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

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.

FINAL BRIEF OF APPELLANT

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STATEMENT OF THE CASE

This litigation involves a question of whether or not a bank may take a net operating loss (NOL) carryforward deduction under the South Carolina bank tax. To decide this question, the history of the South Carolina bank tax must be evaluated to determine if the bank tax is based on taxable income or financial income. The difference is significant. If based on taxable income, the bank tax follows corporate income tax rules. Synovus argues that both legislative history and the 2005 conformity legislation make clear an NOL carryforward is allowed thereunder. The South Carolina Department of Revenue argues the bank tax is a franchise tax and is based on financial or "book income." As a result, an NOL carryforward is not allowed, and the bank tax is limited to the "net income" for one year per the income statement found in the annual financial statements of the bank. Synovus' position on book income is threefold: (1) Synovus asserts "book income" is the wrong tax basis for the bank tax. Using book income as a tax basis creates multiple constitutional issues. (2) If "book income" is the appropriate tax basis for the bank tax, an NOL deduction is still appropriate pursuant to the Generally Accepted Accounting Principles (GAAP), the application of conformity (and the NOL deduction) to book income and based on the definition of "*entire* net income" (as espoused by the ALC). (3) As shown in prior Department determinations, conformity to the corporate income tax code and IRC have previously been applied to the bank tax, even under a book income analysis. "Book income" means that a bank may deduct *all* of its expenses from *all* of its revenues to calculate "entire net income." (R. p. 943; R. p. 11.) For a publicly traded bank to deduct "all of its expenses" and still comport with required accounting principles, the NOL carryforward must be allowed.

Synovus will show that the ALC repeatedly erred in its determinations in the Amended Final Order. The errors of the ALC result from the ALC's use of the wrong statutory construction standard and by giving deference to the Department. The ALC also erred in its conclusion that

"entire net income" does not allow for an NOL carryforward deduction and that book income and/or GAAP are an appropriate proxy for "entire net income." Further, Synovus will show that the ALC repeatedly contradicted its own findings of fact in reaching its ultimate conclusion that the NOL carryforward deduction is not allowed, which was in error.

1. The Parties

A. Synovus Bank

On February 28, 1995, Synovus Financial Corp. acquired NBSC Corporation, the parent company of National Bank of South Carolina (NBSC). (R. p. 416 ¶ 10). Subsequently, on May 6, 2010, NBSC was merged into Columbus Bank & Trust Company and was renamed Synovus Bank (Synovus). (*Id.* ¶ 6.) Each entity is (or was) organized as a corporation. (*Id.* ¶ 12). All operated as a bank in South Carolina during the relevant time period.

B. Department of Revenue

Respondent is the Department of Revenue (Department). The Department is the state agency tasked with the collection of tax revenue in South Carolina.

2. Procedural History

The Department denied Synovus, and all banks in South Carolina, the use of an NOL carryforward by concluding financial income, not taxable income, is the basis for the bank tax. Synovus filed a timely appeal of the Department's determination to the Administrative Law Court (ALC). The ALC initially determined on motions for summary judgement that the bank tax was based on financial income and, therefore, tax conformity to the federal tax code does not apply to the South Carolina bank tax. The ALC then held a one-day trial to determine if a bank in South Carolina is allowed an NOL carryforward deduction under a financial accounting basis and if

GAAP is an appropriate proxy for "entire next income." This appeal stems from the ALC's final, combined order on both issues.

STANDARD OF REVIEW

The standard of review of an administrative law judge's order is set forth in S.C. Code Ann. § 1–23–610(B) (2008), which provides:

> The review of the administrative law judge's order must be confined to the record. The court may not substitute its judgment for the judgment of the administrative law judge as to the weight of the evidence on questions of fact. The court of appeals may affirm the decision or remand the case for further proceedings; or, it may reverse or modify the decision if the substantive rights of the petitioner have been prejudiced because the finding, conclusion, or decision is:
>
> (a) in violation of constitutional or statutory provisions;
> (b) in excess of the statutory authority of the agency;
> (c) made upon unlawful procedure;
> (d) affected by other error of law;
> (e) clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record; or
> (f) arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.

Appellant Synovus asserts errors of law and violations of constitutional and statutory provisions result from the Amended Final Order of the ALC.

FACTS

1. Synovus' Tax Filing History

As a result of the economic downturn suffered by many banks during the relevant time period, Synovus incurred NOLs. Synovus timely filed returns with the Department for tax years 2011, 2012, 2013, and 2014. (R. p. 416 ¶ 13). For each of those tax years, Synovus subsequently filed an amended tax return and claimed a portion of the NOLs on its state tax returns. (R. pp. 416-418 ¶¶ 13-22). The amended returns included NOL carryforward deductions producing tax

refund claims for 2011, 2012, and 2013. (R. pp. 417-418 ¶¶ 16-18, 20, 23-25). Synovus also filed a 2014 tax return that claimed NOL carryforwards. (*Id.* ¶¶ 22, 25). Each amended tax return on which a refund was requested was filed based on book income as instructed by the Department. The NOL carryforward deduction was applied to the book income calculation for each year. (R. pp. 422 ¶¶ 7-13).

For tax years 2012, 2013 and 2014, the Department granted the refunds. However, the Department paid to Synovus the requested refund amounts for only 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." (R. pp. 418 ¶¶ 23-25).

Despite initially approving the refunds, the Department made a subsequent decision to audit the tax years 2012, 2013, and 2014. During the audit, the Department concluded NOL carryforwards are not allowed in computing a bank's tax liability. Following the audit, the Department reversed its prior decision approving the refunds. (R. p. 418 ¶ 26). The Department then issued a Determination, with which Synovus disagreed. Synovus timely filed an appeal to the ALC. (*Id.* ¶ 27). This appeal stems from the ALC's final, combined order.

2. Legislative and Other History of the South Carolina Bank and Income Tax

South Carolina's first tax laws were based on conformity with the federal tax code. (R. pp. 679-680). The term "entire net income" was used as the tax basis in the federal tax code as early as the 1918 Revenue Act. In 1918, the term "entire net income" included all expenses and deductions taken from year to year until "the entire net income ha[d] been accounted for." (*See* R. p. 32 (quoting Revenue Act of 1918)). (R. p. 679). In 1926, the South Carolina General Assembly passed its first substantive state income tax. The 1926 tax applied to both banks and corporations.

The 1926 statute defined the type of income to be taxed 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 base upon which the bank tax was imposed in 1937 was identical to the then-existing corporate income tax in 1937: "entire net income." 1937 S.C. Acts § 563(2).

The term "entire net income" as used in S.C. Code Ann. § 12-11-20, the bank tax section, has not changed since 1937. The bank tax has always been described by the statutes as an "income tax." *See* S.C. Code Ann. §12-11-10 *et al*. In taxing "entire net income" of banks, from a legislative perspective, neither the 1937 bank tax nor any subsequent bank tax section has ever defined "entire net income." Further, from an administrative perspective, the ALC factually found "the Department has no formal ruling or publication interpreting the meaning or calculation of 'entire net income'" in regards to the bank tax, despite the Department's arguments to the contrary. (R. p. 30).

3. Definition of Net Operating Loss

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.

See Tax Mgmt. (BNA) (Series 539-3rd, Net Operating Losses); (*see also* R. pp. 187-188).

4. History of the Net Operating Loss Deduction in South Carolina

In 1955, South Carolina amended the income tax code to include a specific NOL carryforward provision. This 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 Ann. § 65-259(13)). In 1979, the Legislature extended the NOL deduction to include "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 taxpayers").

In 1985, the General Assembly repealed the standalone South Carolina NOL section when it adopted conformity to the federal tax code, instead relying on IRC § 172 for the allowance of an NOL carryforward. Following initial conformity with the IRC in 1985, in 1988, the existing bank tax regulations were repealed as unnecessary. In 2005, the General Assembly again passed conformity that adopted the entire IRC. *See* S.C. Code Ann. § 12-6-40. In 2005, the General Assembly took affirmative action to modify the prior language used in the Decoupling Statute. The Decoupling Statute was clarified to resolve any ambiguity as to the application of conformity to the bank tax. Post 2005, the conformity language was altered to: "this *title* and *all other titles* that provide for taxes administered by the department." S.C. Code Ann. § 12-6-50 (emphasis added). This "Title" is, of course, Title 12, which contains the bank tax.

ARGUMENTS

The ultimate issue stated and addressed by the ALC is "[w]hether a bank can deduct net operating loss carryforwards when calculating its South Carolina bank tax liability." (R. p. 13). However, to ensure the proper context for addressing the issue, the ALC more granularly framed the issue by addressing three questions:

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"?

In reaching the conclusion to each of these questions, the ALC erred as shown below.

1. The ALC Erred in Its Determination that the Term "Entire Net Income" Does Not Inherently Authorize an NOL Carryforward.

A. The ALC Used the Wrong Construction in Reaching the Conclusion as to This Issue

Before the ALC could determine if an NOL carryforward deduction applied, it first had to determine what is the basis of the bank tax – financial or taxable income. Only after the basis for the bank tax is determined did the ALC need to conclude if a deduction is allowed. The ALC erred in taking these two separate questions as one issue and applied the wrong construction analysis as a result. (R. p. 15).

To answer the first question, what is the tax basis of the bank tax, the ALC should have applied the settled rule that ambiguities are resolved "against the government and in favor of the taxpayer." *See 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."); Norman J. Singer, *Sutherland Statutory Construction* § 66:1 (6th ed.). *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).

