6-1130(4) that excludes banks or franchise taxes from an NOL carryforward deduction. When code section 12-6-1130 is reviewed in its entirety the lack of exclusionary language in subsection (4) becomes significant. Code section 12-6-1130(2) does address franchise taxes and disallows a deduction on South Carolina taxes for the franchise tax paid on federal taxes. If the General Assembly did not intend section 11-6-1130(4) to apply to a franchise tax, it would have included similar exclusionary language.

Further, Synovus' position that NOL carryforward deductions are allowed for all taxpayers is consistent with Department policy. *See* Exhibit 12, SC Revenue Ruling #16-7 (Department confirmation that the Use of Net Operating Losses Following a Change in Ownership is allowed for "taxpayers", with *no limitation as to the type of taxpayer*).

2. When Viewed in its Entirety, Title 12 Confirms the Application of the IRC to the Bank Tax Post Conformity

When Title 12 and its relevant Chapters are reviewed in their entirety, post-conformity, there can be no question as to the intent of the Legislature. The General Assembly made clear that banks, which are corporations under South Carolina law and are entities required to file a tax return, are subject to the provisions of Chapter 6. *See* SC Code § 12-6-30(1) ("Taxpayer" defined

to include a corporation, or any other entity subject to the tax imposed by this chapter or required to file a return).

The inclusion of banks as legal entities covered by Chapter 6 is also consistent with the overall scheme found in Title 12. As previously stated, Chapter 11, the bank tax, is a very short chapter containing only six (6) sections today. The only substantive aspects of Chapter 11 serve to make the chapter applicable to banks (S.C. Code § 12-11-10), address property tax (S.C. Code § 12-11-30), and change the tax percentage charged to bank to 4.5% (S.C. Code § 12-11-20). The bank tax chapter itself then directs a taxpayer to Chapter 6 of Title 12 for the administration, enforcement and collection of the bank tax. See SC Code § 12-11-40.

The application of Chapter 6 (income tax) to banks is not only consistent with the statute, but also with past DOR policy. *See* Tax Commission Information Letter #94-35, Exhibit 9 (affirmation that the substantive allocation and apportionment provisions applicable to multi-state taxpayers in Chapter 6 also applies to banks).

Additional support for Synovus' contention that conformity applies to banks is readily apparent. Through conformity, the General Assembly specifically chose to adopt all of "Subchapter H" of the IRC. Subchapter H of the IRC contains the statutes explicitly governing banks. The decision by the General Assembly to adopt the IRC banking statutes in Subchapter H of the IRC was an affirmative one. The General Assembly also chose to exclude certain portions of Subchapter H. *See* S.C. Code §12-6-50 (Exhibit 8). IRC § 584 was not decoupled and was therefore adopted by the General Assembly. IRC § 584 provides instruction to the common trust funds of banks and explains how a bank's common trust fund is to be taxed. IRC § 584 prohibits a bank's common trust fund from taking a net operating loss deduction. *See* 26 U.S.C. § 584(g).

If the General Assembly had no intention of allowing NOL deductions to banks, no reason would exist to tell banks they are not entitled to NOL deductions for their common trust funds. By adopting IRC § 584, the General Assembly expresses its intent to grant banks NOL deductions under IRC § 172. This interpretation is consistent with the principles of statutory construction.

The canon of construction “expressio unius est exclusio alterius” or “inclusio unius est exclusio alterius” holds that “to express or include one thing implies the exclusion of another, or of the alternative.”

Black’s Law Dictionary 602 (7th ed. 1999).

If the General Assembly intended to deny a bank an NOL loss, it would have stated so when it chose to exclude NOL losses for bank common trust funds. The fact that banks were not included in the list of exclusions to conformity implies that the General Assembly intended for all other sections of the IRC, including NOL carryforwards, to apply to banks. “The enumeration of exclusions from the operation of a statute indicates that the statute should apply to all cases not specifically excluded. Exceptions strengthen the force of the general law and enumeration weakens it as to things not expressed.” Norman J. Singer, Sutherland Statutory Construction § 47.23 at 227 (5th ed. 1992) (citations omitted). *See also Hodges v. Rainey*, 341 S.C. 79, 85,533 S.E.2d 578, 581 (2000).

F. The DOR’s Reliance on Alleged Department Policy is Incorrect and Misplaced

DOR asserts that this Court should give great deference to its “alleged long standing policy” that the bank tax is a franchise tax and as such, does not incorporate an NOL deduction. DOR is asking this Court to base its decision on a question that the Court does not need to answer. The question before this Court is not whether the bank tax is an income tax or a franchise tax. The question before the Court is: “Can a bank take an NOL carryforward deduction after 2005 conformity?”

Further, when the Department's arguments are broken down, one sees that they are not sustainable.

1. Synovus' Assertion that the IRC is Applicable to Banks Is Consistent with Actual DOR Policy and the Plain Meaning of the Applicable Statutes.

In this case, it is Synovus, not the DOR, whose argument is based on past DOR policy. Synovus' argument that IRC provisions, including NOL carryforward deductions, are applicable to banks *is consistent* with the long standing policy of DOR. DOR has historically allowed the application of IRC provisions to banks. *See* Exhibit 10, Income Tax Decision I-D-200 (1975) (application of IRC § 368 to banks to ensure full taxation). DOR can point to no contrary prior policy.

Not once has the Department cited or quoted a regulation, or policy document (Revenue Ruling, PLR, or other Policy Document), which contains the alleged "long-standing administrative policy" that an IRC provision, including an NOL carryforward deduction, does not apply to a bank. To the extent the Department contends it is relying on its own unwritten, unpublished, and unpublicized guidance, such "long-standing policy" does not have the force of law and should not be entitled to deference. "Policy or guidance issued by an agency other than in a regulation does not have the force or effect of law." *DIRECTV, Inc. & Subsidiaries v. Dep't of Rev.*, Docket No. 14-ALJ-17-0158-CC (Admin. Law Court, filed June 12, 2015) (citing S.C. Code Ann. § 1-23-10(4) (2005); *Kirven v. Cent. States Health & Life Co., of Omaha*, 409 S.C. 30, 727 S.E.2d 794, 802 (2014) ("[A]n agency guideline does not have the force of law, and in any event, can never trump a regulation Policy or guidance issued by an agency other than in a regulation does not have the force or effect of law") (quoting *Doe v. S.C. Dep't of Health & Human Servs.*, 398 S.C. 62, 68 n.7, 727 S.E.2d 605, 608 n.7 (2011)). Moreover, policy that is "once apparently written down [but is] no longer written anywhere and apparently has not been for some time . . . is

insufficient as a basis for deference” for purposes of relying on a so-called longstanding policy. *See id.*

A number of lower courts have agreed that these “secret” rules asserted by agency staff which have not been promulgated in regulations or binding policy documents are entitled to little, if any, deference. *See* S.C. Tax Comm’n Dec. 93-78 (rejecting taxpayer’s use of long-standing agency interpretation stating that, “we do not believe there are any generally accepted consolidation rules which exist *if they are not codified*,” (emphasis added); S.C. Tax Comm’n Dec. 94-90 (likewise rejecting the taxpayer’s “longstanding administrative policy,” argument, stating “it is important to note that there are no Commission decisions or Department approved policy documents which support that [Department] decision”); *Seigfried v. S.C. Dep’t of Rev.*, 2003 WL 24004736 (S.C. Admin. Law Judge Div. 2003); *S.C. Dep’t of Motor Vehicles v. Lajuenesse*, 2008 WL 1740063 (S.C. Admin. Law Judge Div. 2008); *Coastal Conservation League v. S.C. Dep’t of Health & Envtl. Control*, 363 S.C. 67, 610 S.E. 2d 482 (2005); and *Clarendon Cnty. Mem. Hosp. v. S.C. Dep’t of Health & Envtl. Control*, 2006 WL 1430090 (S.C. Admin. Law Judge Div. 2006).

The Supreme Court recently identified the dangers of non-regulation rule-making by administrative agencies, which Justice Kittredge characterized as “the so-called Fourth Branch of government,” and which have come to threaten “the once sacrosanct constitutional principle of separation of powers.” *Joseph v. S.C. Dep’t of Labor, Licensing and Regulation*, 2016 WL 4792205 (filed September 7, 2016) (J. Kittredge, concurring). According to Justice Kittredge, the traditional separation of powers:

. . . has become blurred in the area of administrative law, where executive branch agencies routinely perform functions traditionally within the sole province of the other two branches of government.

The rise of administrative agencies has allowed legislatures, with the courts’ blessing, to increasingly abdicate their lawmaking

responsibility. Even as early as 1952, Justice Jackson could say that “perhaps more values today are affected by [administrative agencies’] decisions than by those of all the courts.” This trend has continued over the decades and regrettably shows no signs of slowing down any time soon.

Id. (citations omitted).

Because the Department cannot point to any prior policy that states IRC provisions are not applicable to banks, there is no “long standing policy” contrary to Synovus’ position on which this Court should rely.

2. Taxing a Bank on Book Income (as defined by FASB) is an Unlawful and Unconstitutional Delegation of Powers under the South Carolina Constitution and Violates Federal Banking Laws

The DOR’s main (perhaps only) argument is that because the bank tax is a franchise tax, it is based upon book rather than taxable income. There is no support for DOR’s contention that a franchise tax necessarily equals the use of book income accounting. In fact, if the bank tax is a franchise tax *based on book income*, there has been an unconstitutional delegation of powers from the General Assembly to an external entity – the FASB. In accounting, book income is defined in the Generally Accepted Accounting Principles (GAAP) and regulated by the Financial Accounting Standards Board (FASB). *See* Exhibit 2, Robinson Aff. 12. As stated on the FASB website⁶, “Established in 1973, the Financial Accounting Standards Board (FASB) is the independent, private-sector, not-for-profit organization based in Norwalk, Connecticut, that establishes financial accounting and reporting standards for public and private companies and not-for-profit organizations that follow Generally Accepted Accounting Principles (GAAP).” In contrast, the Internal Revenue Code is a product of the political process between Congress and the White House and adopted through conformity by the South Carolina General Assembly.

⁶ <https://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176154526495>.

South Carolina's constitution prevents the legislature from delegating away its legislative power and especially its taxing power to the FASB. In *Eastern Federal Corp. v. Wasson* 281 S.C. 450, 316 S.E.2d 373 (1984), the South Carolina Supreme Court struck down a statute providing for a license tax of 20 percent on admissions to view movies rated "X" by the Motion Picture Association of America (MPAA) since imposing such a tax was an unconstitutional delegation of legislative power to the MPAA in violation of Article III § 1, of South Carolina Constitution. Both the FASB and the MPAA are independent, private sector not for profit organizations. Based on *Wasson*, any delegation of taxing power to the FASB would be a violation of Article III § 1, of South Carolina Constitution.

No delegation issue exists for the income tax laws since SC annually adopts the Internal Revenue Code through conformity. Doing so is an act of the General Assembly imposing its own law using specifically adopted federal taxable income as the based for taxing SC income. As argued above, there is no doubt that as of 2005, the General Assembly chose to expand conformity to all chapters in the tax code (Title 12), including the bank tax. Therefore, as of at least 2005, any assertion by the DOR that the bank tax is a franchise tax based on book income created (or perpetuated) an unconstitutional delegation of powers to the accounting industry, specifically to the FASB, and is in direct contradiction to the intent of the General Assembly. To the contrary, identifying the bank tax as a tax based on federal taxable income with additions and modifications required by SC law post 2005 conformity removes any unlawful delegation issue for the bank tax and complies with the clear intent of the Legislature.

Further, the Department's argument that the bank tax has historically been based on book income violates former federal banking laws. The Department asserts that South Carolina does, and always has, taxed banks on book income. Synovus asserts this is not accurate and if accurate

would have violated former federal bank laws. According to Walter Hellerstein, author of the leading state tax treatise, *State Taxation Vols. I & II* (3rd ed.), ¶ 6.30:

The immunity of national banks from state taxation has constitutional roots that go back to *McCulloch v. Maryland*, which dealt with a state tax on a federally chartered bank. It was in that case that Chief Justice Marshall enunciated his famous dictum that "the power to tax involves the power to destroy." The Court struck down the Maryland tax as an infringement of the supremacy of the U.S. government, of which the bank was found to be an instrumentality.

Shortly after enacting the National Banking Act in 1863, Congress provided that the states could tax national banks only on their real estate and shares. In 1926, Congress amended this statute, which became known as Revised Statutes § 5219 (codified at 12 U.S.C. § 548), to provide that the states could tax national banks in four ways: (1) by taxing bank shares; (2) by including bank share dividends in the taxable income of a shareholder; (3) by taxing national banks *on their net income*; and (4) by levying a franchise tax on national banks *measured by their net income*. (Emp added).

Hellerstein summarizes these rules as follows⁷:

⁷ Historically states imposed franchise taxes to tax income from federal bonds, and to escape the Commerce Clause. As explained in Hellerstein, *State Taxation* ¶ 7.01:

Although there is no longer a constitutionally significant distinction between direct net income taxes and franchise taxes for Commerce Clause purposes, the distinction still retains significance with respect to the states' power to impose taxes on income from federal obligations. Under the intergovernmental immunity doctrine, interest on securities issued by the U.S. government, or its agencies and instrumentalities, is immune from "direct" state income taxation unless Congress waves the immunity. On the other hand, the intergovernmental immunity doctrine does not prevent the states from including interest on federal securities in the measure of an "indirect" franchise or excise tax on the conduct of business in the state. Consequently, while states originally enacted direct net income taxes to avoid the Commerce Clause bar against state taxes that were measured by net income but were imposed on the privilege of doing interstate business, there is currently a comparable incentive for states to adopt franchise taxes (rather than, or as a supplement to, direct net income taxes) to avoid the constitutional bar against state taxation of income from federal obligations.

Hellerstein describes the history of Franchise Taxes as follows:

States have long subjected corporations to special taxes on the license or privilege of conducting business in the state in corporate form or on the actual conduct of business. Historically, these levies, commonly known as franchise taxes, were measured by the amount or value of the corporation's capital stock attributable to the state. Although some states applied net income taxes to corporations during the nineteenth century, it was not until Wisconsin enacted a corporate net income tax in 1911 that such levies began to take hold among the states. The states have increasingly

To recapitulate, from 1864 to 1926, states were limited to taxing national banks on their real estate and shares; from 1926 to 1976, states' taxing powers over national banks were expanded to include direct net income taxes and franchise taxes measured by net income; and since 1976, states have been permitted to tax national banks and state-chartered banks equally. (Emp added).

As such, the Department is requesting this Court uphold a violation of the South Carolina Constitution through a delegation of the taxable power and requests this Court uphold a historical position that violates former federal tax laws.

There is simply no reason for the Department to insist the bank tax must use book income. There is no South Carolina statute or regulation that imposes book income on a franchise tax (as defined by FASB in GAAP). When one looks at other states that impose a franchise tax, the franchise tax is based on net income or capital stock⁸. Further, there is no basis on which DOR can allege the General Assembly intended the franchise tax to be based on book income post 1985 and/or 2005 conformity with the federal tax code. Following conformity, the General Assembly repealed many of the tax regulations, one can assume, because they were contrary to and/or redundant to federal income tax instructions. The DOR has four remaining bank tax regulations.

turned to direct net income taxes upon corporations, either as a supplement to, or a substitute for, their corporate franchise taxes. That development was largely attributable to efforts by the states to circumvent Supreme Court decisions holding that the Commerce Clause prohibits the states from taxing foreign corporations engaging exclusively in interstate commerce within the state for the privilege of carrying on their business.

