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SC Court of Appeals

THE STATE OF SOUTH CAROLINA

In The Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Milton G. Kimpson, Administrative Law Judge
Robert L. Reibold, Administrative Law Judge (on Reconsideration)

Appellate Case No. 2024-001577

Trial Court Case No. 20-ALJ-17-0168-CC

U.S. Bank National Association,..... Appellant,

v.

South Carolina Department of Revenue,..... Respondent.

RECORD ON APPEAL – VOLUME III OF V

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Worksheet 3	Income Tax Credits - Summary Chart
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Worksheet 15	SC Rev. Proc. Bull. #02-4 - Economic Development (Not included in this draft. Available through the Department's website, *www.sctax.org.)*
Worksheet 16	SC Rev. Proc. Bull. #02-5 - Penalty Waiver (Not included in this draft. Available through the Department's website, *www.sctax.org.)*
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Worksheet 18	Information Guide on Appeals (Not included in this draft. Available through the Department's website, *www.sctax.org.)*
Worksheet 19	Representation of Taxpayers
Worksheet 20	Administrative Law Court Rules (Not included in this draft. Available through the Administrative Law Court website, *www.scalc.net*.)

Worksheet 1

Contact Information

Department of Revenue Contact Information

Appeals and Audit Review	803-898-5616
Corporate Tax Section	803-898-5705
Electronic Funds Transfer Help Desk	1-800-476-0311 or 803-898-5740
Forms	803-898-5320
General Information	803-898-5000
Problems Resolution	803-898-5873
Registration	803-898-5872
Taxpayer Rights Advocate	803-898-5444
Voluntary Filer/Nexus Questions	803-898-5664
Withholding Section	803-898-5752
Other Phone Numbers	www.sctax.org

Other State Agencies

SC Government.
www.myscgov.com
Note: This website includes links to all South Carolina state and local government websites, including legislative and judicial sites.

Administrative Law Court
PO Box 11667
Columbia, SC 29211
803-734-0550
www.scalc.net

Coordinating Council for Economic Development
(at the Department of Commerce)
PO Box 927
Columbia, SC 29202
803-737-0095
www.sccommerce.com

Department of Archives and History
8301 Parklane Road
Columbia, SC 29223
803-896-6174
www.state.sc.us/scdah

Department of Commerce
PO Box 927
Columbia, SC 29202
803-737-0400
www.sccommerce.com

Department of Insurance
PO Box 100105
Columbia, SC 29202-3105
803-737-6160 (general questions) or 803-737-6088 (moratorium questions)
www.doi.state.sc.us

Department of Social Services
PO Box 1520
Columbia, SC 29202-1520
803-898-7601
www.state.sc.us/dss

Employment Security Commission
PO Box 995
Columbia, SC 29202
803-737-2400
www.sces.org

Secretary of State
PO Box 11350
Columbia, SC 29211
803-734-2170
www.scsos.com

Small and Minority Business Assistance Office
1205 Pendleton Street, Suite 329
Columbia, SC 29201
803-734-0657
www.govoepp.state.sc.us/osmba

WORKSHEET 3

SUMMARY OF SOUTH CAROLINA BUSINESS TAX CREDITS IN CHAPTERS 6, 10, AND 14 OF TITLE 12 AND TITLES 6 AND 11

(CAUTION: This is a summary written in general terms. It may not be relied on as a substitute for researching original sources of authority. Revised April 2005.)

*"Entities Qualifying for the Credit" refer to those entities which generate the particular tax credit. Each credit has detailed requirements that should be reviewed which may limit the use of a credit passed through to certain entities subject to tax under a specific code section.

CREDIT	CREDIT AVAILABLE AGAINST				ENTITIES QUALIFYING FOR THE CREDIT*				
	Individual Income Tax (12-6-510)	Corporate Income Tax (12-6-530)	License Tax (12-20-50)	Other Taxes Administered by DOR	C Corporation	S Corporation	Partnership	Limited Liability Company	Sole Proprietor
Job Tax Credit SC Code §12-6-3360 Forms TC-4 and 616 •Credit of $1,500 to $8,000 per qualifying job for 5 years based on county ranking of distressed ($8,000), least developed ($4,500), under developed ($3,500), moderately developed ($2,500), or developed ($1,500). •Additional $1,000 credit per qualifying job if in multicounty park. •Additional $1,000 credit per qualifying job if taxpayer meets requirements of Brownfields Voluntary Cleanup Program. •Must be manufacturing, processing, tourism, warehousing, distribution, research & development, corporate office facility, qualifying service related facility, or technology intensive facility. •Create and maintain monthly average of 10 jobs generally; hotel/motel requires 20 jobs; qualified service related facility requires 30, 75, 125 or 250 jobs based on compensation, however, a health service facility in any county, or a retail facility or service related industry in a "distressed" or "least developed" county, requires 10 jobs •Limited to 50% of income tax liability •15 year carryforward	X	X			X	X	X	X	X
Job Development Credit SC Code §§12-10-50(A), 12-10-80 and 12-10-81 Forms WH 1605 and 1606/EAZ/RDA •Credit of 55% to 100% depending on location of project based on 2% to 5% of gross wages paid to new employees •Discretionary incentive approved by the Coordinating Council for Economic Development at the Department of Commerce •Refundable from employee withholding to use for, or reimburse the cost of, qualifying expenditures •Business of type eligible for job tax credit •Provide health care •Revitalization Agreement with Coordinating Council of Department of Commerce •10 - 15 year maximum benefit				X Wage Withholding	X	X	X	X	X

CREDIT	CREDIT AVAILABLE AGAINST				ENTITIES QUALIFYING FOR THE CREDIT*				
	Individual Income Tax (12-6-510)	Corporate Income Tax (12-6-530)	License Tax (12-20-50)	Other Taxes Administered by DOR	C Corporation	S Corporation	Partnership	Limited Liability Company	Sole Proprietor
Job Retraining Credit SC Code §§12-10-50(B) and 12-10-95 Forms WH 1605 and 1606/EAZ/RDA •Credit up to $500 a year for each employee being retrained in production, technology, export, or for each employee in an apprenticeship program; $2,000 maximum credit per employee over 5 years •Discretionary incentive approved by the Coordinating Council for Economic Development at the Department of Commerce •Refundable from employee withholding to use for, or reimburse the cost of, qualifying retraining or apprenticeship programs •Must be manufacturing, processing, or technology intensive facility •Provide health care •Retraining Agreement with Coordinating Council of Department of Commerce •Retraining approved by a technical college •Employer must match amount claimed as credit				X Wage Withholding	X	X	X	X	X
Research and Development Credit SC Code §12-6-3415 Form TC-18 •Credit of 5% of qualified SC research expenses •Must claim tax credit under Internal Revenue Code §41 •Limited to 50% of corporate income tax or license fee liability remaining after all other credits •Unused credit must be used before a tax year beginning 10 years from the qualified expenditure date		X	X		X	X, only at corporate level		X, only if LLC is taxed as a corporation	

CREDIT	CREDIT AVAILABLE AGAINST				ENTITIES QUALIFYING FOR THE CREDIT*				
	Individual Income Tax (12-6-510)	Corporate Income Tax (12-6-530)	License Tax (12-20-50)	Other Taxes Administered by DOR	C Corporation	S Corporation	Partnership	Limited Liability Company	Sole Proprietor
Economic Impact Zone Investment Tax Credit SC Code §12-14-60 Forms TC-11 and TC-11R •Credit of 1% to 5% of cost of property based on property recovery period under Internal Revenue Code §168(e) •Qualified manufacturing and productive equipment must be placed in service in a South Carolina economic impact zone •Limited to $5 million for taxpayers subject to §12-20-100, such as utilities •10 year carryforward •Basis reduction for amount of credit •Recapture if disposed or removed from zone during applicable recovery period	X	X			X	X	X	X	X
Corporate Headquarters Credit SC Code §12-6-3410 Form TC-8 •Part I - Credit of 20% of qualifying real property costs if incur at least $50,000 of real property costs & create at least 40 new jobs with required functions •Part II - Additional 20% credit for personal property if 75 new jobs are created having headquarters functions and certain wages •10 year carryforward; 15 year carryforward if additional job requirements are met •Basis reduction for amount of credit		X	X		X	X, only at corporate level		X, only if LLC is taxed as a corporation	

CREDIT	CREDIT AVAILABLE AGAINST				ENTITIES QUALIFYING FOR THE CREDIT*				
	Individual Income Tax (12-6-510)	Corporate Income Tax (12-6-530)	License Tax (12-20-50)	Other Taxes Administered by DOR	C Corporation	S Corporation	Partnership	Limited Liability Company	Sole Proprietor
Infrastructure Construction or Improvement Credit SC Code §12-6-3420 Form TC-6 • Credit of 50% of certain expenses or contributions for water lines, sewer lines, or roads • Project must be dedicated to public use and not exclusively benefit taxpayer • Credit lost to extent expenditures benefit taxpayer • $10,000 annual limit per project • 3 year carryforward up to $30,000 • Recapture if road removed from public use		X			X	X, only at corporate level		X, only if LLC is taxed as a corporation	
Credit for Hiring Family Independence Recipient SC Code §12-6-3470 Forms TC-12 and TC12-A • "Basic credit" of 20% of wages paid to employee for each full month during first 12 months of employment, 15% of wages during second 12 months, and 10% of wages during third 12 months • "Additional credit" of $175 per full month during first 36 months of employment (up to $2,100 each qualifying year) if full time job is located in a county ranked as "distressed" or "least developed." • Make health insurance available to recipient on same basis as all employees • Apply to Department of Social Services for certification of eligibility by 15th day after tax year end • Maximum $5,500 "basic credit" per employee combined with job tax credit; maximum does not apply to a taxpayer in a "distressed" county. • 15 year carryforward	X	X			X	X	X	X	X