Here, the ALC should have applied a construction analysis in favor of Synovus as to Question 1 – What is the basis of the bank tax? The ALC determined the Department has no formal rule or publication interpreting "entire net income." (R. p. 30 (stating "[the Department's] current interpretation is nascent")). Also, the Department failed to show a lack of ambiguity in the bank tax statute, which contains an admitted undefined term "entire net income." Thus, as a rule of construction, the ALC should have given all doubts on interpretation to Synovus. Instead, the ALC construed liberally in favor of the Department. Doing so was improper.

Further, the inherent unfairness of the liberal construction in favor of the Department is more impactful based on the equitable nature of the ultimate issue in the case. The ALC acknowledged "the principle behind NOL carryforwards [is] an equitable – redistribution [of] a loss over a number of years." (R. p. 15). The ALC further acknowledged the significance of the inequity that occurs if a bank is not allowed to take an NOL carryforward. This issue is caused by the Department's position that the term "entire net income" only refers to the income, and thus expenses, that occur within one year. The ALC acknowledged the equitable problem and the "weakness" in the Department's interpretation.

> 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*.

(R. p. 37 (emphasis added)). Questions of equity, which lie at the heart of the tax carryover concept, should be construed in favor of the taxpayer. *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"); *United States v. Foster Lumber Co.*, 429 U.S. 32, 52 (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. *Lewyt Corp. v. C.I.R.*, 349 U.S. 237, 240 (1955) ("[W]here the benefit claimed by the taxpayer is fairly within the 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[.]"); *United States v. Foster Lumber Co.*, 429 U.S. 32, 52 (1976) (where the aims of justice and equity can be achieved by furthering a tax carryover scheme, the Court should be apt to do so).

Therefore, a determination of the tax base for the bank tax, and the meaning of "entire net income," must be construed in favor of the taxpayer. Once determined, then, and only then, does the issue of the application of an NOL carryforward deduction come into play. The ALC erred by applying a construction standard in favor of the Department related to both questions. As such, the decision of the ALC must be reversed and determined under the appropriate standard of construction.

B. A Determination that the Meaning of "Entire Net Income" is Based on Taxable Income and Conformity Applies to the Bank Tax Decides this Controversy

The Department asserts the term "entire net income" does not inherently authorize NOL carryforward deductions. The Department reaches that conclusion by asserting the bank tax is based on financial accounting. Synovus asserts the term "entire net income" inherently provides for an NOL carryforward. Synovus reaches this conclusion because i) the bank tax is based on taxable income (like the corporate tax), ii) conformity with the IRC applies, and iii) the bank tax is based on the definition and use of the word "entire" by the General Assembly. As the discussion that follows shows, the ALC erred in denying the NOL deduction by determining the basis of the bank tax is financial accounting a/k/a "book income" rather than taxable income, conformity does not apply, and the term "entire" does not mean "all expenses" can be taken as part of "entire net income."

The authority for the NOL deduction flows logically from the General Assembly's use of "entire net income" as an income tax concept; it is not now, and has never been, a concept producing financial accounting or "book income." If "entire net income" is based on taxable income, conformity to the IRC provides an undisputable application of an NOL carryforward deduction through the General Assembly's adoption of 26 U.S.C. §172. As shown below, the General Assembly has never given any indication that the basis of the bank tax is financial accounting a/k/a book income.

Three basic steps used by the ALC in its analysis show the error of interpretation the ALC made in finding the meaning of "entire net income" for banks.

The ALC decision first concludes:

> [A]lthough 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[.]

(R. p. 40).

Second, to find the missing definitions of gross income and deductions, the decision holds:

> 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.

(R. p. 42 (emphasis in original)).

Third, and finally, in deciding how to determine "all revenues" and "all expenses," the decision holds "entire net income" means "book income" and decides:

> [B]ecause [Synovus] keeps it books according to GAAP, [Synovus'] "book income" is equivalent to its "net income" as calculated pursuant to GAAP.

(R. p. 43).

The final findings and conclusion profoundly misinterpret "entire net income" as being "book income" under GAAP. The ALC also erred in the application of its own ruling: on the one hand, holding "entire net income *requires* all revenue and expenses be included in the calculation of a bank's taxable income" and then denying the only method to do so – an NOL carryforward. (R. pp. 11, 13; R. pp. 195-201). Thus, the ALC erred in its denial of the deductions claimed by Synovus.

The term "entire net income" was used by the General Assembly for over a decade before the Legislature employed it as the tax base for taxing banks in 1937. The history of the corporate income tax statutes and bank tax statutes confirms "entire net income" is an income tax concept, not a book income concept as determined by the ALC.

i. The Imposition Statutes for the Corporate Income Tax Set the Meaning of "Entire Net Income" in the Bank Tax Imposition Statute

The bank tax imposition statute taxes "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." S.C. Code Ann. § 12-11-20 (emphasis added). From the inception of the bank tax in 1937 (*see* 1937 S.C. Act 349), the tax base has been "entire net income." Despite

the lack of a definition in the bank tax statutes themselves, finding the definition of "entire net income" is not a difficult task. The term was defined in the 1918 Revenue Tax Act and has been judicially defined for the South Carolina Legislature since at least 1924.

For undefined terms such as "entire net income," the words used must take on their ordinary meaning. *Anderson v. S.C. Election Comm'n*, 397 S.C. 551, 556, 725 S.E.2d 704, 707 (2012) ("Unless there is something in the statute requiring a different interpretation, the words used in a statute must be given their ordinary meaning."). The "ordinary meaning" of words in a statute is the meaning the words had when the statute was enacted. *See Perrin v. United States*, 444 U.S. 37, 42 (1979) (in addressing the meaning of "bribery," the court explained that "[a] fundamental canon of statutory construction is that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning [which requires] we look to the ordinary meaning of the term 'bribery' at the time Congress enacted the statute in 1961."); *In re Hospital Pricing Litig.*, 377 S.C. 48, 54, 659 S.E.2d 131, 134 (2008) ("The history of the period in which the statute was passed may be considered in interpreting the statute."); *Stardancer Casino, Inc. v. Stewart*, 347 S.C. 377, 385, 556 S.E.2d 357, 361 (2001) ("The intent of the legislature is determined in light of the overall climate in which the legislation was amended."); *Crescent Mfg. Co. v. Tax Comm'n*, 129 S.C. 480, 124 S.E. 761, 767 (1924) ("[I]f there [is] doubt as to . . . intent, consideration of the object of any such law, in the light of the contemporary history of the condition and situation of the people at the time of its enactment, should tend strongly to dissipate such doubt.").

ii. The Ordinary Meaning of "Entire Net Income" in 1937 Was Established in 1918 and 1924 and Subsequently Confirmed in 1926

The term "entire net income" originated in the 1918 Revenue Act. It was defined therein to include "the income, any deductions, exemptions or credits of any kind" taken from year to year until the entire balance had been accounted for. (*See* R. p. 32 (quoting the Revenue Act of 1918)).

Subsequently, in *Crescent Mfg. Co. v. Tax Comm'n*, 129 S.C. 480, 124 S.E. 761 (1924), the taxpayer, in filing its federal income tax return for 1921, reported taxable income from all sources of $76,795.61. When filing its South Carolina income tax return under the South Carolina Income Tax Act of 1922 (32 St. at Large, 896), the taxpayer paid taxes of $3,964.53 and reported to South Carolina income of $46,851.53, representing the company's business conducted within South Carolina. The taxpayer filed an income tax return with North Carolina as well and paid an income tax on income from business in North Carolina. Upon audit, the South Carolina Tax Commission concluded the taxpayer failed to report to South Carolina its "entire net income" due to the taxpayer improperly removing income assigned to North Carolina. As a result, the Tax Commission sought an additional tax payment.

The court identified the position advanced by the taxpayer:

> [T]he tax imposed by the act should be held to apply only to such proportion of the *entire net income* of a domestic corporation as arises or accrues from property and business operations within the state.

Id., 124 S.E. at 762.

In its analysis, the court stated the question:

> [I]t is apparent . . . the real question . . . is whether the [income] tax imposed . . . is limited, as to all . . . corporations subject thereto, . . . to such proportion of the recipient's *entire net income* as is derived from sources and operations within the state of South Carolina.

Id., 124 S.E. at 762 (emphasis added). In answering the question, the court found the imposition of the income tax on South Carolina domestic corporations was not limited only to South Carolina income when taxing a domestic corporation's entire net income:

> We think the act, . . . may not soundly be construed and interpreted to limit the tax imposed upon residents and citizens of the state, natural and corporate, to income derived exclusively from sources and operations within the state.

Id., 124 S.E. at 762.

In other words, no later than 1924, the term "entire net income" meant all net incomes in an income tax context regardless of where earned or sourced and regardless of where the business earning the income was conducted. "Entire net income" was the totality of all net incomes for income tax purposes and formed the basis upon which South Carolina taxation was computed.

That meaning was confirmed in 1926 by the General Assembly setting "entire net income" as the base upon which corporations pay income tax in South Carolina:

> 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 per cent of the entire net income of such corporation, as herein defined, received by such corporation during the income year; and every foreign corporation doing business within the jurisdiction of this State shall pay annually an income tax equivalent to four per cent of a proportion of its **entire net income**, to be determined as hereinafter provided in this Act

Section 4 of 1926 S.C. Act 1 (emphasis added). The 1926 definition was applicable to banks as no separate "bank tax" statute had yet been passed and banks were treated as corporations.

Consistent therewith, Section 7 of 1926 S.C. Act 1 defines "net income" as "gross income of a taxpayer less the deductions allowed by this Act." "Gross income" is defined in Section 8 as including a long list of items, among which is "the income of a taxpayer derived from . . . the transaction of any business carried on for gain or profit, or gains, or profits, and income derived from any source whatever." Thus, the General Assembly defined gross income as "income derived from any source whatever." Accordingly, in determining "entire net income," gross income includes *all* income.