Hellerstein also states at ¶ 7.01:

State corporation taxes measure by net income broadly fall into two categories: (1) excise taxes on the privilege of doing, or the license to do, business in the state or simply on doing business, owning property, or engaging in other activities within the state; and (2) taxes on net income derived from or attributable to the state. The excise tax is commonly referred to as a "franchise" tax, and the tax on net income is commonly referred to as a "direct net income" tax. Increasingly, however, because the distinction between franchise taxes and direct net income taxes is largely of historical significance (as described further below), such taxes are described simply, and interchangeably, as corporate income taxes.

⁸ Texas and Delaware impose perhaps the largest franchise taxes, as does California. As may be seen in the attached (Exhibits 13, 14 and 15), Texas imposes the franchise tax on federal taxable income, California on state net income and Delaware on Capital stock and assets. Diligent research reveals not a single state which imposes it on book income.

Reg. 117-1500.1 defines "entire net income" (and picks up taxation obligations of the federal government as discussed by Hellerstein). Not a single Regulation cites book income or GAAP.

3. NOL Carryforward Deductions are Allowed Under the Accepted Accounting Standards for Book Income

If the application of book income to banks is found to be constitutional, DOR still has no reason to deny NOL carryforward deductions. As shown through the tax filings themselves, it is possible to take an NOL deduction under the book income form of accounting. Exhibit 2, Robinson Aff. 8-13. Stated simply, NOL carryforward deductions can be properly taken under the GAAP book income accounting principles (assuming the proper delegation of taxing powers has occurred). DOR has not and cannot defend its blanket position that a NOL carryforward is not allowed under a book income form of accounting or otherwise.

4. The Bank Tax is Not a Franchise Tax Post Conformity and Was, In Fact, Never Intended to be a Franchise Tax by the Legislature

At the end of the day, there is no reason for this Court to determine if the bank tax is a franchise tax or income tax in this litigation. The statutes and prior DOR policy are clear on these two points and affirm that 1) a bank is subject to IRC conformity and 2) a bank can take an NOL carryforward deduction under the IRC.

If the Court does deem it necessary to determine if the bank tax is a franchise tax or an income tax post conformity, Synovus asserts that the bank tax is an income tax and not a franchise tax that uses book income (regulated by the FASB). Under the current tax code, S.C. Ann. § 12-6-50 imposes a 5% corporate income tax rate on every corporation, other than those entities described in § 12-5-540 and § 12-6-550.

Section 12-6-550, "Corporations Exempt from Taxes Imposed by Sections 12-6-530 and 12-6-540", provides:

(a) The following corporations are exempt from the tax imposed by Section 12-6-530 and Section 12-6-540:

(i) *banks* as defined in Section 12-11-10;

S.C. Ann. § 12-6-530 (a)(1).

The exclusion of banks from the provisions of Chapter 6 is limited to the tax rate imposed. Nothing in § 12-6-550(a)(i) exempts banks from any other provision of Chapter 6 other than § 12-6-530 and § 12-6-540 which involve tax rates.

Therefore, the plain language of the statute establishes that, post conformity, banks are removed from the corporate income tax regime identified under Chapter 6 only as it relates to the corporate income tax rate imposed under § 12-6-530 and § 12-6-540. If the General Assembly sought to exempt banks from all of the provisions of Chapter 6 with respect to the taxation of corporations post conformity, then it would have extended the exemption in § 12-6-550 to the entirety of Chapter 6, not simply the statute identifying the corporate tax rate. This reading of the statute is consistent with the bank tax. The bank tax repeatedly describes itself as an “Income Tax” and instructs taxpayers to Chapter 6 for the administration of the bank tax. *See* S.C. Code §§ 12-6-2210, 12-6-2290, 12-6-1130, and 12-8-550. The use of the word “income tax” was not by accident. The General Assembly does not use words by accident. It is also no accident that the terms “franchise tax” and/or “book income” do not appear one single time in the bank tax chapter. There is simply no basis for the DOR to make an assumption that the General Assembly really meant “franchise tax” when it repeatedly used the term “income tax.”

If the South Carolina legislature intended the bank tax to be a franchise tax it would have stated so in the statute. The South Carolina legislature is familiar with the term “franchise tax” as evidenced by its use of the term “franchise tax” in multiple other sections of the tax code. *See* S.C. Code Ann. §§ 12-6-2210, 12-6-2290, 12-6-1130, and 12-8-550. The General Assembly does not

now and has never used the term “franchise tax” in the bank tax section.⁹ As such, there is no logical reason why, post 2005 conformity, the DOR continued to treat the bank tax as a franchise tax upon which it insisted book income be used.

DOR’s primary argument for its interpretation that the bank tax is a franchise tax based on book income is based on the alleged “long standing policy” of the agency to which it argues this Court should give great deference. While deference to agency interpretation is given in certain circumstances, the Court is not bound by any agency interpretation if the agency applies its policy inconsistently, is incorrect, or if a change in the law invalidates the agency policy.

As stated above, conformity radically changed the tax policy of this state. Any alleged “long- standing policy” of the Department must be viewed from the lens of a change in law. The Department has presented no agency policy issued in opposition to Synovus’ position after 2005 conformity during which the General Assembly clearly extended the income tax rules to the bank tax. In fact, post 2005, the agency issued new policy documents regarding NOL carryforwards applicable to all taxpayers, without exclusion for banks. *See* Exhibit 12, SC Revenue ruling #16-7 (issued July 6, 2016). This DOR policy position is consistent with both Synovus’ position and the change in law post conformity.

It is also consistent with prior Department positions in which DOR agreed the bank tax is an income tax and instructed banks to report income each year *based upon its taxable income* not book income (*see* Exhibit 8, S.C. Private Letter Ruling 95-10), the Department’s prior application of the IRC to banks (*see* Exhibit 10, Income Tax Decision 1-0-200) and DOR’s affirmation that the substantive allocation and apportionment provisions applicable to multi-state taxpayers in

⁹ In 2003, regulations were issued that describe the bank tax as a franchise tax. The regulations do not cite to book income or GAAP. These regulations are contrary to the 2005 conformity statute which included the bank tax and are an unconstitutional delegation of taxing powers.

Chapter 6 (income tax) also apply to banks. *See* Exhibit 9, Tax Commission Information Letter # 94-35.

The Department's affirmation of the appropriateness of the use of Chapter 6 (income tax) provisions on banks in Tax Commission Information Letter # 94-35 is not improper, and is in fact, exactly what Synovus is asking this Court to do. The General Assembly specifically instructed the Department to use the corporate tax provisions in Chapter 6 in respect to banks "[f]or the purpose of administration, allocation and apportionment, enforcement, collection, liens, penalties, and other similar provisions, all of the provisions of Chapter 6 of this title that may be appropriate or applicable are adopted and made a part of this chapter" S.C. Code § 12-11-40.

In light of past practice and the plain meaning of S.C. Code § 12-11-40, one begs the question why the Department has chosen not to administer the NOL carryforward deductions requested by Synovus according to Chapter 6, especially in light of the 2005 conformity language that clearly expanded the IRC to the bank tax.

The role of the DOR is to interpret and apply the law, not make it. Any interpretation by DOR that the bank tax is a franchise tax based on book income from which an NOL carryforward deduction may not be taken after the 2005 conformity legislation wholesale changes the law as intended by the legislature and should not be condoned by the Court. While the South Carolina Supreme Court has interpreted statutes in accord with legislative intent despite contrary literal meaning, they do so only where legislative oversight clearly conflicts with the overall intent of the statute, such as when the legislature uses "or" instead of "and" or "county" instead of "city." Accordingly, this Court should not completely disregard the text of an unambiguous statutes and assert a wholesale separate meaning to the words used by the General Assembly. In the instant case, the ordinary meaning of "income tax" found in Title 12, Chapter 11 post 2005 conformity

will not lead to absurd results unintended by the legislature. *See Hodges v. Rainey*, 533 S.E.2d 578, 87-88 (S.C. 2000)¹⁰.

IV. CONCLUSION

Synovus Bank asks this Court to make a determination that banks in South Carolina may make an NOL carryforward deduction on South Carolina taxes. Synovus asks this Court to make this determination based on the 2005 Conformity Language that made clear that an IRC provision not specifically de-coupled by the General Assembly is applicable to all Corporations or any other entities required to file a tax return in South Carolina, including banks.

Dated this 25 day of July, 2018.

Respectfully submitted,



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¹⁰ If the South Carolina legislature's intent is clearly apparent from the statutory language, a court may not embark upon a search for it outside the statute. *Abell v. Bell*, 229 S.C. 1, 91 S.E.2d 548 (1956). When the language of a statute is clear and explicit, a court cannot rewrite the statute and inject matters into it which are not in the legislature's language, and there is no need to resort to statutory interpretation or legislative intent to determine its meaning. *Timmons v. South Carolina Tricentennial Comm'n*, 254 S.C. 378, 175 S.E.2d 805 (1970).

CERTIFICATE OF SERVICE

I hereby certify that on the 25 day of July, 2018, the foregoing PETITIONER'S MEMORANDUM IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT has been served upon the following persons by U.S. First Class Mail, and with the correct amount of postage affixed thereto:

Jason P. Luther, Esq.
South Carolina Department of Revenue
PO Box 12265
Columbia, SC 29211-9979



34679293.13

Exhibit 1
Stipulation of Facts

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Synovus Bank,	)	Docket No. 17-ALJ-17-0418-CC
	)	
Petitioner,	)	
	)	
vs.	)	<u>STIPULATION OF FACTS</u>
	)	<u>AND TO THE ADMISSIBILITY</u>
South Carolina Department of Revenue,	)	<u>OF CERTAIN DOCUMENTS</u>
	)	
Respondent.	)	
	)	
	)	
	)	

For purposes of cross-motions for summary judgment, Petitioner Synovus Bank (Synovus or Taxpayer) and Respondent South Carolina Department of Revenue (Department) stipulate to the following facts:

1. The Parties incorporate by reference the Department's Proposed Assessment, Taxpayer's Protest and the Department Determination into this Stipulation.
2. In the Income Tax Act of 1926, the South Carolina General Assembly adopted a corporate income tax of 4% of a corporation's "entire net income."
3. Initially, banks were subject to the 1926 Act's corporate income tax. However, in 1937, the General Assembly enacted a separate tax on banks and excluded banks from the corporate income tax. The bank tax was 4.5% of the entire net income of the bank.
4. In 1985, the General Assembly through Act No. 101 enacted the South Carolina Income Tax Federal Conforming Amendments of 1985, which revised the South Carolina Code to conform to certain Internal Revenue Code (IRC) provisions. The conformity provisions were included in Chapter 7 of Title 12.

5. On December 20, 1994, the South Carolina Tax Commission issued SC Information Letter #94-35.

6. In 1995, the General Assembly re-codified the conformity provisions in Chapter 7 of Title 12 into Chapter 6 of Title 12.

7. On August 28, 1995, the Department issued SC Private Letter Ruling #95-10.

8. In 2005, the General Assembly amended S.C. Code § 12-6-40 and S.C. Code § 12-6-50.

9. In 2016, the Department of Revenue issued SC Revenue Ruling # 16-7.

10. On February 28, 1995, Synovus Financial Corp. acquired NBSC Corporation, the parent company of National Bank of South Carolina (NBSC).

11. On November 15, 1997 Columbus Bank and Trust Company (CB&T) began filing a SC tax return.

12. On May 6, 2010, NBSC was merged into CB&T and was renamed Synovus Bank. Each of these entities is or was, as the case may be, organized as corporations.

13. Synovus Bank filed Form SC 1101 B titled "Bank Tax Return" for years ending December 31, 2011, 2012, 2013, and 2014.

14. On its respective South Carolina Bank Tax Return, NBSC reported losses for South Carolina bank tax purposes for 2009 and 2010. CB&T reported a loss for South Carolina bank tax purposes for 2009. Synovus reported a loss for South Carolina bank tax purposes for 2010.

15. The total South Carolina losses reported by NBSC, CB&T, and Synovus for 2009 and 2010 was \$391,050,990, as amended. Later, the total South Carolina losses were increased by \$91,000,000 for a total of \$482,050,990 through a proposed audit adjustment by the Department.

16. For bank tax years 2011, 2012, and 2013, Synovus filed its original South Carolina Bank Tax Returns without claiming any net operating loss (NOL) carryforwards from 2009 or 2010.

17. For bank tax year 2011, Synovus filed its original Bank Tax Return on September 14, 2012, an amended return on June 27, 2013, and a second amended return on December 20, 2013. On all three returns, the Taxpayer reported net income apportioned to South Carolina and reported taxes under the South Carolina bank tax.

18. On December 19, 2014, Synovus filed a third amended return for tax year 2011 on which it claimed, for the first time, that it was entitled to deduct the losses from 2009 in the form of NOL carryforwards. As a result, Synovus reported no bank tax liability for 2011 on its third amended return.

19. In its filings, Synovus provided an explanation to the Department as to why it filed the amended Bank Tax Returns

20. For bank tax years 2012 and 2013, Synovus filed original Bank Tax Returns reporting net income apportioned to South Carolina. In 2015, Synovus filed amended Bank Tax Returns for 2012 and 2013. On the amended returns, Synovus claimed NOL carryforwards, which resulted in no bank tax liability for bank tax years 2012 and 2013. These claimed NOL deductions also reduced the alleged NOL carryforwards from 2009.

21. Synovus then filed second amended bank tax return for 2013, in which it claimed that it had NOLs that could be carried forward to 2014 in the amount of \$291,331,561.

22. For bank tax year 2014, Synovus filed an original Bank Tax Return in South Carolina reporting company-wide book income of \$229,295,962 but offsetting its South Carolina

net taxable income by a portion of the 2009 net operating losses. As a result, Synovus reported no bank tax liability in South Carolina and claimed a refund of \$968,585 from South Carolina.

23. For tax years 2012, 2013 and 2014, the Department initially granted the refunds requested by Synovus.

24. The 2012 refund was approved but not paid due to a procedural problem in requiring the 2012 refund to be “held for verification.”

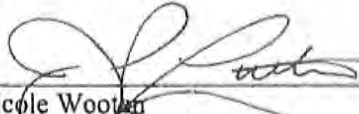
25. The refund requests for tax years 2013 and 2014 were paid by the Department to Synovus.

26. 27. Therefore, the Department conducted an audit of the Synovus Bank returns for 2011 – 2014. On March 14, 2016, the Department issued a Proposed Notice of Adjustment with related “Report of Field Audit” (PNOA) to Synovus. In this PNOA, the Department confirmed and corrected the amount of NOLs at issue, but disallowed Synovus’ claims for NOL deductions in 2011 through 2014. The Department also assessed penalties and interest through April 15, 2016. On or about April 6, 2016, the Department revised the PNOA to Synovus deleting the penalties that it had originally assessed and updating the interest amount. The total assessment on the revised PNOA to Synovus is \$2,076,325.

27. Synovus filed a written protest on both PNOAs on June 7, 2016.

Respectfully submitted,

**SOUTH CAROLINA DEPARTMENT
OF REVENUE**



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Attorneys for Petitioner

July 25, 2018
Columbia, S.C.