CREDIT	CREDIT AVAILABLE AGAINST				ENTITIES QUALIFYING FOR THE CREDIT*				
	Individual Income Tax (12-6-510)	Corporate Income Tax (12-6-530)	License Tax (12-20-50)	Other Taxes Administered by DOR	C Corporation	S Corporation	Partnership	Limited Liability Company	Sole Proprietor
Credit for Hiring Displaced Worker SC Code §12-6-3450 Form TC-10 •Credit of 10% of qualified wages paid for the tax year •Employee's job in a South Carolina economic impact region was terminated due to closing of military or other federal facility •Terminated employee certified by SC Employment Security Commission •10 year carryforward •Reduce deduction for wages by amount of credit	X	X			X	X	X	X	X
Minority Business Credit SC Code §12-6-3350 Form TC-2 •Credit of 4% of payments to subcontractor •State contractor subcontracting with certified minority firm •Limited to one consecutive 6 tax year credit period •Maximum $25,000 per year •No carryforward	X	X			X	X	X	X	X

CREDIT	CREDIT AVAILABLE AGAINST				ENTITIES QUALIFYING FOR THE CREDIT*				
	Individual Income Tax (12-6-510)	Corporate Income Tax (12-6-530)	License Tax (12-20-50)	Other Taxes Administered by DOR	C Corporation	S Corporation	Partnership	Limited Liability Company	Sole Proprietor
Community Development Corporation Investment Credit SC Code §12-6-3530 Form TC-14 •Credit of 33% of qualifying investment or of a pro rata amount if total credits for all taxpayers exceeds $5 million •$1 million maximum credit for all taxpayers in one calendar year •$5 million maximum credit for all calendar years •10 year carry forward •Certification from SC Department of Commerce •Effective for tax years beginning after 2000 •Credit terminates on June 30, 2010	X	X		X Bank Tax	X	X	X	X	X
Child Care Program Credit SC Code §12-6-3440 Form TC-9 •Credit of 50% of capital expenditures, up to $100,000 •Credit of 50% of child care payments, not to exceed $3,000 per participating employee per year •Total credit limited to 50% of tax liability •10 year carryforward	X	X		X Bank Tax	X	X	X	X	X

CREDIT	CREDIT AVAILABLE AGAINST				ENTITIES QUALIFYING FOR THE CREDIT*				
	Individual Income Tax (12-6-510)	Corporate Income Tax (12-6-530)	License Tax (12-20-50)	Other Taxes Administered by DOR	C Corporation	S Corporation	Partnership	Limited Liability Company	Sole Proprietor
Conservation Credit SC Code §12-6-3515 Form TC-19 •Credit of 25% of federal charitable deduction for a gift of land for conservation or for a qualified conservation contribution on a SC real property interest, not to exceed $250 per acre •Maximum $52,500 per year per original transferor •Unlimited carryforward •Unused credit may be transferred upon approval by Department	X	X			X	X	X	X	X
Energy Conservation & Renewable Energy Credit SC Code §12-6-3340 Form TC-1 •Credit of 25% of expenditures for the purchase and installation of conservation tillage equipment, certain drip/trickle irrigation systems, and dual purpose combination truck and crane equipment •One time $2,500 maximum credit for all years for each type of conservation or energy measure •5 year carryforward	X	X			X	X	X	X	X

CREDIT	CREDIT AVAILABLE AGAINST				ENTITIES QUALIFYING FOR THE CREDIT*				
	Individual Income Tax (12-6-510)	Corporate Income Tax (12-6-530)	License Tax (12-20-50)	Other Taxes Administered by DOR	C Corporation	S Corporation	Partnership	Limited Liability Company	Sole Proprietor
Water Impoundment Credit SC Code §12-6-3370 Form TC-3 •Credit of 25% of expenditures for construction, installation, or restoration of ponds, lakes, other water impoundments and water control structures designed for water storage •Construction permit issued by Department of Health and Environmental Control or proof of exemption from DHEC, Natural Resources Conservation District, or local Soil and Water Conservation District •Maximum $2,500 credit per year •5 year carryforward	X	X			X	X	X	X	X
Textile Revitalization Credit SC Code §6-32-40(A)(2) Form TC-23 •Credit of 25% of rehabilitation expenses for the renovation, improvement, and redevelopment of SC abandoned textile mills •For eligible sites placed in service after July 1, 2004 •Credit claimed in equal amounts for 5 years beginning in year property is placed in service •5 year carryforward •Credit is in addition to the rehabilitation credit allowed in SC Code §12-6-3535 •Special rules for allocation of credit by partnerships •May elect a property tax credit under SC Code §6-32-40(A)(1) in lieu of this income tax credit •Credit repealed July 1, 2014	X	X			X	X	X	X	X
Credit for Rehabilitation of Certified Historic Structure SC Code §12-6-3535(A) Form TC-21 •Credit of 10% of qualified rehabilitation expenditures for SC certified historic structure that qualify the federal credit under Internal Revenue Code §47. •Must claim credit under Internal Revenue Code §47 •Credit claimed in equal amounts for 5 years beginning in year property is placed in service •Additional work done for 5 years while credit is being claimed must be consistent with Standards for Rehabilitation, otherwise unused credit is forfeited •Application and certification with SC Department of Archives and History •5 year carryforward of any credit installment	X	X			X	X	X	X	X

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CREDIT	CREDIT AVAILABLE AGAINST				ENTITIES QUALIFYING FOR THE CREDIT*				
	Individual Income Tax (12-6-510)	Corporate Income Tax (12-6-530)	License Tax (12-20-50)	Other Taxes Administered by DOR	C Corporation	S Corporation	Partnership	Limited Liability Company	Sole Proprietor
Habitat Management Credit SC Code §12-6-3520 •Credit of 50% of qualifying costs for habitat management or construction and maintenance of improvements to designated land •Meet requirements of Department of Natural Resources regulations •Land must be certified or determined in need •Limited to 50% of tax liability •10 year carryforward •Recapture if voluntarily leave agreement •Effective only if sufficient funding is available	X	X			X	X	X	X	X
Palmetto Seed Credit SC Code §12-6-3430 Form TC-7 •Credit equal to lesser of: (1) all qualified investments during tax year times 30% or (2) 50% of qualified investments during all years times 30% •Investment in Palmetto Seed Capital Corporation or Limited Partnership •Limited to tax liability after use of all other credits •$5 million maximum credit for all taxpayers •10 year carryforward •Chapter 44, Title 41, containing the Palmetto Seed Capital Fund Limited Partnership, is repealed once the President of the Palmetto Capital Corporation certifies the investments have been liquidated.	X	X		X Bank Tax	X	X	X	X	X
Venture Capital Investment Credit SC Code Title 11, Chapter 45 Form SC 1101B •Tax credit certificate issued by SC Venture Capital Fund if Fund is unable to repay debt to lender •Bank must lend money to SC Venture Capital Fund •Maximum $50 million in tax credits issued at one time •Maximum $20 million in tax credit used in one year •Unlimited carryforward •Unused credit may be transferred among bank and insurance company lenders				X Bank Tax					

CREDIT	CREDIT AVAILABLE AGAINST				ENTITIES QUALIFYING FOR THE CREDIT*				
	Individual Income Tax (12-6-510)	Corporate Income Tax (12-6-530)	License Tax (12-20-50)	Other Taxes Administered by DOR	C Corporation	S Corporation	Partnership	Limited Liability Company	Sole Proprietor
Motion Picture Project Credit SC Code §12-6-3570(A) Forms TC-25 •Credit of 20% of qualifying cash investment •Minimum $250,000 SC project costs & minimum SC filming days •Project certified by SC Film Commission at Department of Commerce •$100,000 maximum credit per taxpayer per project •Limited to 50% of tax liability when combined with any other income tax credit •15 year carryforward •Credit recapture if project does not timely meet statutory requirements Note: See Sections .06 B. 21. and .05 C. 3. of this portfolio for a discussion of the term "taxpayer" for purposes of credit eligibility.	X	X				X (see note)	X (see note)	X, only if LLC is not taxed as a corporation (see note)	
Motion Picture Production/Post Production Facility Credit SC Code §12-6-3570(B) Forms TC-25 •Credit of 20% of value of qualifying investment •Minimum $1-2 million facility investment •Facility certified by SC Film Commission at Department of Commerce •$5 million maximum credit for all taxpayers per project •Limited to 50% of tax liability when combined with any other income tax credit •15 year carryforward •Credit recapture if facility does not timely meet statutory requirements	X	X			X	X	X	X	X
Commercial Production Credit SC Code §12-6-3560 Form TC-24 •Credit of 10% of SC investment in certified commercial production •Must be producing an advertisement, composed of moving images and words, that is recorded on film, videotape, or digital medium in SC for multi-market distribution via television, cable, satellite, or motion picture theater •Production certified by SC Film Commission at the Department of Commerce •Total investment in State certified production must be $500,000 in calendar year •$1 million maximum credit for all taxpayers in one year	X	X			X	X	X	X	X

CREDIT	CREDIT AVAILABLE AGAINST				ENTITIES QUALIFYING FOR THE CREDIT*				
	Individual Income Tax (12-6-510)	Corporate Income Tax (12-6-530)	License Tax (12-20-50)	Other Taxes Administered by DOR	C Corporation	S Corporation	Partnership	Limited Liability Company	Sole Proprietor
Qualified Recycling Facility Credit SC Code '12-6-3460 Form TC-17 $Credit of 30% of investment $$300 million minimum investment required $Must operate or construct a facility certified as a qualified recycling facility $Unlimited carryforward $Recapture if minimum investment is not met by end of year 5 following construction or operation		X	X	X Sales or Use Tax	X	X	X	X	X
Voluntary Environmental Clean Up Credit SC Code §12-6-3550 Form TC-20 •"Basic credit" of 50% of expenses for industrial and commercial environmental contamination site cleanup •"Additional credit" of 10% of expenses, up to $50,000, in final year of cleanup with certificate of completion •Maximum $50,000 "basic credit" per year •5 year carryforward up to $100,000 •Must enter into a nonresponsible party voluntary cleanup contract with SC Department of Health and Environmental Control •Must obtain tax certificate from SC Department of Health and Environmental Control		X			X	X, only at corporate level		X, only if LLC is taxed as a corporation	

NOTE: Some credits may apply to the insurance premium tax administered by the Department of Insurance. Questions concerning the insurance premium tax should be directed to the Department of Insurance.

All credits are nonrefundable unless otherwise provided.