Having defined the starting point of what items constitute gross income, the General Assembly statutorily identified deductions used to reduce gross income to arrive at "entire net income." The deductions are listed in Section 13 and include "[a]ll the ordinary and necessary

expenses paid or accrued . . . .” In addition, the Act in Section 13(9) allowed domestic corporations “having an established business in another State” to “deduct the net income from such business” in computing “entire net income.”

Thus, the term “entire net income” did not mean “book income” in 1926. “Entire net income” was an income tax concept wholly devoid of a financial or “book income” concept. It was “gross income” (a defined term) minus “deductions” (a defined term that included *all expenses*) to arrive at “entire net income.” This definition is virtually identical to the finding of fact by the ALC that, from an accounting perspective, “entire net income means all of company’s gross income minus gross expenses” as applied to bank tax. (R. p 11).

iii. The Law from 1926 to 1937 Confirms the Meaning of “Entire Net Income” in the Corporate Income Tax Statutes Is Also the Meaning of “Entire Net Income” in the Bank Tax Statutes

Beginning in 1937, the bank tax was placed in its own chapter of Title 12. The meaning of “entire net income” as set in 1926 continued to be used therein. To understand why banks were placed in a separate chapter for taxation, the heading of an Act is an appropriate aid to ascertain the reason for an action taken by the General Assembly. *Garner v. Houck*, 312 S.C. 481, 435 S.E.2d 847, 849 (1993) ("For interpretative purposes, the title of a statute and heading of a section are of use only when they shed light on some ambiguous word or phrase and as tools available for resolution of doubt, but they cannot undo or limit what the text makes plain."). The heading of Act 349 of 1937 states:

> 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

Thus, the switch of banks from the corporate income tax to the bank tax was made for two reasons. First, to “raise revenue” and, second, to free banks from all other taxes “except taxes on real property.” Those two goals were accomplished. The bank tax rate was set at 4.5 percent while the

corporate income tax rate was 4 percent, and the specific language of the Act freed banks from all other taxes (including the corporate income tax) except taxes on real property. *See* Act 349 of 1937, § 3.

Nothing in the heading of Act 349 of 1937, or in any other section of the bank tax, suggests any intent by the General Assembly to create a new tax base of "economic income," or "book income" or "financial income." Such a dramatic change to the base for taxing banks would have been identified in the heading as one purpose of the Act. Further, the General Assembly would not have chosen to use identical language, "entire net income," in both the corporate income and bank tax sections if the meaning was not intended to be the same.

Instead, the heading and the body of the Act succinctly and repeatedly state the tax is an income tax on entire net income. The heading of the Act says the Act is "a Tax Upon the *Income* of Banks." The body of the Act in Section 2 states the tax is imposed "with respect to the *entire net income* of the taxpayer." Section 3 announces the subject of the bank tax is "[t]he *income taxes* herein provided." Section 5 explains what should happen if "the *income tax* provided herein shall not be effective." Section 6 explains how "the *income taxes* paid under the provisions of this Act shall be distributed."[1] (Emphasis added.)

The fact that no definition of "entire net income" exists in Act 349 of 1937 or in any later additions to the bank tax is unsurprising. No definition is needed. "Entire net income" was already the base upon which banks had been paying income taxes for over a decade under the corporate income tax. The General Assembly simply intended for banks to continue paying on the same base as before, just at a slightly higher rate and within a structure freeing banks from all other taxes except real property taxes. No more, no less.

[1] As in 1937, today's version of the bank tax continues to refer to itself as an "income tax."

That the General Assembly intended "entire net income" in the bank tax to mean the same as in the corporate income tax is aided by the interpretive rules of *in pari materia.* Both Act 1 of 1926 and Act 349 of 1937 address the same subjects of taxation, and both have the same objects of taxing income based on "entire net income." *Joiner ex rel. Rivas v. Rivas*, 342 S.C. 102, 109, 536 S.E.2d 372, 375 (2000) ("It is well settled that statutes dealing with the same subject matter are *in pari materia* and must be construed together, if possible, to produce a single, harmonious result."); 2B Sutherland Statutory Construction § 51:3 (7th ed.) ("The guiding principle . . . is that if it is natural and reasonable to think that the understanding of legislators or persons affected by a statute is influenced by another statute, then a court construing such an act also should allow its understanding to be similarly influenced.").

Here, in looking to the ordinary meaning of "entire net income" in 1937, it is natural and reasonable to think the General Assembly intended "entire net income" to have the same meaning in the bank tax and the corporate income tax statutes. In short, the General Assembly knew and intended the words it was choosing. Had the General Assembly wished to have chosen a base of "economic income," or "book income," or "financial income," it could have done so. It did not. *See Giannini v. S.C. Dep't of Transp.*, 378 S.C. 573, 587, 664 S.E.2d 450, 457 (2008) ("If the Legislature had intended for the $600,000 aggregate cap to be divided in proportion to the verdicts awarded to each plaintiff, it could have said so."); *Carroll v. Guess*, 302 S.C. 175, 177, 394 S.E.2d 707, 708 (1990) ("If the legislature had intended Section 38-77-180 to overrule the substantial right of a defendant to be tried in the county of his residence as contained in the mandatory language of Section 15-7-30, it would have so stated."). Further, if the General Assembly had intended any meaning other than the definition already known and understood, the same words would not have been chosen, or a definition would have been provided.

iv. The Law from 1937 to 1976 Confirms that the Meaning of "Entire Net Income" in the Corporate Income Tax Statutes Is Also the Meaning of "Entire Net Income" in the Bank Tax Statutes

The law after 1937 and continuing to 1976 shows the bank tax base of "entire net income" was the same income tax base as the corporate income tax.[2]

During all those years from 1937 to 1976, no acts, no amendment, no resolution, and no action of the General Assembly changed the method of taxing "entire net income," whether for a bank or for a corporation.[3] Both banks and corporations were legislatively mandated to pay a tax on their "entire net income." The General Assembly never instituted a new tax on banks based on "economic income" or "book income" or "financial income."

The 1976 codification of the bank tax and the corporate income tax continued the imposition of both taxes on the same tax base of "entire net income." While the bank tax statute's imposition was verbatim the 1937 language, the corporate income tax imposition statute on "entire

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[2] In 1938, the Legislature by Act 862 amended the bank tax to explain how to allocate bank tax revenue between the general fund and the counties and municipalities in which the bank operated. Section 1 of Act 862 stated:

> 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.

The General Assembly in 1938 continued to identify the tax as an "income tax" and gave no indication the base for the tax is "economic income" or "book income" or "financial income." The bank tax was codified in the 1942 Code of Laws of South Carolina with "entire net income" as the tax base (*see* § 2676(2)) and, likewise, the 1942 Code of Laws continued with its use of the same tax base of "entire net income." *See* § 2440(a). The same continuity between the tax base of the bank tax and the tax base of the corporate income tax remained in the 1952 Code, the 1962 Code, and the 1976 Code.

[3] The only "event" applicable to the bank tax during this time period was a 1948 opinion by the Attorney General. The opinion indicated the bank tax is a franchise tax. The opinion gives no meaningful analysis as to why the bank tax is a "franchise tax," and the opinion never uses the term "book income." Particularly important is the fact the Legislature made no definitional changes to the bank tax or the basis for the bank tax as a result of the Attorney General's opinion. *Reeves v. S.C. Mun. Ins. & Risk Fin. Fund*, 427 S.C. 613, 638, 832 S.E.2d 312, 325 (Ct. App. 2019) (holding Attorney General's opinions "are not binding on the [the] Court").

net income" in the 1976 Code changed in relation to domestic corporations due to changes in commerce clause jurisprudence.[4]

However, in 1976, the General Assembly made no such change in the bank statute. Why would the General Assembly believe it could properly impose a tax on the "entire net income" of a bank with no fear of interstate commerce clause limitations? A simple reason—from 1937 to 1976, interstate banking was virtually non-existent; the interstate commerce clause was not an issue.

Not until the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, 12 U.S.C. § 1811, did interstate banking become a reality.[5] Following the enactment of Riegle-Neal, the Department recognized the constitutional impact interstate banking would have on the bank tax. To avoid these constitutional concerns, the Department reacted promptly with a written pronouncement on December 20, 1994.

The Department knew the bank tax was statutorily based on the "entire net income" of a bank whether foreign or domestic. To minimize the constitutional attacks continuing such a taxing

[4] The change in the corporate income tax was required for domestic corporations conducting a multistate business because the prevailing law on commerce clause jurisprudence had changed. Fair apportionment on a domestic corporation's entire net income became the rule. *See Complete Auto. Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). In 1926, domestic corporations paid tax on "the entire net income of the taxpayer." By the 1976 codification, for a domestic corporation, if the "entire business is transacted or conducted within this State, [the domestic corporation] shall make a return and shall pay annually an income tax equivalent to six percent of the entire net income." But, if the domestic corporation is "doing or transacting business partly within and partly without this State, [the domestic corporation] shall make a return and shall pay annually an income tax equivalent to six percent of a proportion of its entire net income to be determined as provided in this chapter."

[5] Before the Riegle-Neal Act, banks were essentially confined to conducting a banking business within a single state. The Riegle-Neal Act gave Congressional blessing for banks to conduct a banking business across state lines in an interstate capacity.

practice would generate, the Department imposed limitations on the bank tax. It issued Information Letter 94-35:

> 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).

S.C. Information Letter No. 94-35.