Exhibit 2
Mark Robinson Affidavit

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Synovus Bank,	)	
	)	
Petitioner,	)	
	)	Docket No. 17-ALJ-17-0418-CC
v.	)	
	)	
South Carolina Department of Revenue,	)	
	)	
Respondent.	)	

AFFIDAVIT OF MARK ROBINSON

I, Mark Robinson, having been duly sworn on my oath, hereby state and affirm as follows:

1. My name is Mark Robinson. I am over the 21 years of age, have personal knowledge of the matters described in this Affidavit, and am competent to testify on the matters set forth herein.

2. I am the Group Executive for Taxation at Synovus Bank. I have been the Group Executive for Taxation (or equivalent) since 1983.

3. My entire professional career has been in tax and accounting.

4. I graduated from Columbus State University in 1981 with a Bachelor of Business Administration in accounting.

5. I graduated from Columbus State University in 1984 with a Master of Business Administration with a concentration in accounting.

6. Since college graduation I have worked in the following tax and accounting roles. During the period beginning January 1983 and ending December 2007, I served as the Tax Director of two publically traded companies, Synovus Financial Corp. (NYSE: SNV), a bank holding company, and Total System Services, Inc. (NYSE: TSS), a bankcard and private label transaction processing company. In December 2007, Synovus, through a tax-free spin-off transaction,

distributed its ownership interest in Total System Services, Inc. (TSYS) to Synovus' shareholders through a dividend ending the TSYS Tax Director Role. Since December 2007, I have continued serving as the Group Executive Tax for Synovus Financial Corp.

7. In tax years 2011 through 2014 Synovus Bank filed tax returns with the South Carolina Department of Revenue.

8. For each of the tax years referenced, Synovus filed an original tax return and subsequently timely filed an amended the tax return.

9. On each amended tax return Synovus claimed a net operating loss deduction based on a carryforward of prior losses by the bank.

10. For each year both the original and amended tax returns were filed in accordance with South Carolina laws and regulations, based on a book income model of accounting.

11. To calculate a net operating loss carryforward Synovus completed its South Carolina Bank Tax Return on Form SC 11001 B determining its South Carolina taxable losses, which were carried forward and applied in subsequent years.

12. In accounting, book income is defined in GAAP and regulated by the Financial Accounting Standards Board (FASB).

13. Synovus followed the Financial Accounting Standards Board (FASB) Accounting Standards to determine the Net Operating Loss on book income.

FURTHER AFFIANT SAYETH NOT.

Mark S Robinson
Mark Robinson

SWORN TO AND SUBSCRIBED before me this
20th of July, 2018.

Barbara Himes Calhoun
Notary Public for the State of Georgia

My Commission Expires: May 18, 2022

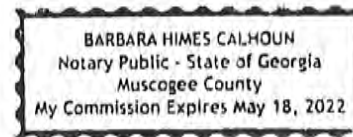


Exhibit 3
1937 Bank Tax

(619)

No. 349.

AN ACT to Raise Revenue for the Support of the State Government by the Levy and Collection of a Tax Upon the Income of Banks in Lieu of All Other Taxes Except Taxes on Real Property.

Section 1. "Banks and taxpayers" defined.—Be it enacted by the General Assembly of the State of South Carolina: For the purpose of this Act and unless otherwise required by the context, the words "banks and taxpayers," wherever used in this Act, shall mean any person, firm or corporation, engaged in a banking business whether incorporated under the laws of this State, any other State, or the United States, or whether unincorporated except cash depositories.

§ 2. Tax on banks.—A tax is hereby imposed upon every bank engaged in business in the State of South Carolina, which tax shall be levied, collected and paid annually, with respect to the entire net income of the taxpayer doing a banking business within this State, or from the sales or rentals of property within this State, computed at the following rate:

Four and one-half ($4\frac{1}{2}\%$) per centum of the entire net income of such bank or taxpayer.

§ 3. In lieu of other taxes except taxes on real property.—The income taxes herein provided shall be in lieu of all other taxes, except taxes on real property. The real property of any such bank, or banking association, shall be taxed in the place where the same may be located, the same as the real property of individuals.

§ 4. Enforcement—administration.—That for the purpose of administration, enforcement, collection, liens, penalties, and other provisions of enforcement, all of the provisions of Sections 2435-2479, inclusive, Code of Laws of South Carolina, 1932, that may be appropriate or applicable are hereby adopted and made a part of this Section for the enforcement and administration of this Act.

§ 5. Invalidity.—In case the first provision (contained in the first sentence) of Section 3 hereof should for any reason be declared to be invalid by a Court of competent jurisdiction, then and in that event, the taxes provided in Section 2663-2667, inclusive, Code of Laws of South Carolina, shall be and remain in full force and effect, and the income tax provided herein shall not be effective.

§ 6. **Payment of tax—distribution.**—The taxes herein provided for shall be paid to South Carolina Tax Commission as is provided in Section Four (4) of this Act and the income taxes paid under the provisions of this Act shall be distributed between the general fund of the State, the County and Municipality in which the bank is located as follows:

Ten (10) per cent to the general fund of the State

Sixty (60) per cent to the County

Thirty (30) per cent to the Municipality in which the Bank is located.

The Tax Commission is authorized and directed to draw warrants on the State Treasurer for such distribution on or before May 15 of each year and the State Treasurer is authorized and directed to honor said warrants.

For the purpose of and in the distribution of the taxes paid under this Act by a bank having one or more branches, each branch of the bank shall be deemed to have paid such portion of the entire tax as its deposits on January 1st of each taxable year bear to the total of the deposits of all branches and the tax distributed accordingly.

§ 7. **Repeal.**—All Acts or parts of Acts inconsistent with this Act are hereby repealed except as hereinabove provided.

§ 8. **Time effective.**—This Act shall take effect immediately upon its approval by the Governor and shall be retroactive so as to apply during the year 1937.

Approved the 19th day of May, 1937.

(623)

No. 350.

AN ACT Abolishing the Governing Board (Advisory Board) and Devolving All the Powers, Duties, Responsibilities and Functions Thereof on the Supervisor of Union County, Abolishing the Salaries of Members of Governing Board (Advisory Board) of Union County, and Making It Unlawful for the Supervisor to Issue Vouchers in Payment of the Same After July 1st, 1937, and Making It Unlawful for the Treasurer of Union County to Honor and/or Pay the Same After July 1st, 1937, with the Exception of Salaries Aforesaid Members of Governing Board (Advisory Board) Earned Prior to July 1st, 1937.

Exhibit 4
1947-78 OP. S.C. Att’y Gen. 294 (March 12, 1948)

Income Tax on Banks

March 12, 1948

The South Carolina Tax Commission, Columbia, South Carolina.

Gentlemen: I have been requested by you to give you my opinion as to my construction of the Section of the Code levying the so-called income tax on Banks.

Section 2676 of the Code of 1942 levies a tax upon, or with respect, to the entire net income of banks. This language includes all income from whatever source derived, even income from non-taxable securities. This is for the reason that the bank tax is a franchise tax for the privilege of operating, or doing business in this State, the amount thereof being measured by the entire net income.

For the above reasons, it is my opinion that banks in this State filing returns required under this Section of the Code, are permitted to deduct all expenses incurred in the operation of their banks including Federal and State income taxes.

Yours very truly,

CLAUDE K. WINGATE,
Assistant Attorney General,
SOUTH CAROLINA TAX
COMMISSION.

Exhibit 5
2005 Act No. 145

South Carolina Legislature

Session 116 - (2005-2006)

H*3768 (Rat #0150, Act #0145 of 2005) General Bill, By Kirsh

Summary: Overdue Debt Collection Act

AN ACT TO AMEND SECTIONS 12-36-140 AND 12-36-2120, CODE OF LAWS OF SOUTH CAROLINA, 1976, BOTH RELATING TO THE SALES AND USE TAX, SO AS TO EXEMPT CERTAIN PROMOTIONAL ADVERTISING DISTRIBUTIONS BY CHAMBERS OF COMMERCE AND VISITORS BUREAUS; BY ADDING SECTION 12-28-1400 SO AS TO REQUIRE THE REPORTING THE DEPARTMENT OF REVENUE REQUIRES BY REGULATION FOR PURPOSES OF THE USER FEE ON MOTOR FUELS AND PROVIDE AN ADDITIONAL CIVIL PENALTY FOR VIOLATORS; BY ADDING SECTION 12-54-123 SO AS TO PROTECT FROM LIABILITY A PERSON WHO SURRENDERS THE PROPERTY OF ANOTHER LEVIED ON BY THE DEPARTMENT OF REVENUE; BY ADDING CHAPTER 55 TO TITLE 12, ENACTING THE OVERDUE DEBT COLLECTION ACT AUTHORIZING THE SOUTH CAROLINA DEPARTMENT OF REVENUE TO IMPOSE A COLLECTION ASSISTANCE FEE ON CERTAIN OVERDUE TAX DEBTS EQUAL TO TWENTY PERCENT OF THE OVERDUE AMOUNT AND TO ALLOW THE DEPARTMENT TO RETAIN A PORTION OF THE COLLECTION ASSISTANCE FEE FOR ITS OPERATION; BY ADDING SECTION 61-4-725 SO AS TO ALLOW A LICENSED WINERY TO SELL, DELIVER, AND PERMIT ON-PREMISES CONSUMPTION ON SUNDAYS IN JURISDICTIONS WHERE MINIBOTTLE SALES ARE ALLOWED ON SUNDAYS; TO AMEND SECTION 6-1-320, RELATING TO THE LIMITS ON ANNUAL INCREASES IN LOCAL GOVERNMENT AND SCHOOL DISTRICT PROPERTY TAX MILLAGE, SO AS TO CLARIFY THE METHOD OF CALCULATING THE ALLOWED CONSUMER PRICE INDEX INCREASE IN THE MILLAGE RATE; TO AMEND SECTIONS 12-6-40 AND 12-6-50, BOTH AS AMENDED, RELATING TO DEFINITIONS AND CONFORMITY PROVISIONS FOR PURPOSES OF THE SOUTH CAROLINA INCOME TAX ACT, SO AS TO UPDATE THE REFERENCE DATE BY WHICH THIS STATE ADOPTS VARIOUS PROVISIONS OF THE INTERNAL REVENUE CODE OF 1986 AND CLARIFY THOSE PROVISIONS NOT ADOPTED; TO AMEND SECTIONS 12-6-1110 AND 12-6-1130, RELATING TO CALCULATIONS OF INCOME, SO AS TO PROVIDE FOR CALCULATIONS WITHOUT SOME OF THE DEDUCTIONS ALLOWED BY THE INTERNAL REVENUE CODE; TO AMEND SECTION 12-6-1140, AS AMENDED, RELATING TO DEDUCTIONS FROM SOUTH CAROLINA INDIVIDUAL TAXABLE INCOME FOR PURPOSES OF THE STATE INCOME TAX, SO AS TO DELETE AN OBSOLETE DEDUCTION RELATING TO MEDICAL INSURANCE PREMIUMS; TO AMEND SECTION 12-6-2220, RELATING TO ALLOCATION AND APPORTIONMENT FOR PURPOSES OF THE STATE INCOME TAX, SO AS TO PROVIDE FOR THE ALLOCATION OF DIVIDENDS; TO AMEND SECTION 12-6-3360, AS AMENDED, RELATING TO THE TARGETED JOBS TAX CREDIT, SO AS TO REVISE THE DEFINITION OF "NEW JOB"; TO AMEND SECTION 12-6-3365, AS AMENDED, RELATING TO THE CORPORATE INCOME TAX MORATORIUM FOR JOB CREATION, SO AS TO CLARIFY THE APPLICATION OF THE MORATORIUM TO INSURANCE PREMIUM TAXES; TO AMEND SECTION 12-6-3480, RELATING TO TAX CREDITS, SO AS TO FURTHER PROVIDE THE MANNER IN WHICH CREDITS ARE ALLOWED AND MAY BE CLAIMED; TO AMEND SECTION 12-6-4910, AS AMENDED, RELATING TO THOSE REQUIRED TO FILE INCOME TAX RETURNS, SO AS TO PROVIDE FOR THOSE NONRESIDENTS REQUIRED TO FILE IN THIS STATE; TO AMEND SECTIONS 12-6-5020, AS AMENDED, AND 12-6-5030, BOTH RELATING TO THE FILING OF CONSOLIDATED CORPORATE INCOME TAX RETURNS AND COMPOSITE INDIVIDUAL INCOME TAX RETURNS, BOTH SO AS TO REQUIRE THE DETERMINATION OF CREDITS ON A CONSOLIDATED BASIS AND FURTHER PROVIDE FOR COMPOSITE RETURNS; TO AMEND SECTION 12-8-520 RELATING TO STATE INCOME TAX WITHHOLDING, SO AS TO PROVIDE FOR THE WITHHOLDING OF PARTNERSHIP AND SUBCHAPTER "S" CORPORATION INCOME OF NONRESIDENTS; TO AMEND SECTION 12-8-1520, RELATING TO STATE INCOME TAX WITHHOLDING, SO AS TO PROVIDE ADDITIONAL REQUIREMENTS FOR WITHHOLDING AGENTS; TO AMEND SECTION 12-10-105, RELATING TO ANNUAL FEES FOR JOB DEVELOPMENT CREDITS FOR PURPOSES OF THE ENTERPRISE ZONE ACT OF 1995, SO AS TO EXTEND THESE FEES TO JOB RETRAINING CREDITS IN EXCESS OF TEN THOUSAND DOLLARS AND PROVIDE FOR THE COLLECTION OF THESE FEES; TO AMEND SECTION 12-20-105, AS AMENDED, RELATING TO TAX CREDITS FOR PURPOSES OF THE CORPORATE LICENSE TAX, SO AS TO CLARIFY THE APPLICATION OF THESE CREDITS; TO AMEND SECTIONS 12-21-1090 AND 12-21-6550, BOTH RELATING TO LICENSE TAXES, BOTH SO AS TO PROVIDE FOR THE PERMISSIVE PROMULGATION OF REGULATIONS AND FURTHER PROVIDE FOR THE APPLICATIONS REQUIRED PURSUANT TO THE TOURISM INFRASTRUCTURE ADMISSIONS TAX ACT; TO AMEND SECTION 12-28-740, RELATING TO EXEMPTIONS FROM THE MOTOR FUELS USER FEE, SO AS TO DELETE A REFERENCE TO A CREDIT; TO AMEND SECTION 12-28-1730, AS AMENDED, RELATING TO PENALTIES FOR PURPOSES OF THE MOTOR FUELS TAX, SO AS TO DELETE A CIVIL PENALTY; TO AMEND SECTION 12-36-530, RELATING TO THE REQUIREMENT FOR THE RETURN OF A RETAIL LICENSE WHEN A BUSINESS CLOSSES OR IS SOLD, SO AS TO ELIMINATE THE REQUIREMENT THAT THE TAX IS DUE AT THE TIME OF SALE AND CONSTITUTES A LIEN ON THE PROPERTY IN THE HANDS OF THE