Worksheet 5

South Carolina Taxation of Limited Liability Companies (LLCs)

A. South Carolina Income Taxes

If an LLC is treated as a corporation for federal income tax purposes, it is treated as a corporation for South Carolina income tax purposes. Likewise, if an LLC is treated as a partnership for federal income tax purposes, it is treated as a partnership for South Carolina income tax purposes. Moreover, if a single member LLC is disregarded as an entity separate from its owner for federal income tax purposes, it is similarly disregarded for South Carolina income tax purposes.

South Carolina has adopted the partnership and corporate provisions (subchapters K, C and S) of the Internal Revenue Code and Internal Revenue Code §7701 which defines "partnership" and "corporation."

Treasury regulations govern how an organization is classified for federal tax purposes. There are US Department of the Treasury regulations for determining the classification of an unincorporated business organization as either a partnership or a corporation for federal income tax purposes. Under these regulations an unincorporated entity can choose to be taxed as a corporation, or be taxed as a partnership (or disregarded as an entity separate from its owner if it is a single member LLC). This classification process is referred to as "check the box." The Department follows the "check the box" regulations.[1]

B. South Carolina Definitions

Definitions in SC Code §12-2-25 provide the following:

As used in SC Code Title 12, *Taxation,* and unless otherwise required by the context:

1. "Partnership" includes a limited liability company taxed for South Carolina income tax purposes as a partnership.

2. "Partner" includes any member of a limited liability company taxed for South Carolina income tax purposes as a partnership.

3. "Corporation" includes a limited liability company or professional or other association taxed for South Carolina income tax purposes as a corporation.

4. "Shareholder" includes any member of a limited liability company taxed for South Carolina income tax purposes as a corporation.

[1] See SC Info. Ltr. #96-25.

Therefore, an LLC classified as a partnership for South Carolina income tax purposes will be deemed a partnership for all other tax purposes in South Carolina. Likewise, an LLC classified as a corporation for South Carolina income tax purposes will be deemed a corporation for all other tax purposes in South Carolina.

SC Code §12-2-25 also provides that a single member LLC which is not taxed as a corporation is not regarded as an entity separate from its owners for all South Carolina tax purposes. This provision makes it clear that a single member LLC which did not elect to be treated as a corporation is treated as part of its owner; *e.g.*, a sole proprietorship if it is owned by an individual, a division of a corporation if it is owned by a corporation, or a division of a partnership if it is owned by a partnership.

C. Issues Related to Single Member LLCs Disregarded as an Entity Separate from Their Owners

1. Nexus

Nexus is a sufficient connection between a state and a taxpayer which allows the state to subject the taxpayer to its taxing jurisdiction. Nexus with a single member LLC which is disregarded as an entity separate from its owner may result in nexus with the owner.

> **Comment:** Assume that Corporation A does not have nexus with South Carolina. A creates a single member LLC, B, to do business in South Carolina. If A does not elect to have B treated as a corporation, it will be disregarded as an entity separate from A. Since B is a part of A and doing business in South Carolina, the authors believe that the Department will take the position that A has nexus in South Carolina. Even if it were determined that A did not have nexus with South Carolina, assuming A and B carried on a unitary business, the Department will likely take the position that B's income tax return must include A's income and apportionment factors.

2. A Member's Liability for a Single Member LLC's Taxes

It is unclear whether a member of a single member LLC which is disregarded as an entity separate from its owner can be held liable for the LLC's taxes. The question arises from the conflict between:

1. An LLC being disregarded for tax purposes, which arguably includes tax collection purposes, and

2. An LLC generally being considered a separate entity for liability and other state law purposes.

In South Carolina relevant statutory authorities are:

1. SC Code §12-2-25 provides that a single member LLC which is not taxed as a corporation will be ignored for all South Carolina tax purposes.

2. SC Code §33-44-201 provides that "[e]xcept as provided in Section 12-2-25 for single-member limited liability companies, a limited liability company is a legal entity distinct from its members."[2]

3. SC Code §33-44-1001 provides that "[e]xcept as provided in Section 12-2-25 for single-member limited liability companies, the laws of the State or other jurisdiction under which a foreign limited liability company is organized govern its organization and internal affairs and the liability of its managers, members, and their transferees,"[3]

4. SC Code §33-44-303, however, provides that "… the debts, obligations, and liabilities of a limited liability company, whether arising in contract, tort, or otherwise, are solely the debts, obligations and liabilities of the company. A member or manager is not personally liable for a debt, obligation, or liability of the company solely by reason of being or acting as a member or manager."

D. Other South Carolina Taxes

1. Corporate License Fees

Corporate license fees are imposed on corporations required to file an annual report. Code Section 12-20-20 provides that, with very few exceptions, every domestic corporation, every foreign corporation qualified to do business in South Carolina, and any other corporation required by SC Code §12-6-530 to file income tax returns, must make a report annually to the Department of Revenue.

SC Code §12-2-25 provides that for purposes of Title 12, "corporation" includes a limited liability company, or professional or other association, taxed for South Carolina income tax purposes as a corporation. Whether an LLC will be taxed as a corporation for South Carolina income tax purposes depends upon whether it is taxed as a corporation for federal income tax purposes.

Therefore, LLCs which are classified as corporations for federal income tax purposes must pay South Carolina corporate license fees.

If a corporation owns a single member LLC that is disregarded for South Carolina tax purposes, the LLC does not owe a separate corporate license fee. The LLC is treated as part of the corporation which owns it and that corporation pays a license fee which includes the LLC. If the single member LLC has elected to be taxed as a corporation, then it is treated as a 100% owned subsidiary and is subject to a separate corporate license fee.

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[2] Emphasis added.

[3] Emphasis added.

2. Deed Recording Fees

SC Code Title 12, Chapter 24, imposes a fee for the privilege of recording a deed transferring realty to another person.The clerks of court and registers of mesne conveyances collect the fee at the time of filing.

a. Imposition and Determination of Value

The fee is $1.85 for each five hundred dollars, or fractional part thereof, of the realty's "value."[4] In arm's length real property transactions, this value is the sales price paid or to be paid in money or money's worth. A deduction, however, is allowed for the amount of any lien or encumbrance existing on the realty before the transfer and remaining on the realty after the transfer.[5]

b. Affidavit of Value

An affidavit must accompany every deed presented for recording and must set forth the value of the realty. The county may require any other information deemed necessary or may, at the discretion of the clerk or register of mesne conveyances, not require the affidavit.

If the deed is exempt from the deed recording fee, an affidavit is not required to state the value, but it must (1) state that the deed is exempt, (2) state the reason or reasons why the deed qualifies for an exemption, and (3) be signed by a responsible person connected with the transaction and state that connection.[6]

c. Liability

The fee is the liability of the grantor or the joint or several liability of the grantors. The grantee is secondarily liable for the fee. However, in the case of a master-in-equity deed, a deed from the federal government, a state or any of a state's political subdivisions, or a qualified retirement plan, the liability falls upon the grantee or grantees.[7]

d. Exemptions

Among the exemptions from the fee affecting LLCs are deeds:

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[4] SC Code §12-24-10.

[5] SC Code §12-24-30. See SC Rev. Rul. #04-6.

[6] See SC Code §12-24-70.

[7] SC Code §12-24-20.

1. Transferring realty from a person to an LLC if the person is a member of the LLC or is in the process of becoming a member, if no consideration is paid for the transfer other than the interest in the LLC or the increase in value of the interest held by the grantor. However, except as provided in 2. below, the transfer of realty from an LLC to a member of the LLC is subject to the fee even if it is transferred to a member which is not an individual.[8]

2. Transferring realty from a "family LLC" (an LLC taxed as a partnership whose members all belong to the same family or are charitable entities)[9] to a member of the LLC as long as no consideration is paid for the transfer other than a reduction in the grantee's interest in the LLC. "Family" means the grantor, the grantor's spouse, parents, grandparents, sisters, brothers, children, stepchildren, grandchildren, and the spouses and lineal descendants of any of them, and the grantor's and grantor's spouse's heirs under the statute of descent and distribution.

3. Transferring realty in a statutory merger or consolidation from a constituent LLC to the continuing or new LLC, as long as all LLCs involved are taxed as corporations, or all are taxed as partnerships.[10]

4. Transferring realty from the owner of a single member LLC (which has not elected to be taxed as a corporation) to the LLC, and transferring realty from the single member LLC (which has not elected to be taxed as a corporation) to its owner. There is no exemption in the statute for these transfers, but the imposition of the recording fee is on the privilege of recording a deed, with respect to any deed whereby any realty is transferred to another person. Since single member LLCs which do not elect to be treated as a corporation are treated as part of their owner, there is no transfer to "another person."[11]

3. Withholding on Income of Nonresident Partners and S Corporation Shareholders

SC Code §12-8-590 requires partnerships and S corporations to withhold income tax at the rate of 5% on nonresident partners' and nonresident S corporation shareholders' shares of South Carolina taxable income, whether or not distributed.

Exceptions. There are three exceptions to the withholding requirements:

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[8] See SC Code §12-24-40(8).

[9] See SC Code §12-24-40(9).

[10] See SC Code §12-24-40(10) and (11).

[11] See SC Code §§12-24-10 and 12-2-25. Also, see SC Rev. Rul. #04-6.

1. A partnership or S corporation is not required to withhold income taxes with respect to any partner or shareholder who submits an affidavit stating the nonresident partner or shareholder is subject to the personal jurisdiction of South Carolina for the purpose of determining and collecting South Carolina taxes.[12]

2. A partnership or S corporation is not required to withhold income taxes with respect to any partner or shareholder for which the partnership or S corporation reports the nonresident partner's or shareholder's income on a composite tax return.[13]

3. A partnership or S corporation is not required to withhold income taxes on income attributable to the sale of real property which is subject to withholding under SC Code §12-8-580, "withholding by buyer of real property or associated tangible personal property from nonresident seller."

Therefore, except as provided above, an LLC which is treated as a partnership or S corporation for income tax purposes must withhold income tax at the rate of 5% on nonresident members' shares of South Carolina taxable income, whether or not distributed.

4. Agricultural Use Property Tax Valuation

Agricultural real property which is actually used for agricultural purposes is taxed on an assessment equal to:

1. Four percent of its fair market value for agricultural purposes for owners or lessees who are individuals or partnerships, and corporations which do not:

   a. Have more than ten shareholders,

   b. Have as a shareholder a person (other than an estate) who is not an individual,

   c. Have a nonresident alien as a shareholder, or

   d. Have more than one class of stock.