Thus, in 1994, the Department admitted and acknowledged confusion existed on the application of the corporate income tax rules to the bank tax. The Department had an unparalleled opportunity to explain to the entire banking industry how "economic income" or "book income" or "financial income" was the statutory tax base for the bank tax if it believed the bank tax base was different from the corporate tax code base. Instead, the Department did no such thing. The Department acted as it always had. Despite calling the bank tax a franchise tax based on book income, when questions arise, the Department reverts to the rules of the corporate income tax and IRC and applies said rules to the bank tax "*in the same manner as required of those corporations subject to the corporate income tax." Id*. It told the banking community to identify the bank's

"entire net income" with the corporate income tax's allocation and apportionment of the corporate income tax base of "entire net income."

v. The Law from 1976 to 1980 Confirms that the Meaning of "Entire Net Income" in the Corporate Income Tax Statutes Is Also the Meaning of "Entire Net Income" in the Bank Tax Statutes

The Corporate Income Tax in 1980 continued to compute "entire net income" as gross income from all sources minus deductions of operational expenses. One deduction available to arrive at "entire net income" is a deduction for an NOL. In 1980, Act 343 at Section 2 provided § 12-7-705(2)(a) allowing the following deduction:

> (2) In addition to other deductions allowed by this chapter, there shall be **allowed to all taxpayers** as a deduction a net operating loss carryover under the following conditions:
>
> (a) The net operating loss as defined in this subsection for any year ending on or after December 31, 1979, may be carried forward to the next succeeding taxable year and annually thereafter for a total period of five 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, whichever occurs first.

Act 343 of 1980, § 2 (emphasis added).

Accordingly, the addition of an NOL carryforward (unhindered from prior duties of establishing a new business) was added in 1980 as an allowable deduction in arriving at the tax base of "entire net income." Further, Act 343 provided the NOL carryforward deduction to "*all taxpayers*." Such language is broad, all encompassing, clear, and unambiguous. "[A]ll taxpayers" includes banks.

vi. The Law from 1980 to 1985 Confirms that the Meaning of "Entire Net Income" in the Corporate Income Tax Statute Is Also the Meaning of "Entire Net Income" in the Bank Tax Statute

In 1985, Act 101 gave South Carolina the 1985 Federal Conformity Act. The heading of the Act is instructive for interpreting the reason for the Act. *See Garner v. Houck, supra* p. 15. A partial statement of the heading states the purposes of the Act include:

> to adopt for South Carolina income tax purposes the definitions of taxable income established by the Internal Revenue Code of 1954 . . . [and] to amend the 1976 Code . . . so as to adopt for South Carolina income tax purposes the federal definitions of taxable income for individuals, corporations, estates, and trusts, to provide for filing status for individual South Carolina taxpayers, to provide modifications for South Carolina purposes of the federal definitions of taxable income, ...

What is noteworthy is the purposes do not remove "entire net income" from being the tax base of the Corporate Income Tax. Instead, the Federal Conformity Act's § 12-7-415 explains "entire net income" is found by using the definitions from the Internal Revenue Code:

> 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

The 1985 Act defines "gross income" at IRC § 61 and "taxable income" at IRC § 63.

As stated in IRC § 61, "gross income means all income from whatever source derived." This definition is virtually identical to the definition of "gross income" from the S.C. Income Tax Act of 1926, which defined "gross income" as "income derived from any source whatever." Hence, the definition of "gross income" from the IRC makes no change in the computation methodology to arrive at "entire net income" as required by S.C. Code Ann. § 12-7-230. Rather, the only new instruction in finding "entire net income" is a direction to look to the IRC for what constitutes "gross income."

Further, the definition of "taxable income" in IRC § 63 also gives no change in the computation of "entire net income." Rather, IRC § 63 defines "taxable income" as "gross income minus the deductions allowed." The IRC § 63 definition is virtually the same as the South Carolina

Income Tax Act of 1926's definition in Section 7 of "net income" being "gross income of a taxpayer less the deductions [including all ordinary expenses] allowed by this Act." It is also nearly identical to the ALC's finding of fact that "'entire net income' means all of a company's gross income minus gross expenses." (R. p .11). Thus, the only new instruction in finding "entire net income" is the "net income" element is now found in the IRC and is now labeled "taxable income."

The actions of the Department after the passage of the 1985 conformity statute make clear that the Department applied conformity to the bank tax. Prior to conformity, the former Tax Commission adopted in Reg. 117-92.4 (pre-1985), which contained some 16 income tax regulations governing the bank tax. (R. pp. 433-435). These regulations gave specific Tax Guidance for Banks. As may be seen in S.C. Tax Commission Information Letter 88-14 (R. pp. 436-439), 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 obsolescence, accumulation of depreciation, gain or loss from demolished property, and gain or loss from exchanges with the federal income tax code. If conformity did not apply to the bank tax, there would have been no need to repeal the bank regulations with other tax regulations repealed as a direct result of the application of conformity.

vii. The Law from 1985 to 1996 Confirms that the Meaning of "Entire Net Income" in the Corporate Income Tax Statute Is Also the Meaning of "Entire Net Income" in the Bank Tax Statute

In 1987, under Acts of 1987, Act No. 170, Part II, Section 2B, the General Assembly amended the bank tax to subject banks to "the requirement to make declarations of estimated tax and make estimated tax payments." Act 170 required that task be performed under "the provisions of Chapter 7 [the income tax chapter] of this Title [12]." In the 1987 amendment to the bank tax, the General Assembly again instructed banks to follow the income tax chapter and gave no

indication that the estimated tax was to be paid on "economic income" or "book income" or "financial income."[6, 7, 8]

In 1995, Act 76, the General Assembly recodified the income tax laws of Title 12, Chapter 7. The former income tax provisions of Chapter 7 became the current income tax provisions of Chapter 6. The recodification substituted § 12-6-530 for the former § 12-7-230. A portion of the heading of Act 76 clarifies the General Assembly's purpose:

> AN ACT TO AMEND TITLE 12, CODE OF LAWS OF SOUTH CAROLINA, 1976, RELATING TO TAXATION, BY ADDING CHAPTERS 6, 8, AND 20, SO AS TO REVISE, REORGANIZE, AND RECODIFY STATE TAX LAWS IMPOSING THE INDIVIDUAL AND CORPORATE INCOME TAX

Act 76, Acts of 1995 (emphasis added).

A recodification is not to be construed as making substantive changes unless the intent to change is patent. *See Passamano v. Travelers Indem. Co.*, 882 P.2d 1312, 1321-22 (Colo. 1994) ("A legislative intent to change the meaning of a statute in the course of a general revision will not be inferred unless such an intention is required by express legislative language."); *Mendez v. Superior Court*, 253 Cal.Rptr. 731, 738 (Cal.Ct.App. 1988) (In a recodification, "there is no reasonable inference that the Legislature has altered its original intent or motivation.").

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[6] In 1994, the Department issued Information Letter 94-35 addressing the Riegle-Neal Interstate Banking and Branching Efficiency Act. The Department instructed banks to use "entire net income" in the same manner as applied by corporations. *See* discussion *supra* pp. 19-20.

[7] Then, also in 1987, the Legislature amended § 12-7-230, the imposition statute imposing an income tax on the "entire net income" of corporations. The amendment lowered in stages the then-existing rate of 6% to 5%. The Legislature took no action to eliminate "entire net income" as the tax base for corporations and thus preserved the same tax base for banks.

[8] Further, as the ALC acknowledged, the Department "has historically recognized partial conformity" with the bank tax and has agreed that "certain provisions of Chapter [6]" do apply to banks. See Information Letter #94-35.The ALC disagreed, however, that an NOL carryforward deduction is applicable. Synovus argues that the statute does not allow for partial conformity without specific decoupling, which did not occur for banks. (R. p .24; R. p. 658).

Both the ALC and the Department made a fundamental error by concluding Act 76 of 1995 replaced the imposition base of "entire net income" by inserting and adopting a wholly new tax base of "taxable income." (*See generally* R. p. 23 ("[While banks use 'entire net income',] corporations taxed under section 12-6-530 use 'taxable income' as their tax base."); R. p. 14-15 ("the Department contends . . . [an] 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'[.]")).

Act 76 of 1995 neither creates nor alters the existing tax base for corporations (and correspondingly, retains the meaning of the tax base for the bank tax). Instead of changing or altering the tax base, Act 76, consistent with the tasks of a mere recodification, simply confirms the existing tax base and uses terminology consistent with the IRC post-conformity.

The statutes address identical subjects:

Section 12-7-230	**Section 12-6-530**
Every corporation organized under the laws of this State, whose entire business is transacted or conducted within this State, shall make a return and shall pay annually an income tax equivalent to five percent of the entire net income received by the corporation during the income tax year, and except as otherwise provided, every corporation organized under the laws of this State, doing or transacting business partly within and partly without this State, shall make a return and shall pay annually an income tax equivalent to five percent of a proportion of its entire net income to be determined as provided in this chapter, and except as otherwise provided, every foreign corporation transacting, conducting, doing business, or having an income within the jurisdiction of this State, whether or not the corporation is engaged in or the income derived from intrastate, interstate, or foreign commerce, shall make a return and shall pay annually an income tax equivalent to five percent of a proportion of its entire net income, to be determined as provided in this chapter. The term "transacting", "conducting", or "doing business", as used in this section, includes the	An income tax is imposed annually at the rate of five percent on the South Carolina taxable income of every corporation, other than those described in Sections 12-6-540 and 12-6-550, and any other entity taxed using the rates of a corporation for federal income tax purposes, transacting, conducting, or doing business within this State or having income within this State, regardless of whether these activities are carried on in intrastate, interstate, or foreign commerce. The terms `transacting', `conducting', and `doing business' include transacting or engaging in any activity for the purpose of financial profit or gain.

engaging in or the transacting of any activity in this State
for the purpose of financial profit or gain.