South Carolina Legislature

PURCHASER; TO AMEND SECTION 12-36-1310, AS AMENDED, RELATING TO THE SOUTH CAROLINA SALES AND USE TAX ACT, SO AS TO FURTHER PROVIDE FOR THE APPLICATION OF SALES TAX TO TELECOMMUNICATIONS SERVICES; TO AMEND SECTION 12-36-2120, AS AMENDED, RELATING TO SALES AND USE TAX EXEMPTIONS, SO AS TO EXEMPT PRESCRIPTIONS AND OVER-THE-COUNTER MEDICINES AND MEDICAL SUPPLIES SOLD TO A FREE CLINIC; TO AMEND SECTION 12-36-2510, RELATING TO THE SOUTH CAROLINA SALES AND USE TAX ACT, SO AS TO PROVIDE FURTHER FOR THE ISSUE OF CERTIFICATES BY THE DEPARTMENT OF REVENUE FOR DIRECT PAY AND EXEMPTIONS AND PROVIDE FOR MORE EFFICIENT ADMINISTRATION OF SALES TAXES AND SALES TAX EXEMPTIONS; TO AMEND SECTION 12-37-220, AS AMENDED, RELATING TO PROPERTY TAX EXEMPTIONS, SO AS TO DELETE OBSOLETE REFERENCES IN EXISTING EXEMPTIONS; TO AMEND SECTIONS 12-54-42 AND 12-54-43, AS AMENDED, BOTH RELATING TO THE UNIFORM METHOD OF COLLECTION AND ENFORCEMENT OF STATE LEVIED TAXES, BOTH SO AS TO CLARIFY THE APPLICATION OF PENALTIES FOR FAILING TO PROVIDE WITHHOLDING STATEMENTS, AND CLARIFY AND REVISE THE APPLICATION OF CIVIL PENALTIES FOR FILING GROUNDLESS RETURNS OR FOR MISUSE OF A SALES TAX CERTIFICATE; TO AMEND SECTION 12-54-90, RELATING TO THE COLLECTION AND ENFORCEMENT OF STATE TAXES, SO AS TO ALLOW THE DEPARTMENT OF REVENUE TO REFUSE TO ISSUE A LICENSE TO A TAXPAYER IN VIOLATION; TO AMEND SECTIONS 12-54-210 AND 12-54-240, AS AMENDED, BOTH RELATING TO THE COLLECTION AND ENFORCEMENT OF STATE TAXES, BOTH SO AS TO INCREASE THE PENALTY FOR FAILURE TO KEEP RECORDS, FILE RETURNS, AND COMPLY WITH REGULATIONS, UPDATE REFERENCES RELATING TO THE CONFIDENTIALITY OF RETURNS, AND DELETE AN EXEMPTION TO THE CONFIDENTIALITY REQUIREMENTS FOR RECORDS SUBPOENAED BY A FEDERAL GRAND JURY; TO AMEND SECTION 12-58-185, AS AMENDED, RELATING TO THE TAXPAYERS' BILL OF RIGHTS, SO AS TO CLARIFY AND EXTEND THE APPLICATION OF HARDSHIP EXTENSIONS TO PAY; TO AMEND SECTIONS 12-60-420 AND 12-60-490, BOTH AS AMENDED, BOTH RELATING TO THE REVENUES PROCEDURE ACT, BOTH SO AS TO PROVIDE THAT THE APPLICATION OF A DIVISION DECISION OR A DETERMINATION OF DEFICIENCY APPLIES TO LOCAL TAXES ADMINISTERED BY THE DEPARTMENT OF REVENUE AND REQUIRE THE NOTICE TO PROVIDE THAT FAILURE TO FILE A PROTEST RESULTS IN A DECISION BECOMING FINAL AND TO PROVIDE, FURTHER, FOR SETOFFS AGAINST TAX REFUNDS; TO AMEND SECTION 61-4-747, RELATING TO REGULATION OF WINE, SO AS TO REQUIRE OUT-OF-STATE WINE SHIPPERS TO PAY SALES AND EXCISE TAXES ON WINE SHIPPED TO RESIDENTS OF THIS STATE BY JANUARY TWENTIETH OF EACH YEAR FOR THE PRECEDING YEAR; BY ADDING SECTION 33-14-420 SO AS TO FURTHER PROVIDE FOR CLAIMANTS AGAINST FUNDS OF A DISSOLVED CORPORATION; TO PROVIDE THAT THIS ACT IS THE MOST RECENT ACTION OF THE GENERAL ASSEMBLY RELATING TO ADOPTION OF AND CONFORMITY WITH PROVISIONS OF THE INTERNAL REVENUE CODE; TO AMEND SECTION 12-6-1130, AS AMENDED, RELATING TO DEDUCTIONS FROM INCOME TAX, SO AS TO PROVIDE THAT THE DEDUCTION FOR CHARITABLE CONTRIBUTIONS BE DETERMINED AS IN THE INTERNAL REVENUE CODE; TO AMEND SECTIONS 12-6-3515, RELATING TO CHARITABLE CONTRIBUTIONS FOR CONSERVATION, SO AS TO PROVIDE THAT THE DETERMINATION MUST BE LIKE SECTION 170 OF THE INTERNAL REVENUE CODE; TO AMEND SECTION 12-43-232, RELATING TO QUALIFICATION FOR AGRICULTURAL USE FOR PURPOSES OF ASSESSMENT, SO AS TO PROVIDE THAT A PERPETUAL CONSERVATION EASEMENT IS AGRICULTURAL REAL PROPERTY; BY ADDING SECTION 12-6-5590 SO AS TO FURTHER PROVIDE GUIDELINES FOR ALLOWING A DEDUCTION FOR A CHARITABLE CONTRIBUTION; TO AMEND SECTIONS 12-44-30, 4-12-30, AND 4-29-67, ALL RELATING TO A FEE IN LIEU OF TAXES, SO AS TO PROVIDE FOR QUALIFICATION OF A CERTIFIED ECONOMIC DEVELOPMENT PROJECT; BY ADDING SECTION 12-37-135 SO AS TO ALLOW A COUNTYWIDE BUSINESS REGISTRATION AND FEE; BY ADDING SECTION 12-45-430 AND TO AMEND SECTION 12-37-2650, AS AMENDED, RELATING TO RECEIPTS FOR PAYMENT OF TAXES, BOTH SO AS TO PROVIDE THAT A RECEIPT MUST NOT BE ISSUED UNLESS ALL TAXES AND OTHER CHARGES HAVE BEEN PAID; TO AMEND SECTION 12-37-2730, RELATING TO USE OF A TREASURER'S TAX RECEIPT TO OBTAIN A LICENSE PLATE, SO AS TO PROVIDE THAT BOTH MUNICIPAL AND COUNTY TAXES AND OTHER CHARGES MUST BE PAID BEFORE ISSUANCE OF A RECEIPT WHEN A MUNICIPALITY CONTRACTS WITH THE COUNTY FOR THE COLLECTION OF ITS VEHICLE AND TO PROVIDE FOR THE ISSUANCE OF A SUMMONS BY A CODE ENFORCEMENT OFFICER TO ENFORCE COLLECTION OF VEHICLE PROPERTY TAX AND VEHICLE REGISTRATION LAWS; TO AMEND SECTION 12-43-220, AS AMENDED, RELATING TO QUALIFICATION FOR THE FOUR PERCENT ASSESSMENT RATIO, SO AS TO PROVIDE A FURTHER PROVISION FOR QUALIFICATION; TO AMEND SECTIONS 12-49-950, 12-51-55, AS AMENDED, AND 12-51-130, AS AMENDED, ALL RELATING TO THE SALE OF PROPERTY FOR NONPAYMENT OF TAXES, SO AS TO PROVIDE THAT ALL UNPAID TAXES, ASSESSMENT, CHARGES, AND ACTUAL COSTS OF THE DELINQUENCY BE INCLUDED IN A BID AND TO PROVIDE THAT AN

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ASSESSMENT INCLUDES AMOUNTS OWED TO A SPECIAL TAXING DISTRICT; TO AMEND SECTION 12-54-25, AS AMENDED, RELATING TO REFUND OF AN OVERPAYMENT OF TAXES, SO AS TO PROVIDE THAT NO INTEREST IS DUE IF THE REFUND IS MADE WITHIN SEVENTY-FIVE DAYS; AND TO AMEND SECTION 12-54-240, RELATING TO CONFIDENTIALITY OF TAX RETURN INFORMATION, SO AS TO ALLOW DISCLOSURE TO A STATE OR COUNTY AGENT OF COUNTY CODE AND CERTAIN JOINT FILING INFORMATION; BY ADDING SECTION 12-37-712 SO AS TO PROVIDE THAT A MARINA PROVIDE ACCESS TO TAXING AUTHORITIES FOR PROPERTY TAX ASSESSMENT; TO PROVIDE FOR A POSTPONEMENT FOR ONE YEAR OF IMPLEMENTATION OF A TAX EQUALIZATION AND REASSESSMENT PROGRAM; TO AMEND SECTION 12-36-2120, AS AMENDED, RELATING TO EXEMPTIONS FROM SALES TAX, SO AS TO ADD TO THE "HOLIDAY" FOR SCHOOL SUPPLIES CERTAIN BEDDING AND BATH LINENS; BY ADDING SECTION 12-45-185 SO AS TO PROVIDE FOR THE WAIVER OF PENALTY FOR LATE TAX PAYMENT UPON PROOF OF TIMELY DELIVERY; AND BY ADDING SECTION 12-6-3575 SO AS TO PROVIDE FOR A NONREFUNDABLE CREDIT AGAINST INCOME TAX FOR FIFTY PERCENT OF THE PREMIUM COSTS FOR HEALTH INSURANCE UNDER CERTAIN CONDITIONS AND WITH CERTAIN LIMITATIONS. - ratified title

03/15/05	House	Introduced and read first time HJ-52
03/15/05	House	Referred to Committee on Ways and Means HJ-56
04/13/05	House	Committee report: Favorable with amendment Ways and Means HJ-10
04/19/05	House	Amended HJ-75
04/19/05	House	Read second time HJ-77
04/20/05	House	Read third time and sent to Senate HJ-24
04/21/05	Senate	Introduced and read first time SJ-2
04/21/05	Senate	Referred to Committee on Finance SJ-2
05/18/05	Senate	Committee report: Favorable with amendment Finance SJ-24
05/19/05	Senate	Amended SJ-93
05/24/05		Scrivener's error corrected
05/25/05	Senate	Amended SJ-60
05/25/05	Senate	Read second time SJ-60
05/26/05	Senate	Amended SJ-308
05/26/05	Senate	Read third time and returned to House with amendments SJ-308
05/31/05	House	Concurred in Senate amendment and enrolled HJ-69
06/01/05		Ratified R 150
06/07/05		Signed By Governor
06/15/05		Copies available
06/15/05		Effective date See Act for Effective Date
06/16/05		Act No. 145

Exhibit 6
Tax Regulations 117-92.4 (Pre-1985)

117-91.11. When Federal Forms W-2, W-4 and 1099 are Acceptable by the South Carolina Tax Commission.

A properly completed Federal Form W-2 (wage and tax statement) is acceptable in lieu of South Carolina Form 1203 provided the W-2 form contains the information required in § 12-9-610 of the 1976 Code.

A properly completed Federal Form W-4 (withholding exemption certificate) is acceptable by the South Carolina Tax Commission in lieu of South Carolina form W/H 1602 as required in § 12-9-130 of the 1976 Code provided the employee claims the same number of personal exemptions for both state and federal payroll purposes.

A properly completed Form 1099 (statement for recipient of income other than from wages) is acceptable by the South Carolina Tax Commission in lieu of South Carolina form 1202, provided that form 1099 contains the information required in § 12-7-1590 of the 1976 Code.

117-92.1. Entire Net Income.

The term "entire net income" as used in § 12-11-10 shall include income derived from any source whatsoever including interest on obligations of the United States, the United States Government or its possessions or of any state and any political subdivision thereof.

117-92.2. Method of Reporting.

The net income of the taxpayer as provided for in § 12-11-20 shall be computed on either a cash or an accrual basis. A bank may request permission to change from a cash to an accrual basis or from an accrual basis to a cash basis over a ten year period.

117-92.3. Federal Income Tax Deduction.

Effective January 1, 1975 (1976 Bank Tax Returns), banks reporting on a cash basis may deduct Federal income estimated tax payments in the year in which they are paid.

Cash basis banks using a method other than above may convert by using ten year conversion period as permitted under Income Tax Regulation 35.2.

117-92.4. [Adoption of Income Tax Rules and Regulations Pertaining to Banks.]

The following Income Tax Rules and Regulations are herewith

adopted and made a part of the Rules and Regulations pertaining to banks:

- 117-63 Pertaining to Depreciation Obsolescence and Depletion
- 117-78 Pertaining to the Filing of Income Tax Returns on Forms Furnished by the Commission
- 117-68 Expenses Incurred or Sum Paid to Influence Legislation
- 117-73 To Provide a Definition of the Term "Related Expenses"
- 117-87.1 Accumulation of Depreciation
- 117-87.6 Prizes
- 117-87.12 Gain or Loss from the Demolition of Business Property
- 117-87.40 Casualty Loss
- 117-87.21 Sales and Use Tax Deduction
- 117-87.22 Treatment of Repossessions
- 117-87.23 Traveling Expenses as an Allowable Deduction
- 117-87.24 Reserve for Bad Debts
- 117-87.52 Cost Basis of Property
- 117-87.55 Gain or Loss on Exchanges—Generally
- 117-87.56 Gain or Loss on Involuntary Conversion of Property
- 117-87.62 Taxability of Easements & Right of Ways

117-92.5. Mergers.

A bank which merges into another bank or consolidates with one or more banks, must file a final return for a portion of the year prior to the merger or consolidation and pay the tax shown to be due thereon.

The liability for filing the final return for the bank or banks ceasing to exist shall vest in the surviving bank since it assumes all assets and liabilities of the bank or banks merging or consolidating.

ARTICLE 6

PROPERTY TAX

New Rules Added

- 117-119.1 Assessment Guides for Personal Property.
- 117-124.1 Classification of Companies.

Exhibit 7
Tax Commission Letter 88-14



301 Gervais Street, P.O. Box 125, Columbia, South Carolina 29214

SC INFORMATION LETTER #88-14

TO: Vicki Jinnette
Public Information Officer

FROM: John Swearingen, Manager
Tax Policy and Procedures Department

DATE: June 10, 1988

SUBJECT: Repeal of Income Tax Regulation

REFERENCE: S.C. Code Ann. Section 12-7-70 (1976)
S.C. Code Ann. Section 1-23-120 (Cum. Supp. 1987)

AUTHORITY: S.C. Code Ann. Section 12-3-140
SC Revenue Procedure #87-3

SCOPE: An Information Letter is a temporary document issued for the purpose of disseminating general tax information and to respond to technical questions from within the Commission which are not related to a specific set of facts.