2. Six percent of its fair market value for such agricultural purposes for owners or lessees who are corporations, except for certain corporations specified in 1. above.[14]

[12] See SC Rev. Proc. #92-5 regarding the affidavit.

[13] See SC Code §12-6-5030 and SC Rev. Proc. #92-5 regarding composite returns.

[14] SC Code §12-43-220(d)(1). See also SC Reg. §117-124.7.

Whether an LLC has a 4 or 6 percent assessment ratio depends on whether it is classified as a partnership, corporation, or sole proprietorship (single member LLC owned by an individual which did not elect corporate treatment). If it is taxed as a corporation, the assessment ratio further depends on whether it meets the requirements above.

E. Conversions of One Type of Entity to Another Involving LLCs

1. Tax Consequences of the Conversion of a Partnership to an LLC[15]

a. Definitions and Assumptions

For this discussion, "organization" means the partnership before the conversion, and the LLC after the conversion; and "owner" means a partner before the conversion and a member after the conversion.

This discussion assumes that (i) the conversion from a partnership to an LLC does not involve the addition or removal of any owner or affect the amount of the organization owned by any owner, (ii) the LLC will continue the same business conducted by the partnership, and (iii) both the partnership and the LLC are organized under the laws of a state of the United States or the District of Columbia.

b. Income Tax

Since South Carolina has adopted subchapter K of the Internal Revenue Code, the Department will follow the federal income tax guidelines set forth in IRS Rev. Rul. 95-37 concerning the conversion of a partnership to an LLC.

Therefore, the conversion is treated as follows:

1. The conversion is treated as a partnership-to-partnership conversion. This treatment applies whether the resulting LLC is formed in the same state or in a different state than the converting domestic partnership. Therefore,

    a. The partnership will not terminate under Internal Revenue Code §708;

    b. If the owners' shares of organization liabilities do not change, there will be no change in the adjusted basis of any owner's interest in the organization;

    c. If the owners' shares of organization liabilities change and cause a deemed contribution of money to the organization by an owner, then the adjusted basis of that owner's interest in the organization will be increased by the amount of the deemed contribution;

[15] See SC Rev. Rul. #95-9.

d. If the owners' shares of organization liabilities change and cause a deemed distribution of money by the organization to an owner, then the adjusted basis of that owner's interest in the organization will be reduced (but not below zero) by the amount of the deemed distribution, and gain will be recognized by the owner to the extent the deemed distribution exceeds the adjusted basis of the owner's interest in the organization; and

e. There will be no change in the holding period of any owner's total interest in the organization.

2. The taxable year of the converting partnership will not close with respect to all the owners or with respect to any owner.

3. The resulting LLC will not need to obtain a new taxpayer identification number.

The tax results of the owners' shares of organizational liabilities changing (see items 1. c. and d. above) should not create too much cause for concern because SC Code §33-44-902(g) provides that a general partner who becomes a member of an LLC as a result of a conversion remains liable as a partner for an obligation incurred by the partnership before the conversion. Moreover, SC Code §33-44-902(h) states that a general partner's liability for obligations of the LLC incurred after the conversion is that of a member of the LLC; a limited partner who becomes a member as a result of a conversion remains liable only to the extent the limited partner was liable for an obligation incurred before the conversion.

c. Sales Tax

Every person engaged in the business of selling tangible personal property at retail must obtain a retail license. Since it has been determined that the conversion of a partnership to an LLC taxed as a partnership is treated as a partnership-to-partnership conversion, and the organization is still considered to be the same entity for South Carolina tax purposes, it is not required to obtain a new retail license.[16]

Note: The Department advises the new LLC to obtain a new retail license for each retail location. If a retail license remains in the name of the partnership, the Department will assume that the general partner or partners are personally liable for any sales or use taxes the LLC fails to pay.

[16] See also SC Code §33-44-903 which confirms that a partnership that has been converted into an LLC is the same entity that existed before conversion and all property owned by the converting partnership vests in the LLC.

Because a new retail license is not required, the Department will waive the $50 application fee for a retail license. Apply for a new license on Form SCTC 111 — Business Tax Application,[17] and write "Partnership Conversion to LLC" on the top of the form.

d. Deed Recording Fees

When a partnership converts to an LLC, it is the mere reorganization of a partnership, and for South Carolina tax purposes the property is still vested in the same partnership. No realty has been "transferred to another person." Therefore, if a partnership converting to an LLC conveys real property to the LLC, no deed recording fee is due.[18]

2. Income Tax Consequences of Other Conversions

a. Tax Consequences of the Conversion of a Corporation to a Limited Liability Company

There are no tax-free reorganizations from corporations to partnerships and, therefore, no tax-free reorganizations from corporations (either C or S) to LLCs taxed as a partnership. A conversion from a corporation to an LLC taxed as a partnership will be viewed as:

1. A distribution of assets to the shareholders followed by their contribution to the LLC;

2. A contribution of the assets from the corporation to the LLC in exchange for interests in the LLC and then distribution by the corporation to the shareholders of the LLC interests; or

3. A contribution of stock in the corporation to the LLC followed by a liquidation of the corporation.

South Carolina follows the federal treatment. In several private letter rulings the Internal Revenue Service has adopted the second characterization.[19]

Under Internal Revenue Code §336, the corporation recognizes gain on the distribution of the property as if the corporation had sold the property and the shareholders must recognize gain to the extent the fair market value of the assets they receive exceed the basis in their stock. Therefore, the conversion of a corporation into an LLC will be taxable at both the corporate and the shareholders levels.

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[17] See Worksheet 10.

[18] See SC Code §12-24-10.

[19] See IRS PLRs 9404021 and 9409016.

The result would be the same if an LLC taxed as a corporation, elects pursuant to the "check the box" regulations, to be taxed as a partnership in the future.

South Carolina is expected follow the federal tax treatment for an LLC which is taxed as a corporation and is converted to a corporation. If the conversion qualifies as an F reorganization under Internal Revenue Code §368(a)(1)(F), South Carolina will also treat it as an F reorganization.[20]

b. The Sale of Interests in an LLC Taxed as a Partnership Where a Single Member LLC results

South Carolina follows the federal tax treatment where one person purchases all of the ownership interest in a domestic LLC that is taxed as a partnership. Therefore, the LLC is deemed to make a liquidating distribution to the members of the partnership prior to the sale. The purchaser is deemed to purchase the assets from the members (other than herself if she was a member).

The purchaser has a cost basis and a new holding period in the assets she is deemed to have purchased. If she was a member of the original LLC she receives a basis in the assets she is deemed to receive in the LLC's liquidation determined by Internal Revenue Code §732(b), and she will report gain or loss, if any, to the extent required by Internal Revenue Code §731(a). She will also include the partnership's holding period in determining her holding period for the assets she is deemed to receive in the liquidating distribution.[21]

c. A Single Member LLC Which is Disregarded as an Entity Separate from Its Owner Becomes an LLC with More than One Owner Taxed as a Partnership

South Carolina follows the federal tax treatment where a single member LLC which is disregarded as an entity separate from its owner becomes an LLC with more than one owner taxed as a partnership.

For example, if A owns a single member LLC which is disregarded, and B purchases 50% of A's ownership interest, B's purchase is treated as the purchase of a 50% interest in each of the LLC's assets, which are treated as held directly by A. Immediately thereafter, A and B are treated as contributing their respective interests in those assets to a partnership in exchange for ownership interests in the partnership.

If A owns a single member LLC which is disregarded, and B contributes cash to the LLC for an interest in the LLC, B's contribution is treated as a contribution to a partnership in exchange for an ownership interest in the partnership. A is treated as contributing all of the assets of the LLC to the partnership in exchange for a partnership interest.[22]

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[20] See IRS PLR 9636007.

[21] See IRS Rev. Rul. 99-6.

[22] See IRS Rev. Rul. 99-5.

Worksheet 6

Notes on Other US and SC Constitutional Limitations

A. Introduction

Although the cases discussed in this Worksheet are not corporate income tax or corporate license fee cases, they concern South Carolina's handling of constitutional limitations, which may, in turn be of use in understanding issues of interest to corporations doing business in South Carolina.

B. United States Constitution — Notes on other South Carolina Cases

1. Privileges and Immunities[1] — *Toomer v. Witsell*

Although hardly surprising today, in *Toomer v. Witsell*[2] the United States Supreme Court invalidated a South Carolina license fee on shrimp fishing boats for violating the Privileges and Immunities Clause. South Carolina imposed a license fee on shrimp fishing boats in its coastal waters at the rate of $25 for each resident-owned boat and $2,500 for each boat owned by a nonresident. The Court concluded that the purpose and effect of the fee were not to conserve shrimp but to exclude nonresidents and thereby create a commercial shrimp monopoly for South Carolina residents.

> "The primary purpose for this [Privileges and Immunities] clause, … was to help fuse into one Nation a collection of independent, sovereign States. It was designed to insure to a citizen of State A who ventures into State B the same privileges which the citizens of State B enjoy. …
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> … one of the privileges which the clause guarantees to citizens of State A is that of doing business in State B on terms of substantial equality with the citizens of that State."[3]

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[1] Article IV, Section 2, the "interstate privileges clause," provides:

> "The Citizens of each State shall be entitled to all Privileges and Immunities of the Citizens in the several States."

[2] 334 U.S. 385, 68 S. Ct. 1156 (1948).

[3] 334 U.S. at 395-396; 68 S.Ct. at 1162.

2. The First Amendment[4] — *Thayer v. SC Tax Commission*[5]

Thayer was assessed a use tax on printed advertising materials (real estate advertising pamphlets) that she purchased out-of-state for distribution within the state. She argued that the state could not tax her materials while exempting newspapers and religious publications from tax. The South Carolina Supreme Court upheld the exemption for newspapers, struck down the exemption for religious publications, and upheld the tax on Ms. Thayer.

The court relied on *Leathers v. Medlock*[6] to uphold the exemption for newspapers. It held that differential taxation of speakers, even members of the press, does not violate the First Amendment unless the tax is directed at, or presents the danger of, suppressing particular ideas; *i.e.*, the tax cannot be dependent upon the content of the publication.