A fair review of both statutes shows § 12-6-530 simply streamlines the language of § 12-7-230. While § 12-7-230 first addresses "corporation[s] organized under the laws of this State" and then separately addresses "foreign corporation[s]," the approach of § 12-6-530 concisely addresses both domestic and foreign corporations by succinctly employing a single characterization for both, the all-encompassing "every corporation."

Further, both statutes address the same tax base, but from different starting points. Section 12-7-230 begins with "entire net income" (gross income minus deductions) and leaves to the body of § 12-7-230 to find "a proportion of its entire net income" upon which to apply the tax rate. It is the finding of that proportion of "entire net income" that produces the "South Carolina taxable income," subject to the 5% tax.

Section 12-6-530 is the same as § 12-7-230 but simply begins with "South Carolina taxable income," while § 12-7-230 ends with "South Carolina taxable income." And, to make § 12-6-530 more streamlined than § 12-7-230, § 12-6-530 shifts to Article 17 the mechanics for getting from "entire net income" to "South Carolina taxable income." Article 17 determines "South Carolina taxable income."

Thus, the error for both the ALC and the Department is concluding these two statutes show a change in the corporate tax base occurred from § 12-7-230 to § 12-6-530—a movement from "entire net income" to "taxable income." No change occurred. Instead, as discussed above, "taxable income" is defined in IRC § 63 as a subtraction formula of "gross income minus the deductions allowed." That exact same subtraction formula is the formula used to reach "entire net income" in § 12-7-230. Both statutes apply an apportionment formula to "entire net income" to produce "South Carolina taxable income." Hence, they both produce the same result, which again

is virtually the same definition as "entire net income" under the bank tax, per the ALC findings of fact. (R. p. 11 ("I find the term entire net income means all of a company's gross income minus gross deductions.")).

The fact that both statutes produce the same result is unremarkable. After all, Act 76 is a recodification. Here, the recodification maintains the same tax base and does so by Article 17's use of "entire net income" in § 12-6-2210. There, South Carolina taxable income is the "entire net income" if the corporation's business is wholly within South Carolina and, if not wholly within, the South Carolina taxable income is "a base which reasonably represents the proportion of the trade or business carried on within this State"; *i.e.*, an apportioned share of "entire net income" is used to produce South Carolina taxable income.[9]

viii. The Law from 1996 to 2005 Confirms that the Bank Tax Statute is subject to the IRC as a result of conformity

Every year since 1985, the General Assembly adopts the entire IRC in a conformity statute; every year it then excludes specific IRC sections in a Decoupling Statute. In typical fashion, the 2005 General Assembly's Conformity Act adopted the entire IRC. But, in 2005, the General Assembly deliberately and significantly changed the language of the Decoupling Statute. *See* S.C. Code Ann. § 12-6-50. Prior to 2005, the typical Decoupling Statute stated: "For purposes of *this chapter* . . . ." "This Chapter" was Chapter 6 [or Chapter 7 depending on the date], which contains income tax sections; bank tax statutes are in Chapter 11. Following the 2005 amendment to S.C. Code Ann. § 12-6-50, the Decoupling Statute language was clarified to make clear it included and applied to *all of Title12*:

[9] In addition, the Department issued Regulation 117-1500.1, which defines "entire net income." While the ALC relied heavily on the Regulation and its definition is one part of its Amended Final Order (R. pp. 16-17), the ALC later contradicted itself and concluded the "definition is not very helpful i[n] resolving th[e] issue before the Court." (R. p. 29).

> 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 Ann. § 12-6-50 (emphasis added).

The change in language underscored conformity's application to all of Title 12 and all other "taxes administered by the Department," including the bank tax in Title 12, Chapter 11. *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 . . . ."). (R. pp. 429-432).

The cardinal rule of statutory construction is to ascertain and effectuate the intent of the legislature. *Charleston Cnty. 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 ALC'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 ALC 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). It is a settled that ambiguities are resolved "against the government and in favor of the taxpayer." *See 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"). Again, the ALC erred in not applying this standard to the question of whether conformity applies to the bank tax.

When Title 12 and its relevant Chapters are reviewed in their entirety, post-conformity, the intent of the Legislature is that banks and corporations are subject to conformity and are required to file a tax return—subject to the provisions of Chapter 6. *See* S.C. Code Ann. § 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 (and prior Department determinations (*see* footnote 11)). As previously stated, Chapter 11, the bank tax, is short, containing only six (6) sections. The substantive aspects of Chapter 11 make the chapter applicable to banks (S.C. Code Ann. § 12-11-10), address property tax (S.C. Code Ann. § 12-11-30), and change the tax rate charged to banks to 4.5% (S.C. Code Ann. § 12-11-20). The bank tax chapter itself directs the taxpayer to Chapter 6 of Title 12 for the administration, enforcement and collection of the bank tax. This was especially important after the prior bank tax regulations were repealed in 1988. *Supra*, p. 23. How else would a bank taxpayer know how to calculate "entire net income?"[10] *See* S.C. Code Ann. § 12-11-40.

> 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 did not intend conformity to apply to the bank tax, the General Assembly would have made clear that the IRC does not apply to the banks by having the 2005

[10] Per the finding of the Court, the "Department did not ha[ve] a long-standing statutory interpretation of how to calculate "entire net income" on which the taxpayer could rely. (R. p. 30).

enactment of Section 12-6-50 state: "For purposes of this Title, except for the bank tax in Chapter 11." It did not do so. The General Assembly deliberately chose to apply the IRC to banks. Thus, the General Assembly intended for all other sections of the IRC, including NOL carryforward deductions, to apply to banks.

Statutory construction supports this conclusion. "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). This is wholly consistent with the history of the corporate tax and the bank tax.

In summary, the General Assembly established "entire net income" as the base for both the corporate income tax and the bank tax. The tax base of "entire net income" as inserted in the bank tax remains the same today as it was in 1937. Were a fundamental alteration to be made to impose a bank tax on "book income," the General Assembly would have stated so affirmatively. It has not. Thus, when considering all reasonable conclusions, the joint bank tax and the corporate income tax base of "entire net income" remain unbroken and apply to the 2011–2014 years here in dispute.

Based on the discussions above, in 1980, South Carolina granted the NOL carryforward deduction to "all taxpayers" by § 12-7-705(2)(a), and that section was used to compute and reach "entire net income." Then, through the 1985 Federal Conformity Act, the NOL carryforward was reinstated for all succeeding years by § 12-7-430(d)(2). To the extent any question on the impact of conformity on the bank tax exists, the language in the 2005 Conformity Statute is controlling. The 2005 Decoupling Statute makes clear 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 use of the term "title," instead of "chapter," in 2005 was no accident. The Legislature makes no accidents. *See Gordon v. Phillips Utils., Inc.*, 362 S.C. 403, 608 S.E.2d 425 (2005) (citing *State ex rel. McLeod v. Montgomery*, 244 S.C. 308, 314, 136 S.E.2d 778, 782 (1964)) ("[T]he legislature intends to accomplish something by its choice of words, and would not do a futile thing."). There are no plainer terms in statutory construction than "title" and "chapter." The meaning of each word is clear and unambiguous. If the Legislature had intended conformity to apply to anything other than all of Title 12, including the bank tax, it would have stated so, but it did not. As a result, IRC § 172, allowing an NOL carryforward deduction, is applicable to a bank in South Carolina.

C. The General Assembly Made Clear Its Intent to Allow All Ordinary and Necessary Expenses to be Deducted Through Its Use of the Term "'Entire' Net Income"

The ALC found that the term "entire net income means all of a company's gross income minus gross expenses." (*See* R. p 11). The ALC also concluded "'entire net income' requires consideration of income and all expenses." (R. p. 36). In fact, "if the word 'entire' captures all different sources of income, it must also capture all expenses." *Id.* The ALC's ultimate holding, however, is contradictory to these findings, as it leads to an end-result that all expenses cannot be fully utilized because such would require application of the expense in subsequent years. This is an incorrect final determination. As was presented at trial, the losses at issue are NOL expenses that exceed income in one year and have been carried over to the next year to allow utilization of *all* such expenses. (R. pp. 187-188). As was presented at trial, the source of the NOL is unquestioned. (*Id.*; *see also* R. p. 401). The NOL was, and is, an expense resulting primarily from mortgage losses. (R. p. 187). No statute or regulation limits the use of such expenses/losses to one year for a bank. (R. pp. 314-318). Likewise, nothing in Section 12-6-1130(4) authorizing the NOL deduction excludes banks (or franchise taxes) from an NOL carryforward deduction. The

ALC's decision also flies in the face of the known definition of "entire net income" at the inception of the bank tax. The Revenue Act of 1918 defined the term "entire net income" to include *all* expenses and deductions taken *from year to year until* "the entire net income ha[d] been accounted for." (*See* R. p. 32 (quoting Revenue Act of 1918)). The 1918 Revenue Act did not allow for "disappearing" expenses, as asserted by the Department's expert at trial. (R. p. 341).