The following Income Tax Regulations have been repealed effective May 27, 1988:

1. Reg. 117-62 "Dependent Spouse" Defined
2. Reg. 117-63 Depreciation Defined
3. Reg. 117-64 Exemption for certain Fraternal Organizations
4. Reg. 117-65 Exemption for certain Veterans' Organizations
5. Reg. 117-66 Operation of Exempt Organizations
6. Reg. 117-67 Deduction for Moving Expenses
7. Reg. 117-68 Lobbyists
8. Reg. 117-69 Investment Tax Credit on Depreciable Property
9. Reg. 117-70 \$200.00 Expense Allowance of Teachers
10. Reg. 117-71 Loss on Sale of Home Not Deductible
11. Reg. 117-72 Valuation of Property of Deceased
12. Reg. 117-87.1 Accumulation of Depreciation
13. Reg. 117-87.2 Federal Income Tax Deduction
14. Reg. 117-87.3 Living Expenses for Required Quarters
15. Reg. 117-87.4 Sale of Personal Residence

16.	Reg. 117-87.6	Prizes
17.	Reg. 117-87.7	Educational Expenses Deductible from S.C. Income Tax
18.	Reg. 117-87.8	Contributions by Corporations
19.	Reg. 117-87.11	Dues to Social Club
20.	Reg. 117-87.12	Gain or Loss from the Demolition of Business Property
21.	Reg. 117-87.13	Federal Income Levied against Fiduciaries
22.	Reg. 117-87.14	Income Held in an Estate
23.	Reg. 117-87.15	Attorney's Fees and Expenses of Litigation
24.	Reg. 117-87.16	Installment Sales or Credit Sales
25.	Reg. 117-87.18	Net Operating Loss Carry-over
26.	Reg. 117-87.19	Soil Conservation Expenditures
27.	Reg. 117-87.21	Sales and Use Tax Deduction
28.	Reg. 117-87.22	Treatment of Repossessions
29.	Reg. 117-87.23	Traveling Expenses as an Allowable Deduction
30.	Reg. 117-87.24	Reserve for Bad Debts
31.	Reg. 117-87.25	Filing of an Income Tax Return of a Dependent
32.	Reg. 117-87.26	Capital Gains
33.	Reg. 117-87.27	Estates-Fiduciaries-Life Estates
34.	Reg. 117-87.28	Involuntary Conversion of Property and Casualty Losses
35.	Reg. 117-87.29	Medical Expenses Incurred on account of the Dependent
36.	Reg. 117-87.30	Limited Nontaxable Dividends
37.	Reg. 117-87.33	Reversionary Trust
38.	Reg. 117-87.34	Loss from Operation of an Estate or Trust
39.	Reg. 117-87.35	Computing Chief Support
40.	Reg. 117-87.37	Service Performed for Charitable Organizations
41.	Reg. 117-87.38	Contributions
42.	Reg. 117-87.39	Capital Expenditures as Medical Expenses
43.	Reg. 117-87.40	Casualty Losses
44.	Reg. 117-87.41	Election to Deduct Certain Administration Expenses of an Estate for Income Tax Purposes
45.	Reg. 117-87.42	Treatment of Federal Civil Service Retirement Income
46.	Reg. 117-87.43	Capital Gain Treatment of Installment Payments Received in Respect of a Decedent
47.	Reg. 117-87.44	Medical Expenses of a Decedent
48.	Reg. 117-87.45	Holding Period for Determining Capital Gain or Loss Treatment
49.	Reg. 117-87.46	Election to Report Sales on the Installment Basis
50.	Reg. 117-87.47	Military Pay Received in Combat Zone
51.	Reg. 117-87.48	Short Period returns
52.	Reg. 117-87.49	Stock Dividends or Stock Rights
53.	Reg. 117-87.50	Scholarships and Fellowships
54.	Reg. 117-87.51	Income from Estates and Trusts
55.	Reg. 117-87.52	Cost Basis of Property
56.	Reg. 117-87.53	Expense of Meals By Officers While on Duty Aboard Ship
57.	Reg. 117-87.55	Gain or Loss on Exchanges - Generally
58.	Reg. 117-87.56	Gain or Loss on Involuntary Conversion of Property

- 59. Reg. 117-87.57 Fiduciaries and Nonresident Beneficiaries
- 60. Reg. 117-87.58 Retired Serviceman's Family Protection Plan
- 61. Reg. 117-87.59 Rental Value of Home Furnished a Clergyman
- 62. Reg. 117-87.60 Definition of "Student" and "Educational Institution"
- 63. Reg. 117-87.61 Resident and Nonresident Estates and Trusts Defined
- 64. Reg. 117-87.62 Taxability of Easements & Right of Ways
- 65. Reg. 117-87.64 Life Insurance - Death Proceeds
- 66. Reg. 117-87.65 Gross Income - Defined
- 67. Reg. 117-87.66 Sick Pay and Disability Retirement Benefits
- 68. Reg. 117-87.67 Reimbursement for Medical Expenses in a Later Year
- 69. Reg. 117-87.68 Adjustments Required by Change in Accounting Method
- 70. Reg. 117-87.70 Tax Sheltered Annuities - Employees of Public Schools
- 71. Reg. 117-87.72 Last-in First-out Method of Computing Inventories
- 72. Reg. 117-87.75 Net Operating Loss Carryover - Three Year Period Defined
- 73. Reg. 117-87.76 Dependent Care - Institutional Expense for Disabled
- 74. Reg. 117-87.79 Losses from Bad Debts and Worthless Stock
- 75. Reg. 117-90.1 License Taxes Measured by Premium Income
- 76. Reg. 117-90.2 Reserve for Losses Incurred but not Reported
- 77. Reg. 117-92.4 Banking Regulations
- 78. Reg. 117-94 Amendment of 1976 Code Section 12-7-560(6)
- 79. Reg. 117-96 Tables for Computing Uniform Premiums on Group Term Life Insurance Policies
- 80. Reg. 117-97 Tax Credit for Qualified Energy Systems

Exhibit 8
SC PLR 95-10

State of South Carolina
Department of Revenue
301 Gervais Street, P. O. Box 125, Columbia, South Carolina 29214

SC PRIVATE LETTER RULING #95-10 (TAX)

TO: Bank

SUBJECT: Bank Reorganizations
(Tax on Banks and Bank Holding Companies)

DATE: August 28, 1995

REFERENCE: S.C. Code Ann. Section 12-7-415 (Supp. 1994)
S.C. Code Ann. Section 12-7-20(11) (Supp. 1994)

AUTHORITY: S.C. Code Ann. Section 12-4-320 (Supp. 1994)
SC Revenue Procedure #94-1

SCOPE: A Private Letter Ruling is an **official advisory opinion** issued by the Department of Revenue to a specific person.

NOTE: A Private Letter Ruling may only be relied upon by the person to whom it is issued and only for the transaction or transactions to which it relates. A Private Letter Ruling has no precedential value.

Question:

For purposes of the reorganization transaction involving Bank, Interim and Holding, will South Carolina follow the federal treatment of the Internal Revenue Code ("IRC") sections specifically listed in the Facts of this private letter ruling?

Conclusion:

For purposes of the reorganization transaction involving Bank, Interim and Holding, South Carolina will follow the federal treatment as to all parties to the reorganization.

Facts:

Bank is a national bank that was formerly a federally chartered stock savings bank. Holding has been formed by Bank in order to allow Bank to engage in a reorganization. Immediately prior to the reorganization, all of the stock of Holding will be held by Bank. Holding will, in turn, form Interim. Immediately prior to the reorganization, all of the stock of Interim will be held by Holding. Both Bank and Holding are South Carolina corporations.

Bank will report its South Carolina taxable income each year based upon its taxable income calculated and reported for federal income tax purposes adjusted for deductions of interest income earned on federal obligations and federal income tax incurred.

On the date of the reorganization, Interim will merge into Bank and the shareholders of Bank will surrender their stock in Bank and will receive stock of Holding in exchange for their stock in Bank. The dissenting shareholders will receive cash in the reorganization. Immediately after the transaction, all of the stock of Bank will be held by Holding, the new holding company.

The transaction as outlined by the taxpayers involves the following sections of the Internal Revenue Code of 1986 ("IRC"), as amended:

IRC Sections 368(a)(1)(A), 368(a)(2)(E), 368(b), 354, 358, 357, 361, 1032 and 1223.

Bank will be a "bank" as that term is defined in Section 12-11-10 of the South Carolina Code of Laws ("Code") and as such is taxed under Chapter 11, Title 12 of the Code (Income Tax on Banks). Holding will be a holding company taxed under the corporate income tax provisions of Chapter 7, Title 12 of the Code and Interim (during the period of its existence) will be a corporation taxed under the corporate income tax provisions of Chapter 7, Title 12 of the Code.

Discussion:

Chapter 11 of Title 12 of the Code imposes a tax upon every bank engaged in business in this State with respect to the net income of the taxpayer doing a banking business within this State or from sales or rentals of property within this State, computed at the rate of four and one half percent of the entire net income of such bank or taxpayer.

Chapter 7 of Title 12 of the Code imposes an income tax on corporations (excluding banks and certain other types of corporations). With respect to such taxation, Section 12-7-415 provides in part:

"The South Carolina gross income and taxable income of a corporation...is the corporation's gross income and taxable income as determined under the Internal Revenue Code with the modifications specified in Section 12-7-430."

Section 12-7-20(11) of the Code as amended by Act. No. 60(July 12, 1995) defines "Internal Revenue Code" as the Internal Revenue Code of 1986 as amended through December 31, 1994. In adopting the Internal Revenue Code, South Carolina, in Section 12 of 1985 Act No. 101, as amended by Section 25P of 1987 Act No. 170, specifically did not adopt certain federal code sections. None of the IRC code sections cited in the Facts above are specifically excluded from the South Carolina law. The question is whether the principles embodied in the Internal Revenue Code sections listed in the Facts which apply to corporations taxed under Chapter 7, Title 12 of the Code should apply to transactions involving banks taxed under Chapter 11, Title 12 of the South Carolina Code of Laws.

The traditional theory of the reorganization provisions of the Internal Revenue Code is that gain or loss should not be recognized on mere changes of form when there is no substantive change in the rights of the parties and their relationship to the corporate assets. The reorganization provisions generally provide that there is no gain or loss recognized at the shareholder level on the exchange of stock in the old corporation for stock in the new corporation or to the corporation on the exchange of its assets provided the transaction can meet the requirements of creating a tax free reorganization. See, Bittker & Eustice, *Federal Income Taxation of Corporations and Shareholders* paragraph 12.01[2] and [3](sixth ed. 1994). The same policy reasons that encouraged the adoption by South Carolina of the Internal Revenue Code sections listed in the Facts to corporations taxed under Chapter 7 of Title 12 encourage the extension of these provisions to transactions that occur among taxpayers subject to tax under Chapter 11, Title 12. Thus, in this case, South Carolina will follow the federal tax treatment of the reorganization.

Note: This document addresses the South Carolina income tax treatment only as it relates to those IRC sections specifically listed in the Facts. Additionally, Chapter 11 of the Code is currently under review and this PLR may only be relied upon for this transaction.

Exhibit 9
Tax Commission Letter 94-35



301 Gervais Street, P.O. Box 125, Columbia, South Carolina 29214

SC INFORMATION LETTER #94-35 (TAX)

SUBJECT: ADMINISTRATIVE PRONOUNCEMENT
Multistate Bank Income Tax Returns
(Income Tax)

DATE: December 20, 1994

SUPERSEDES: All previous documents and any oral directives in conflict herewith.

REFERENCE: S.C. Code Ann. Section 12-11-20 (Supp. 1993)
S.C. Code Ann. Section 12-7-250 (Supp. 1993)

AUTHORITY: S.C. Code Ann. Section 12-4-320 (Supp. 1993)
S.C. Revenue Procedure #94-1

SCOPE: An Information Letter is a document issued for the purpose of disseminating general information or information concerning an administrative pronouncement.

Information Letters issued to disseminate general information have no precedential value and do not represent the official position of the Department. Information Letters designated as administrative pronouncements represent the **official advisory opinion** of the Department.

Changes in federal law will result in a growing number of banks conducting a banking business both within and without this State ("multistate banks"). In South Carolina banks are taxed pursuant to Chapter 11 of Title 12 of the South Carolina Code of Laws. Code Section 12-11-40 applies certain provisions of Chapter 7 to banks. The general corporate income tax in Chapter 7 directs corporations that conduct their businesses within and without this State to pay tax upon an income base that reasonably represents the proportion of the trade or business carried on within this State. There has been some confusion as to whether these provisions of Chapter 7 apply to multistate banks for purposes of computing the bank income tax under Chapter 11.

For returns filed for years ending before 1997, the Department will accept multistate bank returns which are based upon the proportion of the bank's entire net income that reasonably represents the proportion of the bank's trade or business carried on within this State in the same manner as required of those corporations subject to the corporate income tax of Chapter 7 whose principal profits or income are derived from sources other than manufacturing, producing, collecting, buying, assembling, processing or selling, distributing or dealing in tangible personal property (i.e., the gross receipts method under Code Section 12-7-1190).

The Department generally intends that banks who follow this procedure will comply with rules similar to those used by multistate non-bank financial businesses, such as mortgage companies. The Department reserves the right to question on audit any specific method of allocation and apportionment of income employed by a multistate bank.

Exhibit 10
Income Tax Decision I-D-200 (1975)

1975 WL 23751 (S.C.Tax.Com.)

Tax Commission

State of South Carolina

RE: BANK TAX

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August 4, 1975

*1 A merger was effectuated between two South Carolina banks. The assets and liabilities of Bank "A" were transferred to Bank "B" and the name of the resulting entity was changed to Bank "A". The question before the Tax Commission concerns the bank tax liability of Bank "A". The tax is imposed by Section 65-402 of the South Carolina Code.

The taxpayer filed a Bank Tax Return on which it excluded from its income (the base on which the bank tax was computed) the income of Bank "B". The Income Tax Division has included the income of Bank "B" to the date of merger in the base of the tax. The taxpayer has protested on the ground that Bank "B" no longer existed and, therefore, there should be no bank tax assessed against Bank "A" based on Bank "B" income.

The reasoning put forth on behalf of the exclusion of Bank "B" income would apply as well to the exclusion of the income of old Bank "A", it also "did not exist" as a separate entity. Taken to its ultimate conclusion, this argument would dictate that no bank tax would be due when entities changed form during the ensuing tax year. This result was certainly not intended by the Legislature. Substance, not form, must control in the area of taxation, *Gregory v. Helvering*, 293 U.S. 465. Although differing in many respects, it should be noted that the South Carolina Income Tax law has adopted the reorganization provisions of Section 368 of the Internal Revenue Code. This section recognizes the rule that a mere change in form as opposed to economic change should not be controlling for tax purposes.

Section 65-402 has been interpreted to be a franchise tax measured by net income. This method of measuring the tax would be circumvented unless a taxpayer is required to pay its tax based on the economic gain generated by its business during the prior year. The income of both Bank "B" and old Bank "A" certainly inures to the resulting entity of Bank "A". We, therefore, hold that the successor bank in a merger or consolidation is liable for the tax imposed by Section 65-402 based on the entire net income of the merged or consolidated entities during the previous year.

The position of the Income Tax Division is upheld.

AND IT IS SO ORDERED. (August 4, 1975)

Note: Commission Decisions dated before 1987 are from Volume 1 of the South Carolina Tax Commission Decisions. These decisions do not have specific page references, therefore, citations are not available.

1975 WL 23751 (S.C.Tax.Com.)

End of Document

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Exhibit 11
Income Tax Decision I-D-5 (1960)

1960 S.C. Tax LEXIS 5

South Carolina Tax Commission, Income Tax Division

August 02, 1960

No. I-D-5

Reporter

1960 S.C. Tax LEXIS 5 *

INVESTMENT INCOME TAX

Core Terms

investment income, small loan, cost basis, insurance business, net operating loss, no provision, premium, insurance company, income arising, premium income, license tax, net loss

Opinion

[*1]

QUESTION AT ISSUE

1. A life insurance company in connection with the license tax measured by the investment income, takes the position that commission expense should be considered as relating to business premium income and investment income.
2. Taxpayer takes the position that net operating losses on insurance business for the years 1954-57 should be allowed as a cost basis upon which to compute the gain or loss on the sale of industrial and small loan business to another company.
3. The taxpayer further claims that if the cost basis claimed in No. 2 above, is allowed, then the gain on the sale of the business should not be classed as investment income.

DECISION

1. The Commission held that commissions are incurred as an expense directly connected with the production of insurance business, such commissions being a percentage of premiums on the business produced and, therefore, commissions are related entirely to premium income and do not constitute a deduction for purposes of the taxing question.