The Court relied on *Texas Monthly, Inc. v. Bullock*[7] in deciding that the religious publications exemption violated the Establishment Clause of the First Amendment. The court held that the constitutionality of the exemption for religious publications could be considered separately from the constitutionality of sales and use taxes as a whole, so the exemption, not the taxes, was invalid.

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[4] "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; …"

[5] 301 SC 6, 413 S.E.2d 810 (1991).

[6] 111 S.Ct. 1438 (1991). In *Leathers v. Medlock* a cable television subscriber and a trade organization of cable operators brought an action challenging the imposition of sales taxes on cable television services. No sales taxes were charged on the sale of print media. The Court held that Arkansas' extension of its generally applicable sales tax to cable television services alone, or to cable and satellite services, while exempting print media, does not violate the First Amendment. The Court reasoned that the tax is a tax of general applicability that does not single out the press and thereby threaten to hinder it. There was no evidence that Arkansas targeted cable television in a purposeful attempt to interfere with its First Amendment activities. Neither did Arkansas select a small group of speakers to bear the burden of the tax. Finally, the tax was not content based.

[7] 109 S.Ct. 890 (1989). In *Texas Monthly, Inc. v. Bullock* a Texas statute exempted from sales taxes periodicals published or distributed by a religious faith consisting wholly of writings promulgating the teachings of the faith and books consisting wholly of writing sacred to a religious faith.

Three judges held that the exemption lacked sufficient breadth to pass scrutiny under the Establishment Clause of the First Amendment. The tax would have been constitutional if it incidentally benefitted religious groups, as long as the exemption was conferred on a wide array of nonsectarian groups as well as religious organizations in pursuit of some legitimate secular end. One justice concurred based on *Arkansas Writers' Project, Inc. v. Ragland,* 107 S Ct 1722 (1987), which proscribed scrutiny of a publication's content as the basis for imposing a tax, and two justices concurred because the exemption violated the Establishment Clause of the First Amendment.

Comment: This case is important beyond its holding because it is a warning that reading South Carolina statutes is not enough to understand the law. The SC Code still contains §12-36-2120(8) which states that "newsprint paper, newspapers, and religious publications, including the *Holy Bible* and the SC Department of Agriculture's *The Market Bulletin"* are exempt. Religious publications, including the *Holy Bible* are no longer exempt, but no law has been introduced to delete the exemption from the SC Code.

3. Fifth Amendment (Double Jeopardy)[8] — *McMullin v. DOR*[9]

This case considered whether application of the South Carolina Marijuana and Controlled Substance Tax Act,[10] violated plaintiff's constitutional right not to be put in jeopardy twice for the same offense.

The taxpayer relied on the United States Supreme Court's decision in *Department of Revenue of Montana v. Kurth Ranch*.[11] *Kurth Ranch* held that the high rate and deterrent purpose of the tax, in and of themselves, did not necessarily render the tax punitive, but other unusual features set it apart from most taxes. The United States Supreme Court concluded that, "[t]aken as a whole, [the tax imposed under Montana's Dangerous Drug Tax Act] is a concoction of anomalies, too far-removed in crucial respects from a standard tax assessment to escape characterization as punishment for the purpose of Double Jeopardy analysis."[12]

The South Carolina Supreme Court upheld South Carolina's tax by distinguishing *Kurth Ranch.* It stated that a review of the South Carolina Act clearly indicates it does not contain the "unusual features" cited by the *Kurth Ranch* majority. Under the provisions of the South Carolina Act, the tax is imposed whether or not the taxpayer has been arrested for possession of the controlled substance. In other words, the class of taxpayers is not defined by the actions of law enforcement personnel. Further, under the South Carolina Act, the tax is based on actual possession. The Court did not emphasize that the South Carolina tax only applied to illegal possession.

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[8] "… nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; …

[9] 321 S.C. 475 (1996).

[10] SC Code §§12-21-5010 to 12-21-6050.

[11] 511 U.S. 767, 114 S.Ct. 1937, 128 L.Ed.2d 767 (1994).

[12] 511 U.S. at 783; 114 S.Ct. at 1948.

4. Retroactivity of Decisions — *Bass v. South Carolina*

In *Bass v. South Carolina,*[13] South Carolina federal government retirees sued the state and the Tax Commission for refunds for taxes paid on their retirement income. The action was brought because of a United States Supreme Court decision, *Davis v. Michigan Dept. of Treasury*,[14] in which it was held that state taxation of income of persons retired from employment or service with the federal government at a greater rate than the taxation of income of persons retired from state service, violated the doctrine of intergovernmental tax immunity and federal law[15] and was thus prohibited. This case was settled and refunds paid.

> **Comment:** The interesting issue remaining is whether the South Carolina Supreme Court will apply the doctrine of *Chevron Oil Co. v. Huson*[16] in the future to determine if judicial decisions in purely state law and state constitutional cases should be applied prospectively or retroactively. The South Carolina Supreme Court applied *Chevron v. Huson* in the *Bass* case. *Chevron v. Huson* was a non-tax case which held that the result in a civil case would not be retroactive if the case:
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> 1. Announced a new principle of law;
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> 2. Prospectivity would avoid injustice or hardship, and
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> 3. Prospectivity would not unduly undermine the "purpose and effect" of the new rule.

The United States Supreme Court in *Harper v. Virginia*[17] held that when the United States Supreme Court applies a rule of federal law to the parties before it, that rule is the controlling interpretation of federal law and must be given full retroactive effect in all cases still open on direct review and as to all events, regardless of whether an event predates or postdates the announcement of the rule. This rule extended the ban against selective application of new rules in criminal cases to civil cases. The court held that when it does not reserve the question whether its holding should be applied to the parties before it, the opinion is properly understood to have followed the normal rule of retroactive application.

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[13] 302 S.C. 250, 395 S.E.2d 171, vacated and remanded 501 U.S. 1246, 111 S.Ct. 2881, 115 L.Ed.2d 1047 (1991), 307 S.C. 113, 414 S.E.2d 110 (1992).

[14] 489 U.S. 803, 109 S.Ct. 1500, 103 L.Ed.2d 891 (1989).

[15] 4 USC §111. This section authorizes states to tax pay or compensation for personal services as a federal employee, if the taxation does not discriminate against the employee because of the source of the pay or compensation.

[16] 404 U.S. 97, 92 S.Ct. 349, 30 L.Ed.2d 296 (1971).

[17] 509 U.S. 83, 113 S.Ct. 2510 (1993).

C. Overview of the South Carolina Constitution

Article X of the SC Constitution is entitled "Finance, Taxation and Bonded Debt." Most of the tax sections concern property taxes, including a uniformity requirement, assessment ratios, classification of property, and exemptions.[18]

Comment: The requirement in SC Constitution Article X, §1, that the assessment of all property be equal and uniform within the classifications established by the Constitution has been eroded by the General Assembly's power in SC Constitution Article X, §3, to enact exemptions. For example:

1. With certain exceptions, SC Code §12-37-223A authorizes the governing body of a county, by ordinance, to exempt an amount of fair market value of real property located in the county sufficient to limit to 15% any valuation increase attributable to a countywide reassessment program. Countywide reassessment programs are required to be conducted every five years. SC Code §12-43-217;

2. SC Constitution Article X, §3, and SC Code 12-37-220(A) (1) provide that all property of a political subdivision is exempt if the property is used exclusively for public purposes. In *Charleston County Aviation Authority v. Wasson*, 289 S.E.2d 416 (SC 1982), a challenge was raised to the exemption of property owned by the Aviation Authority (a political subdivision) which was leased to a private business. The Court held:

    a. The fact that property is used by a private business entity does not preclude its use from being public;

    b. The lease of the airport authority's property to airlines, car rental companies, a parking lot operator, a limousine and taxi service, an air cargo company and to the operator of a restaurant, snack bar, lounge and gift shop providing various services to meet the needs of passengers were incidental to the public use and such property was exempt under SC Constitution Article X, Section 3, and SC Code §12-37-220(A)(1).

    In *Quirk v. Campbell*, 394 S.E.2d 320 (SC 1990), a taxpayer challenged the constitutionality of one of South Carolina's "fee in lieu" statutes. SC Code §4-29-67 allows a negotiated "fee in lieu of [property] taxes," with no millage increases or increases in the property's value for at least 20 years.

[18] South Carolina Constitution, Article X, §§1–4 and 6.

To qualify for this "fee in lieu," the property was required to be transferred to the county, which then leased it back to the private party making the investment. The lease was a 20 year financing lease that gave the investor the right of repurchasing the property at the end of the lease for $1. The Court in *Quirk*, citing *Charleston County Aviation Authority v. Wasson*, held that:

a. The "fee in lieu" statute was constitutional because the property qualified for the exemption provided for by SC Constitution Article X, Section 3, and SC Code 12-37-220(A)(1) which provides that all property of a political subdivision is exempt if the property is used exclusively for public purposes; and

b. The public purpose was "promoting industrial development."

Since 1990, two other fee in lieu of property tax statutes have been enacted which in some cases allow the fee for 30 years and allow the county and company to agree that the fee payments will be used for infrastructure the company needs.[19]

Section 5 of SC Constitution Article X is applicable to all South Carolina taxes. It provides that no tax may be levied without the consent of the people or their representatives, and that any tax levied "shall distinctly state the public purpose to which the proceeds of the tax shall be applied."

In *Weaver and Richland County Council v. Recreation District*[20] the South Carolina Supreme Court held an act[21] that authorized the Recreation Commission, an appointed body, to levy a property tax to meet the cost of operating and maintaining recreational facilities was unconstitutional. The Court reasoned that the power to tax may not be conferred on a purely appointive body but must be under the supervisory control of elected bodies.

D. Other Local Tax Issues

1. Local taxes

Local governments are generally supported by property taxes, business license taxes based upon gross receipts, local sales and use taxes, and fees. The specifics of property taxes and local sales and use taxes are mandated by state law, as are some of the provisions of business license taxes.[22] No South Carolina local government imposes an income tax.

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[19] See SC Code Title 4, Chapter 12 and Chapter 44.

[20] 328 S.C. 83, 492 SE2d 79 (1997).

[21] Act No. 317, 1969 Acts 382.

[22] See generally Title 12, Chapters 37, 39, and 43 for property taxes; and Title 4, Chapter 10, and Title 6, Chapter 1, for local sales and use taxes.