Further, the ALC erred in denying an NOL carryforward based on the clear meaning of the term "entire." The ALC found this argument unpersuasive because the corporate income tax was amended to affirmatively allow an NOL carryforward in 1955. (R. p. 36). According to the ALC, if the corporate income tax had to be amended to allow an NOL carryforward, the bank tax likewise had to be amended. The ALC held:

> **Moreover, the bank tax *was also based* on "entire net income" at that time.**

(R. p. 36 (emphasis added)). This holding by the ALC affirms that the term "entire net income" had the same meaning in the corporate and bank tax sections as of at least 1955. If this finding of the ALC is accurate, when did it change? The error by the ALC was in not recognizing that this ruling aligns with the arguments of Synovus that the bank tax and the corporate tax have both always been based on taxable income. Essentially, the ALC erred by reaching divergent conclusions in the same order and by not recognizing an NOL carryforward is allowed based on the plain meaning of "*entire* net income."

2. The ALC Erred in Its Determination that "Book Income" Is a Reasonable Proxy for "Entire Net Income"

Beyond the statutory language of the corporate and bank tax discussed above, the ALC erred by improperly giving deference to the Department despite the Department's lack of uniform treatment as to the basis of the bank tax, conformity to the IRC, and the application of NOLs to

banks.[11] It is clear that the ALC did give deference to the Department throughout the Amended Final Order. (*See* R. pp. 10, 18-20, 24-25). The ALC gave deference to the Department despite multiple findings that "the evidence [does] not show the Department has a long-standing statutory interpretation of how to calculate 'entire net income[.]'" (R. p. 30).[12] Therefore, all deference that

[11] The Department argued that tax conformity did not extend to the application of an NOL carryforward to banks because banks are treated "differently" in South Carolina from other corporations. (R. p. 14). The Department then admitted that conformity does apply to banks in South Carolina, but only in certain, limited situations. (R. pp. 20, 24 (referencing Information Letter 94-35)); (R. p. 25 (referencing P.L. Ruling #95-10 (Aug. 28, 1995)); (R. p. 25 (referencing Form 1101 B)). In addition, on at least 4 occasions, the Department has issued an opinion contrary to its current position in this litigation:

(1) Prior to this dispute, the Department has agreed that NOL carryforward deductions are allowed for *all taxpayers*. (*See* R. pp.452-465, 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) PLR 95-10 issued by the Department 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*. (R. p. 442). 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 Department affirmed the income tax rates should apply to banks in this scenario. (R. p. 442). The PLR adopted the IRC reorganization sections notwithstanding that the bank tax did not specifically include them. (R. p. 443).

(3) In Tax Commission Information Letter # 94-35, the Tax Commission adopted the substantive allocation and apportionment provisions found in the corporate tax chapter for use by banks. The Information Letter states: 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. S.C. Code § 12-11-40, and the conformity to the IRC applied therein, was subsequently amended to statutorily take this position.

(4) 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, and 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).

[12] The findings of the ALC specifically state: "the Department practice of using financial accounting, or book income, to calculate the basis of the bank tax does not meet the legal

was given by the ALC to the Department (which is the very basis for the proposition that "entire net income" equals "book income") (*see* R. p. 30) is in error.

A. Deference Given to the Department on Any Issue Related to the Bank Tax Is Improper.

In the Amended Final Order and in the denial of the Motion to Reconsider, the ALC set a new standard of review when considering agency deference. (*See* R. p. 2; R. p. 23). In briefing, the Department argued that the ALC may give deference to the Department's position under either of two separate standards. The first is when the agency charged with administering a statute interprets a statute that is a silent or ambiguous. This facet for agency deference was addressed in *Kiawah Dev. Partners, II v. S.C. Dep't of Health & Envtl. Control*, 411 S.C. 16, 32-33, 766 S.E.2d 707, 717 (2014). The Department argued a second standard can apply when the agency has taken a uniform position for many years so that it can be characterized as a long-standing interpretation of a statute or regulation. This was addressed most recently in *Charleston Cnty. Assessor v. Univ. Ventures, LLC*, where 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)).

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parameters of the deference doctrine." (R. p. 29); "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" (R. p. 30); "[the Department's] current interpretation is nascent" (*id.*); "the Department has no formal ruling or publication interpreting the meaning or calculation of 'entire net income'" (*id.*); "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" (*id.*); "recent, undocumented interpretation or policy does not entitle the Department to deference." (R. p. 31).

The ALC reviewed these decisions and determined these holdings must not be treated as separate and unrelated principles, but as part of an overall consideration as to when it is appropriate to apply agency deference. (*See* R. pp. 1-4 (rejecting the deference arguments by the Department)). The ALC was in error when it determined to combine the existing deference standard and erred in giving deference to the Department when the Department did not meet the standards set forth under the *Kiawah* or *Charleston County* cases, per its own finding of fact. (*See* R. pp. 29-31).

In addition to the above, deference should not be given to the Department based on the following additional findings of the ALC:

> 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 S.C. Regulation 117-1500.1.[13]

(R. pp. 29-30). Further, the ALC factually found:

> **[T]he Department has no formal ruling or publication interpreting the meaning or calculation of "entire net income"** . . . [and] the Department's further inference that "book income" is based on GAAP was not reflected by expert testimony.

(R. p. 30 (emphasis added)). Here, after 83 years of bank taxation, the Department has articulated no published standard for compliance by the public and the banking industry for calculating "entire net income." As such, the Legislature similarly could have not been expected to know and acquiesce to the Department's interpretation. (R. p. 30). The Department had never taken a position on an NOL carryforward deduction (other than to state an NOL applies to all taxpayers (*supra* n.11)) or the applicability of GAAP to the bank tax before this litigation. (R. pp. 28, 30; R. p. 150). As a result, no deference to the definition or calculation of "entire net income" should be given to

[13] The ALC found S.C. Regulation 117-1500.1 was not helpful. (R. p. 29).

the Department under the *Kiawah* deference standard.[14] Further, because the Department has failed to take a uniform position on how to determine or calculate "entire net income," no interpretation can be characterized as "long-standing" under *Charleston County*.

The ALC held the Department's own interpretation of the term "entire net income" has never been uniform. (*See* R. p. 30). The inconsistent application of the bank tax basis by the Department from 1937 forward is omnipresent in this dispute. The Department's inconsistency goes not just to the subject matter, but also to the very terms used to describe the bank tax basis. In the decisions on which the ALC relies for its improper conclusion that the bank tax is based on "book income," the Department fails to use consistent terminology. Instead, the basis of the bank tax is described to be "net income," "total net income," a "franchise tax," "book income," and GAAP. (*See* R. pp. 12, 17-18). Always without definition or legislative justification. Paradoxically, the bank tax form itself requires a bank taxpayer to begin its tax calculation of "book income" by listing its federal *taxable income*. (R. pp. 581-586). That instruction to taxpayers is one the Department's own expert agreed "wasn't a very good way of starting." (R. p. 301).

Ironically, it is Synovus, not the Department, whose argument points to past Department written policy. When a question has arisen regarding the bank tax, the Department has repeatedly turned to the corporate tax code and IRC for guidance. The ALC focused, in error, on the continued assertion by the Department that the bank tax is a franchise tax. (R. p. 19). The ALC failed to take into account, however, that the result in multiple decisions issued by the Department

[14] Synovus does note that the ALC erred in its statement that both parties agree there is no statute that allows an NOL deduction for banks. (*See* R. p. 15). At all times, Synovus has argued the NOL deduction is found via IRC § 172 through conformity and in the definition of "entire net income." Synovus does acknowledge and agree there is no standalone statute in the bank tax referring to an NOL deduction.

is that when a question arose related to the bank tax, the rules of taxable income under the corporate tax and IRC were applied, despite the use of the franchise tax moniker. *See* n.11. The Department can point to no contrary prior policy and has, in fact, acknowledged NOLs are applicable to all taxpayers. *See* S.C. Revenue Ruling #16-7 (Department confirmation that the use of NOLs following a change in ownership is allowed for "taxpayers," with no limitation as to the type of taxpayer).[15]

The Supreme Court recently identified the dangers of non-regulation rule-making by administrative agencies, which the Court 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 the Court, 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

[15] To the extent the Department contends it relies on its own unwritten, unpublished, and unpublicized guidance that the bank tax is based on "book income" and on how said "book income" should be calculated, such reliance has no force of law and is not entitled to deference. *See Kirven v. Cent. States Health & Life Co., of Omaha*, 409 S.C. 30, 727 S.E.2d 794, 802 (2014) ("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)). The Department itself has held "secret" rules asserted by agency staff are entitled to little, if any, deference since such alleged rules have not been promulgated in regulations or issued in policy documents. 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").

> continued over the decades and regrettably shows no signs of slowing down any time soon.

Id. (citations omitted).

In light of the Department's inconsistent application and descriptions of the bank tax basis since its inception and its wholesale failure to indicate to a bank taxpayer how to calculate "entire net income," no more "compelling reason" can exist to overrule the ALC's Amended Final Order, which is based on the Department's own unclear stance on the most basic issue of a tax statute—the base upon which the tax is levied. Without deference to the Department and without any alleged "long-standing" interpretation that "entire net income" means "book income," no basis exists on which the ALC Amended Final Order can stand given that *no other source exists* for the conclusion that the bank tax is tax on "book income."