Section 65-932, provides that investment income includes all money or income received on account of ownership or use of real or personal property situated within the State [*2] and all income arising from any form of business or trade whatsoever in this State, except income arising from (a) premiums paid for an insurance contract, (b) mortgage loans, (c) policy loans, or (d) bonds or securities of the State or its political subdivisions.

2. The Commission stated that losses on the operation of the industrial or small loan business for the years 1954-57, were not incurred on the sale of the insurance business and there is no provision for the carrying over of net operating losses. The Commission, therefore, held that such losses cannot be allowed as a direct expense or cost of selling the business.

Glenda Chastain

The insurance company in connection with the domestic insurance license tax measured by premium receipts or net income, claims that the sale of the industrial and small loan business to another company should have a cost basis on which to compute net gain or loss and that such cost basis would be comprised of the net losses suffered on the operation of the industrial and small loan business for the years involved. There is no provision of law for carrying over of net operating losses except with respect to taxpayers who have established a new business or industry [*3] during and after the calendar year 1955. This taxpayer commenced operating in 1954. The Commission, therefore, held that no provision was made for the carrying over of its net losses.

3. The Commission held that the gain on sale of its industrial and small loan business does not come within the meaning of the exemption provision in Section 65-932, but does come within the meaning of income from any form of business or trade whatsoever in this State. Since the gain does not come within the exclusion of this Section it is subject to the tax.

End of Document

Exhibit 12
SC Revenue Ruling #16-7



STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE

300A Outlet Pointe Blvd., Columbia, South Carolina 29210
P.O. Box 12265, Columbia, South Carolina 29211

SC REVENUE RULING #16-7

SUBJECT: Use of Net Operating Losses Following a Change in Ownership
(Income Tax)

EFFECTIVE DATE: Applies to all periods open under the statute

SUPERSEDES: Technical Advice Memorandum #89-22

REFERENCES: S. C. Code Ann. Section 12-6-580 (2014)
S. C. Code Ann. Section 12-6-40 (Supp. 2015)
S. C. Code Ann. Section 12-6-50 (2014)
S. C. Code Ann. Section 12-6-5020 (2014)

AUTHORITY: S. C. Code Ann. Section 12-4-320 (2014)
S. C. Code Ann. Section 1-23-10(4) (2005)
SC Revenue Procedure #09-3

SCOPE: The purpose of a Revenue Ruling is to provide guidance to the public. It is an advisory opinion issued to apply principles of tax law to a set of facts or general category of taxpayers. It is the Department's position until superseded or modified by a change in statute, regulation, court decision, or another Departmental advisory opinion.

I. INTRODUCTION

This document provides an overview of South Carolina net operating losses (NOLs), the application of Internal Revenue Code (IRC) Section 382 limitations on South Carolina NOL carryforwards, and the application of IRC Section 382 limitations and other NOL use limitations on South Carolina consolidated returns.¹

¹ South Carolina's consolidated income is not calculated in the same manner as federal consolidated income. See further discussion in Overview of South Carolina Consolidated Returns and NOL Limitations for Consolidated Members, Part VII.

II. OVERVIEW OF SOUTH CAROLINA NOL CALCULATION

Code Section 12-6-580 provides that a corporation's South Carolina gross income and taxable income are computed as determined under the IRC with certain modifications and subject to allocation and apportionment.² Code Section 12-6-50 provides a list of IRC sections that are specifically not adopted for South Carolina income tax purposes.

With the exception of IRC Section 172(b)(1), relating to NOL carrybacks, which South Carolina does not adopt,³ South Carolina adopts IRC Section 172 for the purpose of calculating NOLs, including the 20 year carryforward period. As a result, a South Carolina NOL deduction is computed in accordance with the IRC as adopted by South Carolina subject to the modifications in Article 9, Chapter 6 of Title 12 of the South Carolina Code of Laws. Additionally, a taxpayer that transacts or conducts business partly within and partly without South Carolina is subject to allocation and apportionment under Article 17, Chapter 6 of Title 12. South Carolina NOLs are apportioned in the year the loss is incurred.

III. SOUTH CAROLINA LIMITATION ON NOL CARRYFORWARDS

A. Overview of the Federal Section 382 Limitation on NOL Carryforwards⁴

IRC Section 382 limits the use of NOL carryforwards of a loss corporation after a change in ownership with respect to the loss corporation.⁵ A change in ownership occurs when the percentage of stock held by one or more 5% shareholders of the loss corporation increases by more than 50 percentage points over the lowest stock ownership held by such shareholders on a particular testing date within a prescribed period (usually a three-year period).⁶ IRC Section 382 places an annual limit on the amount of income that can be offset by NOLs incurred before the ownership change. Any pre-ownership change NOL carryforward that cannot be deducted in the taxable year because of the IRC Section 382 limitation is carried forward to the following year. The IRC Section 382 limitation is calculated by multiplying the loss corporation's value at the time of the ownership change by the published federal long-term tax-exempt rate.⁷ The value of the loss corporation is generally the fair market value of its stock at the time of the ownership change. This calculation results in the amount of income of the loss corporation that can be offset by a pre-ownership change NOL carryforward each year following the ownership change.⁸

² South Carolina generally adopts the IRC through the immediately preceding December 31st. Code Section 12-6-40. Article 9, Chapter 6, Title 12 contains modifications and Article 17, Chapter 6, Title 12 contains allocation and apportionment provisions.

³ Code Sections 12-6-50(6) and 12-6-1130(4).

⁴ This document provides a brief overview of IRC Section 382. It is not a comprehensive analysis of IRC Section 382.

⁵ IRC Section 382(k)(1) defines a "loss corporation" as a corporation entitled to use an NOL carryover or having an NOL for the taxable year in which the ownership change occurs.

⁶ IRC Section 382(g).

⁷ The federal long-term tax-exempt rate for ownership changes is published monthly in an IRS Revenue Ruling.

⁸ The effect of built-in gains and built-in losses on the use of the NOL carryforward is discussed below.

B. South Carolina Section 382 Limitation on NOL Carryforwards

South Carolina adopts IRC Section 382.⁹ However, the South Carolina Section 382 limitation amount will depend on whether the loss corporation conducts its entire business within South Carolina, or conducts its business partly within and partly without South Carolina, during the taxable year that the ownership change occurs. If, during the taxable year that the ownership change occurs, the loss corporation has conducted its entire business within South Carolina, the federal Section 382 limitation and the South Carolina Section 382 limitation generally will be the same.¹⁰

If, during the taxable year that the ownership change occurs, the loss corporation has apportioned its South Carolina income/losses because it has conducted its business partly within and partly without South Carolina, the South Carolina Section 382 limitation is calculated by apportioning the federal Section 382 limitation using the South Carolina apportionment ratio for the taxable year that the ownership change occurs.

For example, assume the following for Company A at the time of ownership change:

- Company A's value is \$5,000,000;
- The applicable federal long-term tax exempt rate is 2.80%;¹¹
- Company A's federal NOL carryforward is \$1,000,000;
- Company A's previously apportioned South Carolina NOL carryforward is \$350,000;
- Company A's South Carolina apportionment ratio for the year of the ownership change is 25%.

Company A's federal Section 382 limitation is \$140,000 ($\$5,000,000 \times 2.8\%$). Accordingly, Company A can use its pre-ownership change federal NOL carryforward to offset up to \$140,000 of its federal taxable income in each year following the ownership change. The South Carolina Section 382 limitation is \$35,000 ($\$5,000,000 \times 2.8\% \times 25\%$). Accordingly, the taxpayer can use its pre-ownership change South Carolina NOL carryforward to offset up to \$35,000 of its South Carolina taxable income in each year following the ownership change.

The Section 382 limitation is an annual limitation on the amount of taxable income that can be offset by a pre-ownership change NOL carryforward (in the above example \$35,000 for South Carolina purposes). The Section 382 limitation amount remains the same each year, except in the case of certain built-in gains discussed below. Any pre-ownership change South Carolina NOL carryforward that cannot be deducted in the taxable year because of the South Carolina Section 382 limitation is carried forward to the following year. The South Carolina NOL remains subject to the maximum 20 year carryforward period.

⁹ Code Section 12-6-40.

¹⁰ For members of a federal consolidated group see Part VII.

¹¹ For this example the rate used was from IRS Revenue Ruling 2015-1, Table 3.

IV. INTRODUCTION TO BUILT-IN GAINS AND BUILT-IN LOSSES

IRC Section 382(h) requires that on the date of an ownership change, a loss corporation must determine if there is a net unrealized built-in gain (NUBIG) or a net unrealized built-in loss (NUBIL). The NUBIG or NUBIL is the difference between the fair market value of the loss corporation's assets (other than cash and certain cash equivalents) and the aggregate adjusted tax basis of those assets. If a corporation's NUBIG exceeds the federal threshold discussed below, IRC Section 382(h) provides that the IRC Section 382 NOL limitation is increased by certain recognized built-in gains in the year the gain is recognized. If a corporation's NUBIL exceeds the federal threshold, IRC Section 382(h) requires that the pre-ownership change NOL carryforward be increased by certain recognized built-in losses.

Note that a loss corporation benefits from recognized built-in gains which allow it to increase its Section 382 limitation and thereby use a greater amount of its pre-ownership change NOLs. Recognized built-in losses, on the other hand, must be added to the pre-ownership change NOL and those losses are subject to the Section 382 limitation. Accordingly, a loss corporation with NUBIG benefits from meeting the threshold while a loss corporation with NUBIL benefits from failing to meet the threshold.

V. BUILT-IN GAINS

A. Federal Tax Treatment – IRC Section 382(h)(1)(A)

At the time of ownership change, the loss corporation may have substantially appreciated assets despite the existence of an NOL carryforward. Under IRC Section 382(h)(1)(A), if the loss corporation has a "net unrealized built-in gain" (NUBIG)¹² – i.e., on the date of the ownership change the fair market value of its assets (other than cash and certain cash equivalents) exceeds their aggregate adjusted basis – the Section 382 limitation amount is increased by any "recognized built-in gain" (RBIG) during the five-year period after the ownership change.¹³ The Section 382 limitation increase is only in the year that the built-in gain is recognized, and the aggregate increase in the Section 382 limitation during the five-year period after the ownership change cannot exceed the loss corporation's NUBIG.

Federal NUBIG Threshold Requirement. For federal tax purposes, the Section 382 limitation adjustment allowed under IRC Section 382(h) applies only if the loss corporation meets the statutory NUBIG threshold requirement. The loss corporation's NUBIG must exceed either (1) 15% of the fair market value of the loss corporation's assets (other than cash and certain cash equivalents) on the date of ownership change or (2) \$10 million.¹⁴ If the loss corporation's NUBIG does not exceed the statutory threshold, no Section 382 limitation adjustment is allowed.

¹² IRC Section 382(h)(3)(A).

¹³ IRC Section 382(h)(1)(A)(i). The RBIG must be recognized during the statutory "recognition period." Under IRC Section 382(h)(7)(A), the recognition period is the five-year period beginning on ownership change date. For example, if the change date is October 1, Year 1, the recognition period is the five-year period beginning on October 1, Year 1, and ending on September 30, Year 6. No Section 382 limitation adjustments are allowed for built-in gains recognized after the recognition period.

¹⁴ IRC Section 382(h)(3)(B).

B. South Carolina Tax Treatment¹⁵

For South Carolina income tax purposes, a loss corporation's South Carolina NUBIG must meet the South Carolina NUBIG threshold requirement in order to qualify for the South Carolina Section 382 limitation adjustment. The analysis for determining the loss corporation's South Carolina NUBIG and South Carolina NUBIG threshold depends on whether the loss corporation has met the federal NUBIG threshold requirement.¹⁶

1. If Loss Corporation Has Met Federal NUBIG Threshold

If the loss corporation has met the federal NUBIG threshold requirement on a separate company basis, then the loss corporation will be deemed to have met the South Carolina NUBIG threshold requirement. The loss corporation must then calculate its South Carolina NUBIG using one of two available methods:

a. Simplified Method. Under the simplified method, the loss corporation's South Carolina NUBIG is calculated by multiplying the loss corporation's federal NUBIG amount, calculated on a separate company basis, by the South Carolina apportionment ratio for the year the ownership change occurs.

b. Detailed Method. Under the detailed method, the loss corporation's South Carolina NUBIG is calculated, on a separate company basis, using South Carolina income tax modifications and allocation and apportionment provisions. This method is explained in detail below.

2. If Loss Corporation Has Not Met Federal NUBIG Threshold

South Carolina NUBIG Threshold Requirement. If the loss corporation has not met the federal NUBIG threshold requirement on a separate company basis, the loss corporation may still meet the South Carolina NUBIG threshold requirement if the loss corporation's detailed South Carolina NUBIG (explained below) exceeds either (1) 15% of the fair market value of the loss corporation's assets (other than cash and certain cash equivalents) multiplied by the loss corporation's South Carolina apportionment ratio for the year that the ownership change occurs or (2) \$10 million multiplied by the loss corporation's South Carolina apportionment ratio for the year that the ownership change occurs.

Detailed South Carolina NUBIG Calculation. The loss corporation's detailed South Carolina NUBIG is calculated using South Carolina income tax modifications and allocation and apportionment provisions. For example, South Carolina's modification provisions do not allow bonus depreciation under IRC Section 168(k).¹⁷ As a result, a taxpayer must adjust the federal basis of the property for South Carolina purposes to reflect that bonus depreciation was not used. South Carolina's allocation provisions provide the gain from the sale of real property located in

¹⁵ See Exhibit A for flow chart of built-in gains.

¹⁶ See Part VII for corporations filing federal consolidated returns.

¹⁷ Code Section 12-6-50(4).

South Carolina is allocated to South Carolina.¹⁸ Therefore, any built-in gain must reflect this allocation. After allocating any applicable built-in gain or loss, the remainder of the built-in gain or loss will be apportioned to South Carolina using the apportionment ratio for the year that the ownership change occurs.

EXAMPLE¹⁹

Federal NUBIG Calculation

<u>Asset</u>	<u>FMV</u>	<u>Adjusted Basis</u>	<u>Unrealized BIG</u>
Land in SC	\$100,000	\$75,000	\$25,000
Land in VA	\$50,000	\$30,000	\$20,000
§ 168(k) Asset	\$100,000	\$0	\$100,000
Other Asset	\$200,000	\$40,000	\$160,000
Federal NUBIG			\$305,000

Simplified South Carolina NUBIG Calculation

(Assume the SC apportionment factor is 25% for Year of Ownership Change)

<u>Federal NUBIG</u>	<u>SC Apportionment Ratio</u>	<u>South Carolina NUBIG</u>
\$305,000	25%	\$76,250

Detailed South Carolina NUBIG Calculation

(Assume the SC apportionment factor is 25% for Year of Ownership Change)

<u>Asset</u>	<u>FMV</u>	<u>Adjusted Basis</u>	<u>Unrealized BIG</u>
Land in SC	\$100,000	\$75,000	\$25,000 – allocated to SC
Land in VA	\$50,000	\$30,000	\$20,000 – allocated to VA
§ 168(k) Asset	\$100,000	\$50,000	\$50,000 – apportioned
Other Asset	\$200,000	\$40,000	\$160,000 – apportioned

Unrealized BIG Allocated to SC	\$25,000
Unrealized BIG Apportioned to SC $[(50,000+160,000) \times 25\%]$	\$52,500
South Carolina NUBIG	<u>\$77,500</u>

¹⁸ Code Section 12-6-2220(4). The amount of gain which represents the return of amounts deducted as depreciation is allocated to South Carolina to the extent of depreciation previously deducted in computing South Carolina taxable income. Gain in excess of recaptured depreciation is allocated to the state where the real property is located whether or not the real property was used in or connected with the taxpayer's trade or business.