Although South Carolina municipalities and counties have "home rule,"[23] the South Carolina Constitution essentially left it up to the General Assembly to decide local government powers.[24] Acting under this authority, the General Assembly enacted various statutes restricting the tax and revenue raising powers of counties and municipalities. For example, SC Code §6-1-310 provides that a local government may not impose a new tax unless specifically authorized by the General Assembly.

In addition, SC Code §6-1-330 provides that a local government may only impose a new service or user fee if it is approved by a "positive majority." A service or user fee is a charge required to be paid in return for a particular government service or program made available to the payer that benefits the payer in some manner different from the members of the general public not paying the fee.[25] A "positive majority" is a vote for adoption by the majority of the members of the entire governing body, whether present or not.[26]

> **Comment:** There is a state Revenue Procedures Act and Taxpayers' Bill of Rights.[27] There are no local government equivalents. In one case, BellSouth was able to obtain a temporary restraining order[28] from the federal district court in South Carolina against Seneca, South Carolina, preventing the city from enforcing a new city gross receipts tax on telecommunications. BellSouth argued that the federal Tax Injunction Act[29] was

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[23] Article VIII of the SC Constitution. See also *Hospitality Association of South Carolina, Inc., v. The County of Charleston, The Town of Hilton Head Island, South Carolina, and The City of Charleston,* 320 S.C. 219, 464 S.E.2d 113 (1995).

[24] Article VIII SC Constitution; *Hospitality Association of South Carolina, Inc., v. The County of Charleston, The Town of Hilton Head Island, South Carolina, and The City of Charleston,* 320 S.C. 219, 464 S.E.2d 113 (1995); and *Town of Hilton Head, Kiawah Island, City of Charleston, County of Georgetown v.Morris (Comptroller General),* 324 S. C. 30, 484 S.E.2d 104 (1997).

[25] SC Code §6-1-300(6).

[26] SC Code §6-1-300(5).

[27] SC Code Title 12, Chapters 60 and 58, respectively. See Sections .11 B. and G. of this portfolio for a discussion of the Revenue Procedures Act and the Taxpayers' Bill of Rights.

[28] Prof. William J. Quirk, BellSouth Gets Order Against South Carolina Municipal Telecom Tax, 98 *State Tax Notes* 230-17 (December 1, 1998). The order was obtained November 23, 1998. See also *BellSouth Telecommunications, Inc., v. City of Seneca* C/A No.: 8:98-3451-13 (U.S. Dist. SC April 28, 1999), denying the city's motion to dismiss.

[29] 28 USC §1341.

inapplicable because there was no predeprivation or postdepriviation remedy for this tax provided by law; *i.e.*, the law did not permit a taxpayer to withhold payment while litigating the tax, and if the tax was paid the law did not provide for a refund.[30]

2. Equal Protection, Due Process, and Intrastate Jurisdiction to Tax — *Eli Witt Co. v. City of West Columbia*

The South Carolina Constitution has its own Due Process and Equal Protection Clauses, although taxpayers tend to rely on their federal counterparts. *Eli Witt Co. v. City of West Columbia*[31] surprised many South Carolina tax practitioners.

Eli Witt is a wholesale distributor which sells various items to convenience and grocery stores in South Carolina. It owned a warehouse in West Columbia, South Carolina. Eli Witt's gross income in South Carolina was approximately $22 million of which only $1.8 million was derived from sales within the City of West Columbia. West Columbia has a business license tax ordinance which imposes a tax on a business's gross income earned within the state, minus gross income taxed by another city. Eli Witt was not subject to tax in any other city so West Columbia taxed the entire $22 million.

Eli Witt claimed that the ordinance violated the Equal Protection Clause of the constitution because it was treated differently than a business which is taxed by another municipality. Eli Witt also argued that the ordinance violated the Due Process Clause of the constitution because the measure of the tax was not limited to the income earned within the City. The court upheld the tax on Eli Witt's entire state gross income.

It held that the ordinance does not violate the Equal Protection Clause because it is rationally related to the legislative purpose, members of a class are treated alike, and classification rests on a reasonable basis.

With regard to the Due Process Clause issue, the Court quoted *Triplett v. City of Chester*[32] which stated that it was "not contemplated that the various phases of a business should be segregated and only that part taxed which was actually carried on within the corporate limits. The tax was imposed for the privilege of maintaining or conducting a place of business within that municipality and it was intended that the business should be considered as a whole."[33]

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[30] Bell South relied on *McKesson Corp. v. Division of Alcoholic Beverages*, 496 US 18 (1996); *Reich v. Collins*, 513 US 106 (1994); and *Newsweek Inc. v. Florida Dept. of R*ev., 522 U.S. 442, 118 S.Ct. 904 (1998).

[31] 425 S.E.2d 16 (S.C. 1992).

[32] 40 S.E.2d 239 (1972).

[33] 425 S.E.2d at 18.

The South Carolina Supreme Court distinguished and limited *Southern Bell Tel. & Tel. Co v. City of Spartanburg*[34] to its facts. In *Southern Bell,* the Supreme Court held that cities could not tax revenues from intrastate long distance calls or services to customers outside of the city limits with its local business license tax base. The Court stated that the "city lacked power to tax revenues from services the company rendered to customers residing outside the city limits."[35]

3. Local Taxation of Insurance Companies — *Charleston v. Government Employees Insurance Company*

In *Charleston v. Government Employees Insurance Company,*[36] the South Carolina Supreme Court upheld a local business license tax on gross premiums collected on insurance policies written on property or risks located within the city. The insurance companies argued that the ordinance violated the Commerce Clause of the U.S. Constitution. The Court pointed out that the U.S. Supreme Court in *U.S. v. South-Eastern Underwriters Ass'n.*[37] held that insurance was commerce within the meaning of the Commerce Clause, but the next year Congress enacted the McCarran-Ferguson Act[38] restoring regulatory and taxing authority to the states. Charleston contended, and the Court agreed, that South Carolina law[39] permitting municipalities to collect a business license fee or tax based upon insurance premiums delegated the State's McCarranFerguson Act immunity to municipalities.

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[34] 285 S.C. 495, 331 S.E.2d 333 (1985).

[35] 331 S.E.2d 333 at 334.

[36] *Charleston v. Government Employees Insurance Company,* 334 S.C. 67, 512 S.E.2d 504 (1999).

[37] 322 U.S. 533, 64 S.Ct. 1162 (1944).

[38] 15 U.S.C. §§1011 through 1025 (1977).

[39] SC Code §38-7-160.

Worksheet 12

Public Law 86-272 (15 USC §381)

Public Law 86-272 places certain limits on the power of a state to impose a tax on the income derived from within its borders. It reads, in pertinent part:

(a) No State, or political subdivision thereof, shall have power to impose... a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

(b) The provisions of subsection (a) of this section shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to

(1) any corporation which is incorporated under the laws of such State; or

(2) any individual who, under the laws of such State, is domiciled in, or a resident of, such State.

(c) For purposes of subsection (a) of this section, a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance, of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

(d) For purposes of this section

(1) the term “independent contractor” means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for the sale of, tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and

(2) the term “representative” does not include an independent contractor.

Worksheet 19

A. Administrative Law Court Rule on Representation of Taxpayers

Rule 9.A. Parties and Their Representatives

Parties in a contested case have the right to participate or to be represented in all hearings or pre-hearing conferences related to their case. A partnership, corporation or association may be represented by any member, officer, director or duly authorized employee. An agency may be represented by the director, an official, or duly authorized employee of the agency. Any party may be represented by an attorney admitted to practice, either permanently or pro hac vice, or as otherwise authorized by law. In tax related cases, any party may be represented by a certified public accountant. No one shall be permitted to represent a party where such representation would constitute the unauthorized practice of law. A party proceeding without legal representation shall remain fully responsible for compliance with these Rules and the Administrative Procedures Act. This Rule shall not be construed to permit law student practice except to the extent authorized by Rule 401 of the South Carolina Appellate Court Rules.

B. The Supreme Court of South Carolina Rule on Unauthorized Practice of Law Rules Proposed by the South Carolina Bar.

THE SUPREME COURT OF SOUTH CAROLINA

In re: Unauthorized Practice of Law Rules Proposed by the South Carolina Bar

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O R D E R

In June 1991 the South Carolina Bar through a special subcommittee of the Unauthorized Practice of Law Committee (Committee) submitted to the Supreme Court a set of proposed rules governing the unauthorized practice of law (Proposed Rules). This comprehensive set of Proposed Rules represents the Committee's collective wisdom accumulated during its thirteen years of existence, as well as the efforts of the special subcommittee which spent over a year drafting these rules. The Proposed Rules attempt to define and delineate the practice of law, and to establish clear guidelines so that professionals other than attorneys can ensure they do not inadvertently engage in the practice of law.

It is impossible for anyone not familiar with the scope of the issues embraced by the Proposed Rules to truly appreciate the enormity of the task undertaken by the special subcommittee. After careful review of the Proposed rules, the documentation in support of these rules, and the tremendous amount of memoranda in opposition to their adoption, we conclude that the Proposed Rules should not be adopted. We commend the subcommittee for its Herculean efforts to define the practice of law. We are convinced, however, that it is neither practicable nor wise to attempt a comprehensive definition by way of a set of rules.

Instead, we are convinced that the better course is to decide what is and what is not the unauthorized practice of law in the context of an actual case or controversy.

The Constitution commits to this Court the duty to regulate the practice of law in South Carolina. S. C. Const. art. V, § 4; see also S. C. Code Ann. § 40-5-10 (1986). We take this opportunity to clarify certain practices which we hold do not constitute the unauthorized practice of law.

First, we recognize the validity of the principle found in S.C. Code Ann. § 40-5-80 (1986): any individual may represent another individual before any tribunal, if (1) the tribunal approves of the representation and (2) the representative is not compensated for his services. We have refused, however, to allow an individual to resprent a business entity under the statute. See State ex rel. Daniel v. Wells, 191 S.C. 468, 5 S.E.2d 181 (1939). We modify Wells today to allow a business to be represented by a non-lawyer officer, agent or employee, including attorneys licensed in other jurisdictions and those possessing Limited Certificates of Admission pursuant to Rule 405, SCACR, in civil magistrate's court proceedings. Such representation may be compensated and shall be undertaken at the business's option, and with the understanding that the business assumes the risk of any problems incurred as the result of such representation. The magistrate shall require a written authorization from the entity's president, chairperson, general partner, owner or chief executive officer, or in the case of a person possessing a Limited Certificate, a copy of that Certificate, before permitting such representation.