B. The ALC's Improper Deference to the Department Produces an Order Creating Multiple Constitutional Issues

i. The Conclusion that "Entire Net Income" Means "Book Income" Results in an Unconstitutional Delegation of the State's Taxing Powers to a Third Party

The Department's main (perhaps only) argument is that because the bank tax was considered to be a franchise tax by the 1948 Attorney General, the bank tax is based upon book income rather than taxable income. In 1948, the Attorney General opined that the bank tax is a franchise tax. 1947-48 OP. S.C. Att'y Gen. 294 (March 12, 1948). (R. p. 427-428). The Department issued no regulation and provided no guidance on how the 1948 opinion required banks to pay a bank tax as a franchise tax. Somehow, apparently as a result of the 1948 opinion, accountants began to assume book income was to be used to calculate the bank tax. The Department presented no evidence as to the origin of this practice. The Department, at best, acquiesced to this practice by taking no affirmative action. At no point in subsequent Department publications of any kind has the Department told the bank taxpayer *how* to calculate entire net

income, whether under book income, as a franchise tax, a cash basis, or any other basis. (R. p. 30). Simply stating the bank tax is a franchise tax based on "book income" (a slang term in accounting (R. p . 13)), is not enough. In addition, no legislative or other support exists for the Department's contention that a franchise tax necessarily equals the use of book income accounting. (*See* R. pp. 404-406; R. p. 659).

Further, 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 Financial Accounting Standards Board (FASB). In accounting, book income is determined through GAAP and regulated by the FASB. (R. p. 7). As acknowledged by the ALC, the FASB is the independent, private-sector, not-for-profit organization that establishes financial accounting and reporting standards for public and private companies and not-for-profit organizations that follow GAAP. (R. p. 28). In contrast, the IRC is a product of the legislative process adopted through conformity by the General Assembly. As admitted by the Department's expert at trial, unlike the annual legislative act to conform the corporate tax to the IRC, the General Assembly has never formally adopted GAAP as the basis of bank tax or as the means by which the basis of the bank tax should be determined.[16] (R. pp. 164, 328-332).

If financial income equates to book income and book income means use GAAP, then the FASB determines how "entire net income" will be defined and calculated under the bank tax. At trial, the Department presented no testimony that it even tracks the many changes made to GAAP

[16] In response to the Motion to Reconsider, the Department relies heavily on *Cert. Power & Light Co. v. Sharp*, 919 S.W.2d 485 (Tex. App. 1996). (R. pp. 943-944). This reliance by the Department again highlights the problem with the Department's position. In Texas, the taxing agency had promulgated a regulation that *specifically adopted* GAAP, which included procedure to prevent the arbitrary exercise of the entity's powers. *See Sharp*, 919 S.W.3d at 492. No such regulation exists in this case, and the Department has never formally issued guidance on the application of the GAAP accounting principles/standards to banks. (R. p. 28).

or that it evaluates any of the guidance set forth by the FASB. (R. pp. 184-185). The only trial testimony elicited was that the Department does not follow or track GAAP changes. (R. p. 150). The Department also did not address the fact that GAAP/ASC 740 was not in existence at the time the bank tax was enacted and, therefore, could not have been the legislative intent in 1937. (R. p. 181-183).

South Carolina's Constitution prevents the Legislature (or the Department) from delegating away legislative power or taxing power. Here, the improper delegation is to the FASB. In *Eastern Fed. 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 *Eastern Federal*, any delegation of the taxing power to the FASB is a violation of Article III, § 1 of the South Carolina Constitution. As a result, the ALC erred in its conclusion that "book income" is a reasonable proxy for "entire net income" based on GAAP because such a conclusion results in the FASB determining the tax and calculation matrix for the bank tax.

The ALC acknowledged an unconstitutional delegation of power *could* result from reliance on the FASB. (R. p. 28). The ALC stated the unconstitutional delegation of power occurs if GAAP creates a binding norm. As shown below, the Department's reliance on GAAP does create "a binding norm," which is unconstitutional. To hold that reliance on GAAP is simply an "evaluative tool" was in error. GAAP sets forth the principals to calculate "net income" based on financial income. A publicly traded bank, like Synovus, must use GAAP in its financial

statements. (R. p. 8). It is not an "optional" evaluation tool. It is required. (R. p. 8). If the Department mandates financial accounting a/k/a/ "book income" as the tax base for Synovus, a publicly traded bank, it is requiring the use of GAAP.

ii. The Court Erred by Creating a Result Violating Due Process

Definiteness is required to meet the minimum standard of due process. *Huber v. S.C. State Bd. of Physical Therapy Examiners*, 316 S.C. 24, 26-27, 446 S.E.2d 433, 435 (1994) ("When the persons affected by the law constitute a select group with a specialized understanding of the subject being regulated, the degree of definiteness required to satisfy due process is measured by the common understanding and knowledge of the group."). Here, despite the ALC's determination that "book income" is a reasonable proxy for "entire net income," the ALC failed to enter a conclusion of law required by its findings of fact. The ALC factually found:

> 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 S.C. Regulation 117-1500.1.

(R. pp. 29-30). Therefore, even after the Amended Final Order of the ALC, the banking industry still has no certainty as to how the bank tax is calculated.

Accordingly, the ALC's factual findings fail to produce a required conclusion of law regarding its holdings on "book income" and the reasonableness of "entire net income" as a proxy. This failure violates Synovus' due process rights of definiteness when a state agency with authority to issue regulations fails to issue regulations on the most fundamental issue of taxation: what income and what expenses constitute the taxable base upon which the bank tax is imposed. Simply stating the bank tax is based on "book income," without defining that term and how it should be calculated, is not enough.

Not all agency positions must be promulgated as a regulation.[17] The line of demarcation is whether the agency action establishes a "binding norm." *Home Health*, 312 S.C. at 328, 440 S.E.2d at 378. If "yes," a regulation is required; if "no," a regulation is not required. The existence of a binding norm turns on "the extent to which the challenged policy leaves the agency free to exercise its discretion to follow or not to follow that general policy in an individual case, or, on the other hand, whether the policy so fills out the statutory scheme that upon application, one need only determine whether a given case is within the rule's criterion." *Ryder Truck Lines, Inc. v. United States*, 716 F.2d 1369, 1377 (11th Cir. 1983).

The ALC's factual findings state the Department's policy is a "longstanding practice . . . to use financial accounting to calculate the basis of the bank tax." (R. p. 10). Thus, under this finding of fact, the agency has no ability "to exercise its discretion to follow or not to follow" the use of financial accounting. *Id.* For the Department the analysis is Synovus is a bank; financial income is required. Under such a rule no discretion exists; a binding norm exists. Having set a binding norm, the agency was required to promulgate regulations telling the taxpaying public what "entire net income" is and how it will be calculated. *Joseph v. S.C. Dep't of Labor, Licensing & Regulation*, 417 S.C. 436, 451, 790 S.E.2d 763, 771 (2016).

Likewise, arbitrary actions by governmental agencies violate due process. *Worsley Co., Inc. v. Town of Mount Pleasant*, 339 S.C. 51, 56, 528 S.E.2d 657, 660 (2000) ("Substantive due process protects a person from being deprived of life, liberty or property for arbitrary reasons."). In addition, substantive due process is violated if governmental demands impose duties that are

[17] On one hand, a regulation is required if an agency applies a position announcing a rule having "general public applicability." S.C. Code Ann. § 1-23-10(4); *Home Health Serv. Inc. v. S. C. Tax Comm'n,* 312. S.C. 324, 328, 440 S.E.2d 375, 378 (1994). On the other, a regulation is not required if the agency is simply making a policy statement. *Id*.

"overly vague." *Gardner v. S.C. Dep't of Revenue*, 353 S.C. 1, 19 (S.C. 2003) (where actions must "at a minimum, [have] a rational basis, and [are] not arbitrary or overly vague.")

As discussed below under equal protection, the ALC's Amended Final Order allows a bank to use "whatever accounting method" it wishes. A standard that invites accounting limited only by a "whatever method" is inherently irrational and arbitrary. Further, one is hard pressed to identify a standard more vague than "whatever method." Such a standard less-standard subjects Synovus to arbitrary treatment and is a due process violation.

Accordingly, the ALC erred in failing to conclude Synovus' due process rights were violated by the Department's dereliction in not issuing a regulation or providing the minimum degree of definiteness required by due process. And, because the Department failed in its duty, the well-defined concept of taxable income is a more persuasive choice in this controversy than the undefined amorphous concept of "book income," a concept advanced illegally through a failure to comply with the Administrative Procedures Act.

iii. The ALC Erred by Determining the Bank Tax is Based on Financial Accounting and Has Created an Equal Protection Issue.

The ALC correctly determined Synovus is a publicly traded bank required to follow GAAP. (R. p. 8). For entities such as Synovus, GAAP requires accrual-based accounting for its financial statements.[18] *Id.* As was presented at trial, the bank tax regulations allow a bank taxpayer to use *cash based or accrual based accounting*. (R. p. 149, 299-300). Further, there are multiple accrual-based accounting methods other than GAAP. (R. pp. 7, 13). Cash-based accounting does not and cannot use GAAP accounting. (R. p. 186; R. p. 8). As a GAAP tax filer, the ALC found "[Synovus'] 'book income' is equivalent to its 'net income.'" (R. p. 43). In doing so, the ALC

[18] Synovus also prepares financials based on taxable income. This is the initial amount reported on the S.C. bank tax form. (R. pp. 581-586).

made a broad finding in footnote 34 holding "'book income' represents the revenues minus losses based upon *whatever accounting method is used*, which may be GAAP." (R. p. 43 n. 34 (emphasis added)).[19]

The difference in accounting methods can be substantial. An accrual-based, publicly-traded bank operating under GAAP accounting will see a different bank tax result from a non-GAAP, cash-based filer having the ability to adjust high earning volatility resulting from temporary conditions such as losses in one year reflected in a subsequent year, just as in an NOL carryforward. (R. pp. 186-187). Equal protection concerns are inevitable in a "whatever accounting method" world of banking.[20]

Likewise, an equal protection issue arises in the application of losses suffered by *a bank* in South Carolina as a result of mortgage defaults (which is the primary basis for Synovus' losses at issue) versus that of a *mortgage broker* that processes mortgages on homes in South Carolina but has no physical location in South Carolina. (R. p. 187). As admitted by the Department's expert, losses incurred under these identical scenarios result in different outcomes for taxpayers if an NOL carryforward is not allowed to the bank. (R. p. 322).