¹⁹ Numbers presented are in 1000s.

3. South Carolina RBIG

A loss corporation that meets the South Carolina NUBIG threshold requirement as provided above can increase its South Carolina Section 382 limitation by any South Carolina RBIG recognized during the five-year recognition period following the ownership change. The increase is allowed only in the year that the built-in gain is recognized, and the aggregate increase in the South Carolina Section 382 limitation cannot exceed the South Carolina NUBIG calculated at the time of the ownership change.

The South Carolina RBIG is calculated in the same manner that the detailed South Carolina NUBIG was calculated. In other words, the South Carolina RBIG is computed using South Carolina modifications and is subject to allocation and apportionment using the apportionment ratio for the tax year that the ownership change occurs. For example, if a loss corporation has a South Carolina RBIG of \$20,000 in Year 3 following the ownership change, then the loss corporation's South Carolina Section 382 limitation is increased by \$20,000 for Year 3.

Note: The South Carolina RBIG is calculated under the detailed method regardless of whether the loss corporation calculated its South Carolina NUBIG under the simplified method or the detailed method.

VI. BUILT-IN LOSSES

A. Federal Tax Treatment – IRC Section 382(h)(1)(B)

IRC Section 382(h) also addresses the treatment of the loss corporation's pre-ownership change built-in losses. Under IRC Section 382(h)(1)(B), if the loss corporation has a "net unrealized built-in loss" (NUBIL)²⁰ – i.e., on the date of the ownership change the aggregate adjusted basis of the loss corporation's assets (other than cash and certain cash equivalents) exceeds the assets' fair market value – any "recognized built-in loss" (RBIL)²¹ of the loss corporation during the five-year period after the ownership change is subject to the Section 382 limitation in the same manner as if it were a pre-ownership change NOL carryforward.²² The total amount of RBIL subject to the Section 382 limitation under this rule is limited to the loss corporation's NUBIL at the time of ownership change.²³

Federal NUBIL Threshold Requirement. As in the case of built-in gains, the Section 382 limitation on RBILs applies only if the loss corporation meets a statutory threshold requirement. The loss corporation's NUBIL must exceed either (1) 15% of the fair market value of the loss corporation's assets (other than cash and certain cash equivalents) on the date of ownership change or (2) \$10 million.²⁴ If the loss corporation's NUBIL does not exceed the statutory threshold, then the loss corporation's federal RBILs are not subject to the Section 382 limitation.

²⁰ IRC Section 382(h)(3)(A).

²¹ RBIL is any loss recognized during the five-year recognition period on the disposition of any asset that was held by the loss corporation immediately before the ownership change. IRC Section 382(h)(2)(B).

²² IRC Section 382(h)(1)(B)(i).

²³ IRC Section 382(h)(1)(B)(ii).

²⁴ IRC Section 382(h)(3)(B).

B. South Carolina Tax Treatment²⁵

For South Carolina income tax purposes, the South Carolina Section 382 limitation on South Carolina RBIL is triggered only if the loss corporation meets the South Carolina NUBIL threshold. As in the case of built-in gains, the analysis for determining the loss corporation's South Carolina NUBIL and South Carolina NUBIL threshold depends on whether the loss corporation has met the federal NUBIL threshold requirement.

1. If Loss Corporation Has Not Met Federal NUBIL Threshold

If the loss corporation's federal NUBIL does not exceed the federal statutory threshold – i.e., none of the loss corporation's federal RBILs is subject to the Section 382 limitation – then none of the loss corporation's South Carolina RBILs is subject to the South Carolina Section 382 limitation. Accordingly, the loss corporation does not need to calculate its detailed South Carolina NUBIL or NUBIL threshold.

2. If Loss Corporation Has Met Federal NUBIL Threshold

South Carolina NUBIL Threshold. If the loss corporation's federal NUBIL exceeds the federal statutory threshold – i.e., the loss corporation's federal RBILs are subject to the Section 382 limitation – the loss corporation must first calculate its South Carolina NUBIL threshold. The loss corporation's South Carolina NUBIL threshold is the lesser of either (1) 15% of the fair market value of the loss corporation's assets (other than cash and certain cash equivalents) multiplied by the loss corporation's South Carolina apportionment ratio for the year that the ownership change occurs or (2) \$10 million multiplied by the loss corporation's South Carolina apportionment ratio for the year that the ownership change occurs.

Detailed South Carolina NUBIL Calculation. After determining its South Carolina NUBIL threshold, the loss corporation must then calculate its South Carolina NUBIL using the detailed method. The loss corporation's detailed South Carolina NUBIL is calculated in the same manner as the loss corporation's detailed South Carolina NUBIG. That is, the loss corporation calculates its detailed South Carolina NUBIL using South Carolina income tax modification and allocation and apportionment provisions using the apportionment factor in the year of the ownership change. If the loss corporation's detailed South Carolina NUBIL does not exceed the loss corporation's South Carolina NUBIL threshold, then none of the loss corporation's South Carolina RBILs is subject to the South Carolina Section 382 limitation. If the loss corporation's detailed South Carolina NUBIL exceeds its South Carolina NUBIL threshold, then the loss corporation's South Carolina RBILs become part of the prechange NOL and subject to the South Carolina Section 382 limitation.

²⁵ See Exhibit B for flow chart of built-in losses.

EXAMPLE²⁶

Federal NUBIL Calculation

<u>Asset</u>	<u>FMV</u>	<u>Adjusted Basis</u>	<u>Unrealized BIL</u>
Land in SC	\$100,000	\$170,000	(\$70,000)
Land in VA	\$50,000	\$130,000	(\$80,000)
§ 168(k) Asset	\$50,000	\$0	\$50,000
Other Asset	\$75,000	\$100,000	(\$25,000)
Federal NUBIL			(\$125,000)

Detailed South Carolina NUBIL Calculation

(Assume the SC apportionment factor is 25% for Year of Ownership Change)

<u>Asset</u>	<u>FMV</u>	<u>Adjusted Basis</u>	<u>Unrealized BIL</u>
Land in SC	\$100,000	\$170,000	(\$70,000) – allocated to SC
Land in VA	\$50,000	\$130,000	(\$80,000) – allocated to VA
§ 168(k) Asset	\$50,000	\$35,000	\$15,000 – apportioned
Other Asset	\$75,000	\$100,000	(\$25,000) – apportioned

Unrealized BIL Allocated to SC	(\$70,000)
Unrealized BIL Apportioned to SC $[(\$15,000 - \$25,000) \times .25]$	(\$2,500)
South Carolina NUBIL:	<u>(\$72,500)</u>

3. South Carolina RBIL

If the loss corporation's detailed South Carolina NUBIL exceeds the loss corporation's South Carolina NUBIL threshold, then the loss corporation's South Carolina RBIL during the five-year recognition period following the ownership change is treated as a pre-ownership change South Carolina NOL carryforward subject to the South Carolina Section 382 limitation. The aggregate amount of the South Carolina RBIL subject to the South Carolina Section 382 limitation under this rule is limited to the loss corporation's detailed South Carolina NUBIL at the time of ownership change. The South Carolina RBIL that is recognized during the five-year recognition period is subject to the South Carolina Section 382 limitation for all periods open under the carryforward.

The South Carolina RBIL that is subject to the South Carolina Section 382 limitation is calculated in the same manner that the detailed South Carolina NUBIL was calculated. In other words, the South Carolina RBIL is computed using South Carolina modifications and is subject to allocation and apportionment using the apportionment ratio for the tax year of the ownership change.

²⁶ These numbers are in 1000s.

VII. OVERVIEW OF SOUTH CAROLINA CONSOLIDATED RETURNS AND NOL LIMITATIONS FOR CONSOLIDATED MEMBERS

A. Overview of South Carolina Consolidated Returns

A South Carolina "consolidated" return (also called a "combined return") is permitted for entities doing business in South Carolina that share at least 80% ownership of the total combined voting power of all classes of stock.²⁷ A corporation doing business entirely within South Carolina may consolidate with a corporation doing a multistate business and two or more corporations doing a multistate business may file a consolidated return.²⁸ A South Carolina consolidated return is not prepared in the same manner as a federal consolidated return. South Carolina has not adopted the federal consolidation rules in IRC Sections 1501 through 1505²⁹ (or the regulations thereunder). South Carolina taxable income or loss is computed separately for each corporation. Income is allocated separately for each corporation, and income is apportioned separately for each corporation.³⁰ There are no elimination adjustments for intercompany transactions such as those required for federal consolidated returns. The separately computed South Carolina income or loss for each participating member of the group is added together to arrive at the South Carolina income or loss for the consolidated group and reported on a single return for the consolidated group.³¹

B. Calculation of South Carolina Section 382 Limitations for Consolidated Members

For federal income tax purposes, the IRC Section 382 limitation is computed on a consolidated basis. However, because South Carolina does not have a federal type consolidated return, the South Carolina Section 382 limitation must be computed separately for each member of the South Carolina consolidated group. In order to calculate a member's South Carolina Section 382 limitation, the member must first compute its separate value at the time of ownership change. Then the member's value must be apportioned using the South Carolina apportionment ratio for that member for the year of the ownership change.

C. Built-In Gains and Losses on South Carolina Consolidated Returns

For South Carolina purposes both net unrealized built-in gains/losses and recognized built-in gains/losses must be calculated separately for each member in the South Carolina consolidated group in the same manner as discussed in Parts V and VI above.

²⁷ Code Section 12-6-5020(A).

²⁸ Code Section 12-6-5020(C).

²⁹ Code Section 12-6-50(15).

³⁰ Code Section 12-6-5020(D).

³¹ Code Section 12-6-5020(D).

D. Separate Return Limitation Years (SRLY)

For federal income tax purposes, the SRLY rules apply to the use of NOLs in a consolidated group. If a corporation with NOL carryforwards becomes a member of a consolidated group, the SRLY rules limit the amount of the consolidated group's taxable income that may be offset by NOL carryforwards that the acquired corporation brings into the consolidated group. In general, the SRLY rules limit the consolidated group's use of separate return limitation year losses to the amount of income generated by the acquired corporation after it becomes a member of the group.³² South Carolina has not adopted the SRLY rules.³³ The provisions of IRC Section 382, along with other IRC sections adopted by South Carolina (*e.g.*, IRC Sections 269 and 384), provide the safeguards to prevent the abusive use of NOLs in South Carolina.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/Rick Reames III
Rick Reames III, Director

July 6 _____, 2016
Columbia, South Carolina

³² For federal purposes, generally SRLY NOL limitations will not apply to corporations joining a consolidated group within six months before or after an IRC Section 382 ownership change. In that case only the IRC Section 382 rules will apply. IRC Reg. 1.1502-21(g).

³³ In 1989, the Department issued Technical Advice Memorandum (TAM) #89-22 which at least suggests that South Carolina follows the SRLY rules even though South Carolina does not adopt the consolidated return provisions of the IRC or IRC regulations. Code Section 12-6-50(15). In 1995, *Anonymous Taxpayer v. South Carolina Department of Revenue*, 95-ALJ-17-0228, was heard by the South Carolina Administrative Law Court (ALC). The Department argued and the ALC agreed that the SRLY rules did not apply in South Carolina since those provisions of the IRC were not adopted by South Carolina.