Second, we hold that State agencies may, by regulation[1], authorize persons not licensed to practice law in South Carolina, including laypersons, Certified Public Accountants (CPAs), attorneys licensed in other jurisdictions and persons possessing Limited Certificates of Admission, to appear and represent clients before the agency. These regulations are presumptively valid and acts done in compliance with the regulations are presumptively not the unauthorized practice of law. We recognize, however, that such an agency practice could be abused, and reserve the authority to declare unenforceable any regulation which results in injury to the public.

Third, our respect for the rigorous professional training, certification and licensing procedures, continuing education requirements, and ethical code required of Certified Public Accountants (CPAs) convinces us that they are entitled to recognition of their unique status. We hold that CPAs do not engage in the unauthorized practice of law when they render professional assistance, including compensated representation before agencies and the Probate Court, that is within their professional expertise and qualifications. We are confident that allowing CPAs to practice in their areas of expertise, subject to their own professional regulation, will best serve to both protect and promote the public interest.

We also take this opportunity to reaffirm the rule that police officers may prosecute traffic offences in magistrate's court and in municipal court. Only the arresting officer may prosecute the case, although if the officer is new or inexperienced, he may be assisted at trial by one of his supervisors. State v. Sossamon, 298 S. C. 72, 378 S.E.2d 259

[1] A copy of the proposed regulation shall be filed with the Supreme Court Clerk at the same time it is filed with the Legislative Council.

(1989); see also State ex rel. McLeod v. Seaborn, 270 S. C. 696, 244 S. E.2d 317 (1978).

Finally, we recognize that other situations will arise which will require this Court to determine whether the conduct at issue involves the unauthorized practice of law. We urge any interested individual who becomes aware of such conduct to bring a declaratory judgement action in this Court's original jurisdiction to determine the validity of the conduct. We hope by this provision to strike a proper balance between the legal profession and other professionals which will ensure the public's protection from the harms caused by the unauthorized practice of law.

Let this order be published with the Administrative Orders of this Court.

IT IS SO ORDERED.

Columbia, South Carolina
September 21, 1992

The opinions expressed in this paper are the authors' opinions and should not be attributed to the South Carolina Department of Revenue. This paper is revised through June 10, 2005, but does not reflect legislation passed in the 2005 South Carolina legislative session.

XII. Bibliography

A. Web sites

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2. SC Government: www.myscgov.com
   Note: This website includes links to all South Carolina state and local government websites, including legislative and judicial sites.

3. South Carolina Courts: www.judicial.state.sc.us

   Administrative Law Court: www.scalc.net

4. University of South Carolina School of Law: www.law.sc.edu

5. SC Code and Regulations: www.lpitr.state.sc.us/code/statmast.htm

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7. Department of Commerce: www.sccommerce.com

B. *South Carolina Tax Incentives for Economic Development,* Burnet R. Maybank III, Deana West, Rick Handel, John McCormack, Jerilynn VanStory, and Edward Ingram (SC Department of Revenue 2005 ed.)

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SOUTH CAROLINA DOR DEPARTMENT OF REVENUE

Foreign Audit Corporate Manual

SOUTH CAROLINA DEPARTMENT OF REVENUE
FOREIGN AUDIT /FIELD OPERATIONS

FOR INTERNAL USE ONLY

MARCH 2022

DISCLAIMER

This field audit manual has been developed for the guidance of the South Carolina Department of Revenue's audit staff. It is intended to be an internal training tool and a reference guide. The auditing methods and techniques suggested in this manual serve primarily as administrative guidance and may not be appropriate, applicable, or necessary for every audit. Although this manual provides an overview of general practices and procedures, the SCDOR reserves the right to depart from the standard practices and procedures outlined herein, if the facts and circumstances of a particular audit warrant such a departure. Auditors should use discretion when deciding which methods or techniques to use in a particular audit and should consult with their supervisors whenever unique factual or legal issues arise. Departure from the standard practices and procedures does not undermine or invalidate any audit assessment where all applicable statutory or regulatory requirements are met.

This manual does not reflect changes in laws, regulations, notices, decisions, or administrative procedures that may have been enacted, issued, or adopted since the manual was last updated. Statements within this manual regarding court decisions do not necessarily indicate acquiescence to those precedents. This manual does not constitute a public policy statement of the SCDOR. It is not a rule, regulation, written guidance, or an advisory opinion by the SCDOR to the public at large or any specific taxpayer as described in or for purposes of S.C. Code Ann. § 12-4-320. This manual and the information contained therein may not be cited to support an audit position nor may it be relied upon by a taxpayer to estop SCDOR or deprive the State of the due exercise of its statutory authority.

NOTE: There are hyperlinks throughout this document, including each line of the Table of Contents. If you would like to go between the hyperlinks that you have clicked on, press the ALT key and the left arrow (to go back) or right arrow (to go forward).

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Definitions

A B C D E F G H I J K L M N O P Q R S T U V W X Y Z

Affiliate Attribution Nexus. Focuses on the relationship between the taxpayer and a related entity operating in the state. The activity of the related entity is attributed to the taxpayer and nexus asserted. South Carolina ("SC") does not use affiliate attribution to assert nexus on a taxpayer. However, if the activity between the entities is unitary and so intertwined that the two entities lack economic substance as separate entities, an alternative apportionment, including a unitary combination, may be considered.

Allocation or Allocable Income. The assignment of specific income types to a particular state in order to remove that income from the apportionable income base[1]. Nonbusiness income is usually allocated to the state of the corporation's commercial domicile, or to where the property giving rise to the income is located[2]. With regard to SC, everywhere nonbusiness income is allocated less related expenses (Net amounts allocated directly to SC and other states) on Schedule F, columns 1-3 on lines 1-7 on the SC 1120. Net amounts allocated directly to SC is shown on lines 1-7 of column 4 of the SC 1120. Net Income allocated to SC is also recorded on line 5 of Schedule G of the SC 1120. Refer to SCCL §12-6-2220 for details of what is considered allocable income for SC purposes.

Alternative Apportionment. If the allocation and apportionment provisions under SCCL §§12-6-2252(A) or 12-6-2290 do not fairly represent the taxpayer's business activity in SC, SCCL §12-6-2320(A) allows for the taxpayer to request or the department to require a different method that fairly reflects the taxpayer's business activity in the state, such as unitary combined reporting, separate accounting, inclusion of one or more additional factors, etc. (SC RR #15-5) The burden of proof for the alternative apportionment is on the party stating the SCCL §§12-6-2252(A) or 12-6-2290 does not fairly represent the taxpayer's business activity in SC.

Apportionment. The distribution of income among the states in which a multistate or multinational corporation is doing business, using a percentage based on the ratio of the in-state factors to the everywhere factors, namely sales, property and payroll. Since 2010, the only factor used in SC is the sales (schedule H-1) or gross receipts (schedule H-2) factor, or one of the special apportionment formulas provided in SCCL §§12-6-2290 through 12-6-2310 (schedule H-3).

Apportionment Workpapers. This is the detail support for the apportionment factors for the SC and everywhere sales/receipts reflected in the SC 1120 (Schedules H-1, H-2 or H-3). This is an item that is always requested in the initial IDR and the taxpayer should provide the support to include a breakdown of revenue streams for both the SC sales/receipts and the everywhere sales/receipts.

[1] From page 6 of the Georgia manual
[2] From page 5 of the MTC manual

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Audit Appeal. After a proposed assessment is issued the taxpayer must pay or appeal the assessment within 90 days from the issue date of the assessment. The appeal is also referred to as a protest. SC RP #20-1 outlines the appeal procedures.

Audit Program Checklist. A checklist needs to be completed for each audit and lists out the general steps needed to complete an audit from beginning to end. This checklist needs to be attached in DORWAY for each audit.

Audited Financial Statements. These are generally Balance Sheets, Income Statements and Cash Flow Statements that have been audited by Certified Public Accountants and an Opinion Rendered as to whether the statements are reported in accordance with Generally Accepted Accounting Principles. If the taxpayer is not a public company and not required to report a 10-K with the U.S. Securities and Exchange Commission, the Audited Financial Statements should be requested in the initial IDR.

Banks. Any person engaged in a banking business, except cash depositories. Banks are exempt from SC income taxes and license fee but a franchise tax based upon the entire net income is imposed. Entire net income is defined as income from any source whatsoever including interest on obligations of the United States, or its possessions or of any state or political subdivision.

Burden of Proof on Alternative Apportionment. It is the Department's burden of proof in determining that the taxpayer's statutory reporting method does not represent the taxpayer's business activity in SC and the alternative apportionment method used is reasonable. From SC RR #15-5: The party advocating an alternative apportionment method has the burden of proving by a preponderance of the evidence that: "(1) the statutory formula does not fairly represent the taxpayer's business activity in SC and (2) its alternative accounting method is reasonable." (*CarMax* SC)

Business Activity. Transactions and activities occurring in the regular course of a particular trade or business of the taxpayer.

Business Income. Income arising from transaction and activity in the regular course of the taxpayer's trade or business; it includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. There are two tests to determine business income: transactional test (Does the income arise from transactions and activities conducted in the regular course of the taxpayer's trade or business operations?) and functional test (Does the income come from property where the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade of business?).

Captive Insurance Company. A captive is an insurance company created and wholly owned by one or more non-insurance companies to insure the risks of its owner(s).

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Captive REITs. A Captive Real Estate Investment Trust (REIT) is created to take advantage of tax breaks provided to REITs. There are two types of captive REITs: rental REITs, which are typically used by multi-state retailers, and mortgage REITs, which are used by large banks.

Cash Sweeping. The action of moving the cash in a company's outlying bank accounts into a central concentration account, from which is the funds can be more easily invested.

C Corporation. A legal structure for a corporation in which the owners, or shareholders, are taxed separately from the entity.