The practical result of the ALC's Amended Final Order violates the equal protection requirements of the South Carolina Constitution. *Joseph*, 417 S.C. at 451, 790 S.E.2d at 771 ("Under the rational basis test, the Court must determine: (1) whether the law treats similarly

[19] Accordingly, the ALC's Amended Final Order sua sponte created a new, first-time position not addressed by either side in prior arguments, and the ALC declined to address the issue even after being urged to do so by Synovus in its Mot. for Recons. The issue the ALC raised by its Amended Final Order has serious ramifications.

[20] The ALC seemed to acknowledge the potential equal protection issues that could arise if the Department does not have a consistent, long-standing interpretation. (*See* R. pp. 2-3). As stated previously, the ALC made a finding that there is no longstanding interpretation that the bank tax is book income or subject to GAAP. *See supra* n.12.

situated entities differently; (2) if so, whether the legislative body has a rational basis for the disparate treatment; and (3) whether the disparate treatment bears a rational relationship to a legitimate government purpose."). The problem with the ALC's conclusion is the ALC's failure to appreciate the practical impact of its decision. "Book income" as determined by the ALC's Amended Final Order would only apply to a publicly traded bank that uses GAAP. (R. p. 8). It would not apply to cash-based banks or to other entities operating in the same space and industry with identical losses but employing "whatever accounting method" to achieve significantly different tax liabilities. Such a result violates equal protection and is in error.

3. The ALC Erred in its Determination that Reliance on GAAP as a Proxy for "Entire Net Income" Is Proper Because Such a Conclusion Requires Only the Application of the Income Statement, Not the Entire GAAP "Financial Books" of a Bank, to be Applied to the Bank Tax.

In addition to the arguments raised above, the ALC's determination that GAAP is an appropriate proxy for "entire net income" is in error. First, even the Department's expert acknowledges it is only "generally assumed that books will be maintained on GAAP principals."[21] (R. p. 327).

Further, as the ALC acknowledged, "net income and book income are not necessarily synonymous." (R. p. 13). GAAP does not define or even contain the words "book income" or "entire net income." (R. p. 29). Instead, GAAP uses the term "net income." (R. p. 10). "Entire net income" and "net income" are different terms.

Finally, all the experts and the ALC agreed GAAP requires the use of multiple financial statements in conjunction with each other, not just the income statement on which the "net income" for one year is found. (R. pp. 111, 117, 201, 281; R. p. 9). All the experts agreed "net income" as applied to one year does not allow a bank to account for "all of a company's gross income minus

[21] This is true for banks generally, but not for publicly traded banks that must follow GAAP.

gross expenses," which the ALC has ruled is the definition of "entire net income." (R. pp. 283-284; R. p. 11).

To follow the ALC's ultimate conclusion, that book income does not allow a method for deducting "all expense" (through an NOL or otherwise), a bank must only apply the income statement to the bank tax; thus, disregarding the ALC's own findings that GAAP required multiple financial statements to reach "entire net income." The fallacy with the ALC's Amended Final Order becomes clear when one understands GAAP and the Department's position. The ALC adopted the Department's expert's unilateral and arbitrary conclusion that only the income statement is applied to the bank tax.

> Q. **So when you look at entire net income, you would admit it is all four financial statements, but yet when you want to apply the definition to the tax base, you want to limit it to only net income, which you deem to be the income statement, correct?**
>
> ***
>
> **A. For bank tax purposes, yes.**

(*See* R. p. 341). For the ALC to adopt this position is clear error. It also makes no common sense. No authority and no guidance from the Legislature or Department establishes only the income statement equals "entire net income" under GAAP or otherwise.

A. GAAP Does Allow for the Use of "All Expenses"

Simply put, the only manner for a publicly traded bank under GAAP to calculate and include "all expenses" in the calculation of entire net income if expenses exceed income in a twelve month period is to use ASC 740.[22] ASC 740 is applicable to taxes based on income. ASC 740 looks beyond what a tax is called to how the tax is calculated. As a result, ASC 740 is applicable

[22] Financial accounting principles have historically addressed how to account for excess losses on income. (*See* R. pp. 681-684).

to some taxes that have been called franchise taxes, like the South Carolina bank tax. (R. pp. 144, 152-154, 162, 192). ASC 740 discusses and specifically prescribes that an NOL carryforward is the manner in which excess expenses or losses from one year must be accounted for in a subsequent year. As quoted by the ALC, as far back as the 1918 Revenue Act, which uses the term "entire net income," all expenses and deductions were taken from year to year until "the entire net income ha[d] been accounted for." (R. p. 32 (quoting the Revenue Act of 1918)). The change in how the accounting is performed, which today is performed according to ASC 740, and an NOL deduction does not change the underlying intent and purpose of the Legislature to account for *all expenses* in the calculation of "entire net income."

Losses, such as those incurred by Synovus, are accounted for in the income statement only in the year in which they occur. (R. pp. 195-196). Any losses that cannot be offset by profits in that year are moved from the income statement to the balance sheet. This is a basic GAAP principal. (R. p. 199). In the next year in which the corporation has profits, the excess losses are moved from the balance sheet and are taken after the net income is determined in the income statement through an NOL carryforward deduction. (R. pp. 197-201). If "book income" can be equated to the tax base for banks, the method just described is the appropriate manner to determine "entire net income." To disallow this mechanism means the bank in question will not be able to take advantage of "all ordinary expenses." The use of "all ordinary expenses" is allowed for book income purposes through the term "entire net income" pursuant to the ALC's Amended Final Order. (R. pp. 11, 36).

This process is consistent with the Department's prior ruling that the application of the corporate income tax and IRC are applicable to banks (*see* n.13) and with the 2005 Conformity

Statute (which is applicable to the bank tax). An NOL deduction may be applied by a bank, even if a financial accounting base is utilized.[23]

CONCLUSION

The ALC erred when it applied the wrong rule of construction to the initial question it needed to determine this matter. Imposition statutes such as the bank tax on "entire net income" must be construed in favor of the taxpayer since the meaning and calculation of "entire net income" is undefined in the bank tax statutes. The ALC erred in its disregard of the cannons of statutory construction showing the intent of the General Assembly to treat the corporate tax and bank tax as having the same base. The General Assembly established "entire net income" as the base for both the corporate income tax in 1926 and the bank tax in 1937. The tax base of "entire net income" in the bank tax in 1937 remains the same today.

The history of the two taxes as discussed above shows beyond all reasonable doubt that both taxes remained conjoined from 1937 to 1995. Minimal doubt arises in Act 76 of 1995, which rearranged statutes by moving them into new locations in a newly created Chapter 6 of Title 12. However, such actions, taken as part of a mere recodification, cannot reasonably be interpreted to work a transformational change causing the bank tax to undergo a metamorphosis from a tax based on "entire net income" governed by the IRC to a tax based on "book income" governed by the FASB. Were such a fundamental alteration in the taxing scheme relative to banks to be made, the General Assembly would not use a simple recodification Act as the vehicle of change. Thus, when considering all reasonable conclusions, the joint bank tax and the corporate income tax base of "entire net income" remains unbroken and applies to the 2011–2014 years here in dispute.

[23] This is, in fact, how Synovus calculated its NOL carryforward in the tax filings at issue in this case. *See supra* pp. 3-4.

In 1980, South Carolina granted the NOL carryforward deduction to "all taxpayers" by § 12-7-705(2)(a), and that section was used to compute and reach "entire net income." Then, while § 12-7-705 was repealed in the 1985 Federal Conformity Act, the same deduction was simultaneously reinstated for all succeeding years by § 12-7-430(d)(2). To the extent there is any question as to the impact of conformity on the bank tax, one need look no further than the language in the 2005 Conformity Statute. In 2005, the General Assembly took affirmative steps to intentionally change and clarify the language used in the Decoupling Statute. The General Assembly stated conformity applies to all taxes in Title 12. This includes the bank tax. The affirmative expansion of the Decoupling Statute is consistent with the rest of the tax code, which had already made clear the bank tax is subject to conformity and the IRC.

Further, the application of book income, and therefore GAAP, to the bank tax is in error. Such an application results in an unconstitutional delegation of power to a third party, the FASB, and creates due process and equal protection issues. If GAAP were to be properly applied to banks, "book income" would not be arbitrarily limited to the income statement. Rather, the application of all four accounting statements would act together to determine "entire net income." If all four statements are viewed as one, even under GAAP, all expenses are allowed to be deducted to reach "entire net income." As such, the NOL deduction is still allowed even under a "book income" result. This conclusion is consistent with past Department practice of applying the IRC and corporate income tax provisions to the bank tax (even under a book income analysis) and with the 2005 Conformity Statute.

Based on the above, Synovus respectfully requests that this Court overturn the ruling of the ALC and issue an order holding the bank may claim an NOL carryforward deduction for the tax years here in dispute.

Dated this 16th day of February 2021.

Respectfully submitted,

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THE STATE OF SOUTH CAROLINA
In the South Carolina 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.

CERTIFICATE OF COUNSEL

The undersigned certified that this Final Brief of Appellant complies with Rule 211(b), SCACR.

February 16, 2021.

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Proof of Service

I certify that I have served Appellant's Final Brief before the Court of Appeals on Respondent South Carolina Department of Revenue on February 16, 2021, by Email to the following addresses:

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