EXHIBIT A

BUILT-IN GAINS

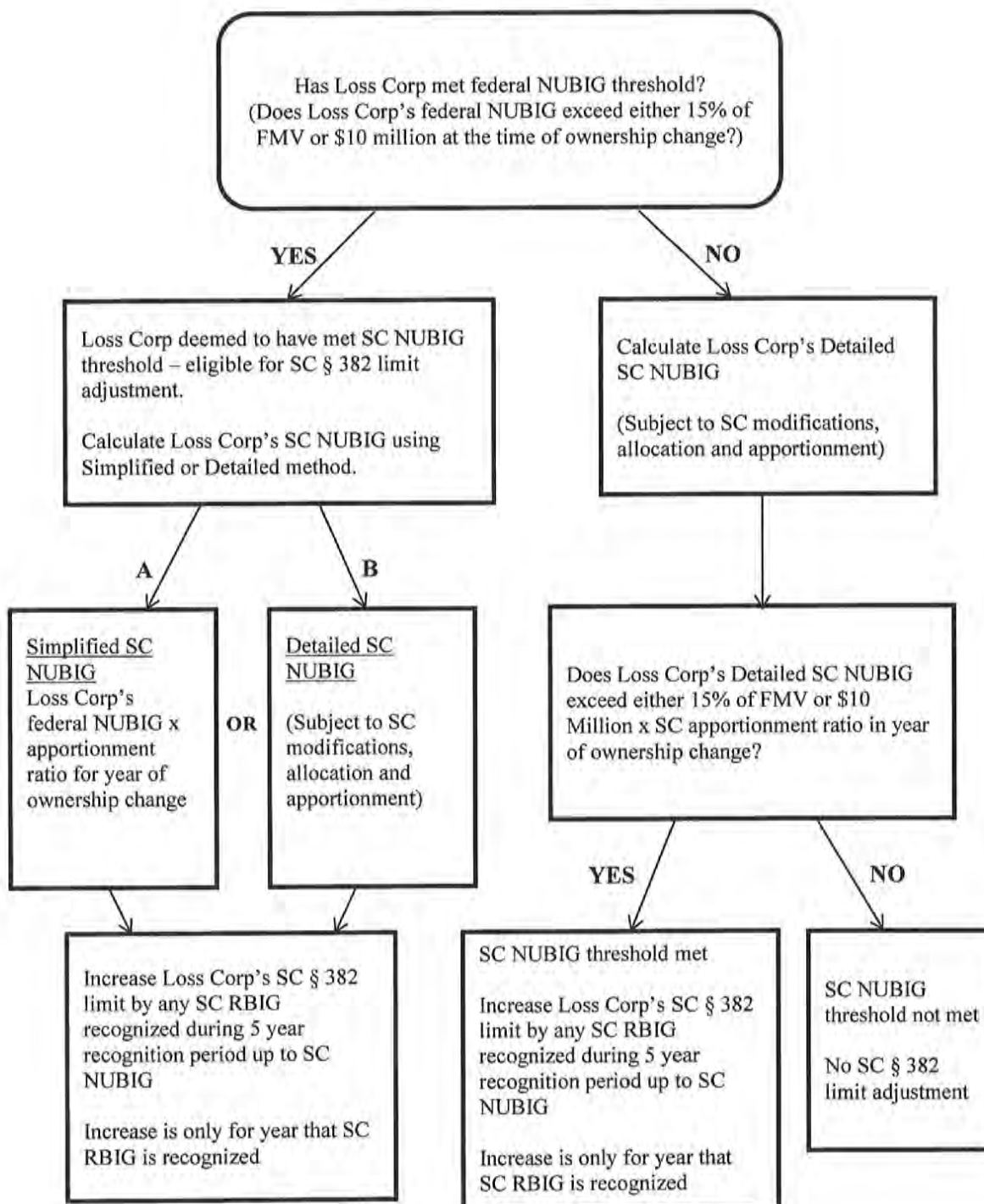


EXHIBIT B

BUILT-IN LOSSES

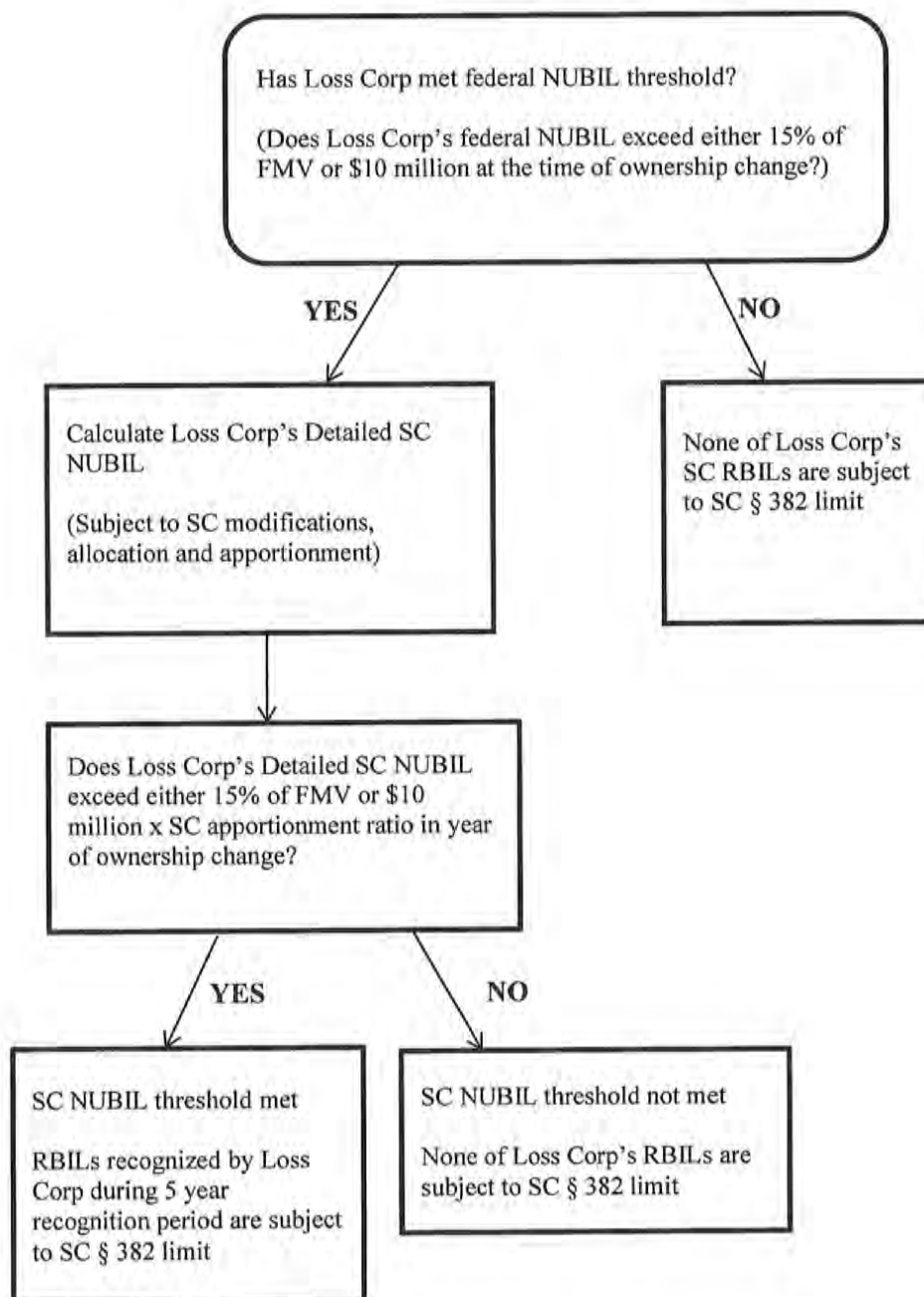


Exhibit 13
Texas Franchise Tax Overview



Glenn Hegar
Texas Comptroller of Public Accounts

Taxes

Franchise Tax Overview

This information applies to reports originally due on or after Jan. 1, 2008, unless otherwise noted.

Entities Subject to Franchise Tax

Each taxable entity formed in Texas or doing business in Texas must file and pay franchise tax. These entities include:

- corporations;
- limited liability companies (LLCs), including series LLCs;
- banks;
- state limited banking associations;
- savings and loan associations;
- S corporations;
- professional corporations;
- partnerships (general, limited and limited liability);
- trusts;
- professional associations;
- business associations;
- joint ventures; and
- other legal entities.

See Franchise Tax Rule 3.586 for a list of some activities considered to be "doing business in Texas."

Entities Not Subject to Franchise Tax

The following entities do not file or pay franchise tax:

- sole proprietorships (except for single member LLCs);
- general partnerships when direct ownership is composed entirely of natural persons (except for limited liability partnerships);
- entities exempt under Tax Code Chapter 171, Subchapter B;
- certain unincorporated passive entities;
- certain grantor trusts, estates of natural persons and escrows;
- real estate mortgage investment conduits and certain qualified real estate investment trusts;

- a nonprofit self-insurance trust created under Insurance Code Chapter 2212;
- a trust qualified under Internal Revenue Code Section 401(a);
- a trust exempt under Internal Revenue Code Section 501(c)(9); or
- unincorporated political committees.

Calculation of the Tax

Margin

Franchise tax is based on a taxable entity's margin. Unless a taxable entity qualifies and chooses to file using the EZ computation, the tax base is the taxable entity's margin and is computed in one of the following ways:

- total revenue times 70 percent;
- total revenue minus cost of goods sold (COGS);
- total revenue minus compensation; or
- total revenue minus \$1 million (effective Jan. 1, 2014).

Total Revenue

Total revenue is determined from revenue amounts reported for federal income tax minus statutory exclusions.

Exclusions from revenue include the following:

- dividends and interest from federal obligations;
- Schedule C dividends;
- foreign royalties and dividends under Internal Revenue Code Section 78 and Sections 951-964;
- certain flow-through funds; and
- other industry-specific exclusions.

See Tax Code Section 171.1011 and Rule 3.587 for more information about total revenue.

Cost of Goods Sold

Cost of goods sold generally includes costs related to the acquisition and production of tangible personal property and real property. There are other cost of goods sold allowances for certain industries. Taxable entities that only sell services will not generally have a cost of goods sold deduction.

See Tax Code Section 171.1012 and Rule 3.588 for more information about cost of goods sold.

Compensation

The compensation deduction includes the following:

- W-2 wages and cash compensation paid to officers, directors, owners, partners and employees (including net distributive income to natural persons) for the 12-month period upon which the tax is based, subject to the inflation-adjusted per person wage and cash compensation limitation [comptroller.texas.gov/taxes/franchise/]; and
- benefits provided to all personnel to the extent deductible for federal income tax purposes, including workers' compensation, health care and retirement benefits.

Compensation does not include 1099 labor or payroll taxes paid by the employer.

See Tax Code Section 171.1013 and Rule 3.589 for more information about compensation.

Apportionment

Margin is apportioned to Texas using a single-factor apportionment formula based on gross receipts.

See Tax Code Section 171.106 and Rule 3.591 for more information about apportionment.

Available Credits

The following franchise tax credits are available:

- Temporary Credit for Business Loss Carryforwards [comptroller.texas.gov/taxes/franchise/faq/credits.php] under Texas Tax Code Section 171.111 (effective for reports originally due on or after Jan. 1, 2008)
- Research and Development Activities Credit [comptroller.texas.gov/taxes/qualified-research/] under Texas Tax Code Chapter 171, Subchapter M (effective for reports originally due on or after Jan. 1, 2014)
- Certified Historic Structures Rehabilitation Credit [comptroller.texas.gov/taxes/historic-structures/] under Texas Tax Code Chapter 171, Subchapter S (effective for reports originally due on or after Jan. 1, 2015)

Combined Reporting

Taxable entities that are part of an affiliated group engaged in a unitary business must file a combined group report. Members of a combined group must use the same method to compute margin.

See Tax Code Section 171.1014 and Rule 3.590 for more information on combined reporting.

Franchise Tax Returns and Information Reports

Each taxable entity must file a Franchise Tax Report (No Tax Due, EZ Computation or Long Form) and an Information Report (Public Information Report or Ownership Information Report).

Franchise Tax Rates, Thresholds and Compensation Deduction Limits

See Tax Rates [comptroller.texas.gov/taxes/franchise/] for information on current and historic tax rate information.

Due Dates, Extensions and Filing Methods

Franchise tax reports are due on May 15 each year. If May 15 falls on a Saturday, Sunday or legal holiday, the next business day becomes the due date.

The Comptroller's office will tentatively grant an extension of time to file a franchise tax report upon timely receipt of the appropriate form. Timely means the request is received or postmarked on or before the due date of the original report. See Franchise Tax Extensions of Time to File [comptroller.texas.gov/taxes/franchise/filing-extensions.php] for more information.

You can file your franchise tax report, or request an extension of time to file, online.

There is a \$50 penalty for a franchise tax report filed after the due date, even if no tax is due with that report and even if the taxpayer subsequently files the report.

Questions?

Visit our website [comptroller.texas.gov/taxes/franchise/] for more information about the franchise tax, including answers to frequently asked questions [comptroller.texas.gov/taxes/franchise/faq/].

Disclaimer

This publication is intended as a general guide and not as a comprehensive resource on the subjects covered. It is not a substitute for legal advice.

98-806
(01/2016)

Exhibit 14
California Franchise Tax Overview



STATE OF CALIFORNIA
Franchise Tax Board

Is my corporation subject to franchise tax or income tax?

The franchise tax is a tax for the privilege of doing business within California and is imposed upon all banks and corporations "doing business" in California. The amount of the tax is the greater of:

- California net income times the appropriate tax rate.
- The \$800 minimum franchise tax.

See Doing Business in California for more information.

If you qualified with the Secretary of State, your corporation is subject to the franchise tax until you dissolve your corporation.

The income tax is imposed on all corporations that, while not "doing business" in California, do "derive income from sources within this state". For example, if your corporation is a limited partner in a limited partnership doing business in California, your corporation would be subject to corporate income tax. Unincorporated associations are also subject to corporation income tax. The amount of tax is California net income times the appropriate tax rate.

See tax rates table for more information.

Taxpayers doing business or deriving income from within and outside the state will use Schedule R to determine their California net income.

Last Updated: 12/18/2017

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Exhibit 15
Delaware Franchise Tax Overview

Corp Menu
(<https://delaware.gov>)

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Search 

Delaware Division of Corporations

How to Calculate Franchise Taxes



Effective January 1, 2018, a domestic stock or non-stock for profit corporation incorporated in the State of Delaware is required to pay annual franchise tax. The minimum tax is \$175.00, for corporations using the Authorized Shares method and a minimum tax of \$400.00 for corporations using the Assumed Par Value Capital Method. All corporations using either method will have a maximum tax of \$200,000.00. Corporations owing \$5,000.00 or more make estimated payments with 40% due June 1st, 20% due by September 1st, 20% due by December 1st, and the remainder due March 1st.

The Annual Franchise Tax assessment is based on the authorized shares. Use the method that results in the lesser tax. The total tax will never be less than \$175.00, or more than \$200,000.00.

Non-Stock for Profit

All non-stock, for profit entities that do not comply with the Exempt Corporation requirements will be required to pay a Franchise Tax of \$175.00

Authorized Shares Method

For corporations having no par value stock the authorized shares method will always result in the lesser tax.

- 5,000 shares or less (minimum tax) \$175.00.
- 5,001 – 10,000 shares – \$250.00,
- each additional 10,000 shares or portion thereof add \$85.00
- maximum annual tax is \$200,000.00

For Example

A corporation with 10,005 shares authorized pays \$335.00(\$250.00 plus \$85.00).

A corporation with 100,000 shares authorized pays \$1,015.00 (\$250.00 plus \$765.00[\$85.00 x 9]).

Assumed Par Value Capital Method

To use this method, you must give figures for **all issued shares** (including treasury shares) and **total gross assets** in the spaces provided in your Annual Franchise Tax Report. Total Gross Assets shall be those "total assets" reported on the U.S. Form 1120, Schedule L (Federal Return) relative to the company's fiscal year ending the calendar year of the report. The tax rate under this method is \$400.00 per million or portion of a million. If the assumed par value capital is less than \$1,000,000, the tax is calculated by dividing the assumed par value capital by \$1,000,000 then multiplying that result by \$400.00.

The example cited below is for a corporation having 1,000,000 shares of stock with a par value of \$1.00 and 250,000 shares of stock with a par value of \$5.00 , gross assets of \$1,000,000.00 and issued shares totaling 485,000.

1. Divide your total gross assets by your total **issued** shares carrying to 6 decimal places. The result is your "assumed par".
Example: \$1,000,000 assets, 485,000 issued shares = \$2.061856 assumed par.
2. Multiply the assumed par by the number of **authorized** shares having a par value of less than the assumed par. Example: \$2.061856 assumed par x 1,000,000 shares = \$2,061,856.
3. Multiply the number of authorized shares with a par value greater than the assumed par by their respective par value. Example:
250,000 shares x \$5.00 par value = \$1,250,000
4. Add the results of #2 and #3 above. The result is your assumed par value capital.
Example: \$2,061,856 plus \$1,250,000 = \$3,311,856 assumed par value capital.
5. Figure your tax by dividing the assumed par value capital, rounded up to the next million if it is over \$1,000,000, by 1,000,000 and then multiply by \$400.00.
Example: 4 x \$400.00 = \$1,600.00
6. The minimum tax for the Assumed Par Value Capital Method of calculation is \$400.00.

— **NOTE:** If an amendment changing your stock or par value was filed with the Division of Corporations during the year, issued shares and total gross assets within **30 days** of the amendment must be given for **each portion** of the year during which each distinct

authorized amount of capital stock or par value was in effect. The tax is then prorated for each portion of the year dividing the number of days the stock/par value was in effect by 365 days (366 leap year), then multiplying this result by the tax calculated for that portion of the year. The total tax for the year is the sum of all the prorated taxes for each portion of the year.

Large Corporate Filer Information

(<https://corpfiles.delaware.gov/LargeCorporateFiler.pdf>)

You may also use our Franchise Tax Calculator (/taxcalc/) for estimating your taxes.

Related Topics: alternative tax method (<https://corp.delaware.gov/tag/alternative-tax-method/>), calculating franchise tax (<https://corp.delaware.gov/tag/calculating-franchise-tax/>), franchise tax (<https://corp.delaware.gov/tag/franchise-tax/>), franchise tax annual report (<https://corp.delaware.gov/tag/franchise-tax-annual-report/>)



Delaware's Governor (<https://governor.delaware.gov>)
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 State Employees (<https://dhr.delaware.gov/personnel/employee-resources.shtml>)
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 Phone Directory (<https://phonedirectory.delaware.gov>)
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 Delaware Marketplace (<https://www.choosehealthde.com/Health-Insurance>)
 Tax Center (<https://delaware.gov/topics/TaxCenter>)

Personal Income Tax (https://revenue.delaware.gov/pit_onlinefiling.shtml)

Privacy Policy (<https://delaware.gov/help/privacy>)

Weather & Travel (<https://delaware.gov/topics/weatherpage>)

Contact Us (<https://delaware.gov/help/degov-contact.shtml>)

Corporations (<https://corp.delaware.gov/>)

Franchise Tax (<https://corp.delaware.gov/paytaxes.shtml>)

Gross Receipts Tax (<https://grossreceiptstax.delaware.gov/grtpublic/>)

Withholding Tax (<https://dorweb.revenue.delaware.gov/EDIOOnline/EDIOOnline.dll>)

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