Certificate of Authority. By obtaining a Certificate of Authority from the SC Secretary of State, a foreign corporation or a foreign limited liability company, whether or not taxed as a corporation, agrees to be subject to the jurisdiction of the Department and SC courts to determine its SC tax liability, including withholding and estimated taxes, together with related interest and penalties, if any. Obtaining a Certificate of Authority is not an admission of tax liability. SCCL §§33-15-105(d) and 33-44-1002(c)

NOTE: The Department has never argued that merely obtaining a Certificate of Authority creates nexus.

Certificate of Compliance. A certificate issued by the department as prima facie evidence that the tax has been paid, that the return has been filed, or that information has been supplied as required.

Combined Report or Combined Unitary Filing. A combined report is a report in which the business income and apportionment factors of a unitary group of corporations are combined for purposes of determining each taxpayer's share of the unitary business income[3]. SC does not provide for combined reporting unless an agreement is reached with the taxpayer or the Department determines it is appropriate.

Commerce Clause. United States Constitution Article 1, Section 8, Clause 3 states that the United States Congress shall have power to regulate Commerce with foreign Nations, and among the several States, and with the Native American Tribes. This includes the Foreign Commerce Clause, Interstate Commerce Clause and Indian Commerce Clause.

Commercial Domicile. The principal place from which the trade or business of a taxpayer is directed or managed.

Commission Decision (CD). An older decision from the department comparable to a department determination issued today.

[3] From page 5 of MTC manual

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Common Officers and Directors. Common officers and directors may indicate the unitary nature of businesses through centralization of management and communication between management of the businesses.

Common Ownership and Control. Common ownership does not exist unless the corporation is one which is a member of a group of two or more corporations more than 50 percent of the voting stock of each member of which is directly or indirectly owned by a common owner or by common owners, whether they be corporate or non-corporate entities, or by one or more of the member corporations of the group[4].

NOTE: All entities within a unitary combined return must be commonly owned.

Consolidated returns. A consolidated return is a single income tax return filed by two or more affiliated corporations subject to Corporate Income Tax. On a consolidated return, income or loss is determined separately for each corporation and combined and reported on a single return for the controlled group. Credits and credit carryforwards are used on a consolidated basis. Also see SC Consolidated Corporate Income Tax Return.

NOTE: Federal Consolidated Income Tax Return eliminates intercompany transactions.

Controlled group. A Controlled Corporation for purposes of filing a SC Style Consolidated return means the ownership of at least eighty percent of the total combined voting power of all classes of stock. SCCL §12-6-5020 (A)(2)

Corporate Minutes. The minutes taken by the board of directors of a company, including the minutes of any committee or subcommittee of the board of directors. The minutes are highly confidential and generally, may only be reviewed if permitted at the corporate headquarters or the location of the corporate minutes.

Cost of Performance. Service revenue is sourced to the state where the greater cost of performing the service occurs. Depending on the laws a specific state, either 100% of the sale is sourced to where the greater cost is located or a portion of sale is sourced to where the greater cost is located. SC has not adopted the cost of performance method for sourcing sales (see income producing activity).

Department Determination (DD). This is a report laying out the Department's Final Decision in a protested/contested tax matter. Department Determinations are issued by the Department's legal Department. If the taxpayer does not agree with the Department's Determination, they may request a contested hearing before the Administrative Law Court.

Disregarded Entities. Entities that elect to be disregarded as a separate entity for federal income tax purposes. These entities are considered to be divisions of its owner. If the entity makes the election for federal income tax purposes, they are also a disregarded entity for SC purposes.

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[4] From MTC manual

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Domestic International Sales Corporation - DISC. A DISC is a corporation which files the federal Form 1120-DISC or Form 1120-IC-DISC. SC conforms to the federal treatment of interest charge domestic international sales corporations (IC-DISCs) and exempts them from its corporate income tax. SCCL §12-6-40

DORWAY. The tax system used by the Department.

Due Date of Return. Returns must be filed on or before the 15th day of the 4th month following the taxable year, pursuant to SCCL §12-6-4970, unless they meet one of the following exceptions. S corporations and partnerships must file on or before the 15th day of the 3rd month. Foreign corporations that do not maintain an office or place of business in the U.S. must file on or before the 15th day of the 6th month. Organizations exempt under IRC §501 reporting unrelated business income pursuant to SCCL §12-6-4910(8) must file on or before the 15th day of the 5th month. Information returns provided in SCCL §12-6-4950 must be filed on or before March 15th each year. An extension up to 6 months may be granted to file a return pursuant to SCCL §12-6-4980. If the taxpayer has been granted an extension for federal income tax purposes, the taxpayer does not have to request the extension but needs to provide a copy of the federal extension form. Taxes are due must be paid at the time the return is due without regard to an extension of time to file the return. If the taxpayer has not been granted an extension for federal income tax purposes, the taxpayer must request an extension to file by submitting tentative return and full payment of any income tax and license fee.

Due Process. This clause guarantees "due process of law" before any government may take away an individual's "substantive" rights of "life, liberty, or property". The clause protects taxpayers against arbitrary state action. The U.S. Supreme Court has ruled that a tax statute that is so arbitrary that it amounts to the confiscation of property violates the Due Process Clause (*A. Magnano Co. v. Hamilton* (1934) 292 US 40). Double taxation does not violate Due Process unless it is arbitrary (*Shaffer v. Carter* (1920) 252 US 37).[5]

East/West Companies. Companies that are generally members of a unitary business divided into two corporations. The west company is located in a state where combined unitary reporting including both the west and east company is required. The east company is located in a state where separate entity reporting is required. The east company pays the west company for the use of intangibles, management fees, or other services generating an expense for the east company. The west company's income is not increased by these payments since the west company is already filing a combined unitary report that includes the east company. Per SC RR #15-5, the department has required or approved combined unitary reporting as a reasonable alternative apportionment method in situations involving east/west companies within a unitary group.

Economic Nexus. State nexus (Corporate income and license fee, sales and use) nexus created through the economic presence of a taxpayer.

[5] From Checkpoint

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Economic Presence Nexus. Economic Presence Nexus is a legal term that refers to the requirement for entities conducting business in a state, including professional service firms, to collect and pay tax on income derived in that state even though the business may lack a physical presence[6]. With regard to SC, corporate income and license fee nexus SC has been an economic nexus state since the *Geoffrey* (SC) case was decided in 1994.

Eliminations. Also called Consolidating Eliminations. Most software taxpayers use to prepare a federal consolidated return have eliminating or consolidating Elimination Schedules that show intercompany transactions that have been eliminated in preparation of the federal consolidated return. This is something that should always be requested for audits. The auditors need to know the various intercompany transactions among the affiliates included in the federal consolidated return to properly audit a SC filer.

Excel Template. Preset Layouts of excel workpapers for entering data for various type audits including Unitary Combined audits, separate entity audits, NOL Schedules, Tax credit schedules, etc. These can be found under the foreign audit SharePoint site. Please remember, these schedules are used by various auditors and the totals and formulas need to be verified for correctness.

Extended Due Date of the Return. The statutory filing date for a SC return has been allowed to be extended. SC accepts the extended due date for a federal return. The extended due date is the 15th day of the tenth month of the taxable year for SC 1120 filers. (SCCL §§12-6-4970 and 12-6-4490)

Factor Presence Nexus. Many states (SC is not one of them) have established a factor presence standard that establishes Corporate Income Nexus and required sourcing or Income to the state based on the amount of property or payroll or Sales/receipts in the state for Nonresident taxpayers. SC does have a nexus standard for sales tax. The sales nexus standard is 100,000 of sales into SC per calendar year. (SC RR #18-14)

Failure to File Return Penalty. In the case of failure to file a return on or before the date prescribed by law, determined with regard to any extension of time for filing, there must be added to the amount required to be shown as tax on the return, a penalty of five-percent of the amount of the tax if the failure is for not more than one month, with an additional five percent for each additional month or fraction of the month during which the failure continues, not exceeding twenty-five percent in the aggregate. SCCL §12-54-43(C)(1)

Failure to Pay Penalty on tax shown on Return Filed. In case of failure to pay the amount shown as tax on any return on or before the date prescribed by law, determined with regard to any extension of time for paying, there must be added to the tax due a penalty of one-half of one percent of the amount of the tax if the failure is for not more than one month, with an additional one-half of one percent for each additional month or fraction of the month, during which the

[6] From www.otcpas.com/advisor-blog/what-economic-presence-nexus/

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failure continues, not exceeding twenty-five percent in the aggregate. SCCL §12-54-43 (D)

Failure to Pay Penalty on Tax Not Shown on Return. In case of failure to pay any amount of any tax required to be shown on a return which is not shown, including an assessment within ten days of the date of the notice and demand for payment, there must be added to the amount of tax stated in the notice and demand one-half of one percent of the amount of the tax if the failure is for not more than one month, with an additional one-half of one percent for each additional month or fraction of a month during which the failure continues, not exceeding twenty-five percent in the aggregate. SCCL §12-54-43(E)

FDIC website. Federal Department of Insurance Corporation. Search FDIC and the website will come up. The Federal Deposit Insurance Corporation (FDIC) is an independent agency created by Congress to maintain stability and public confidence in the nation's financial system. To accomplish this mission, the FDIC insures deposits; examines and supervises financial institutions for safety, soundness, and consumer protection; makes large and complex financial institutions resolvable; and manages receiverships. Go to Bank Find in the FDIC website to locate financial information on Banks you are auditing. Various information that may be helpful in your research include Bank income statements, Balance Sheets, Locations by State. Deposits by States etc.

Federal consolidated return. Filing method under federal law which allows commonly controlled corporations (over 80 percent ownership) to file a single tax return and pay one tax amount. Intercompany transactions are eliminated in arriving at consolidated taxable income.

Federal Form 1118. Corporations use this form to compute their foreign tax credit for certain taxes paid or accrued to foreign countries or U.S. possessions.

Federal Form 1120-F. Form 1120-F is used for foreign corporations to report income, gains, losses, deductions and credits against any tax liability in the United States. If a foreign corporation overpaid taxes during the tax year, Form 1120-F is used to request a refund. If a foreign Corporation has nexus in SC, the taxpayer should file an SC 1120 to report the SC activity reflected on the federal form 1120-F.

Federal Form 1120 pro forma. Tax return prepared for each subsidiary of a federal consolidated group and is not the Form 1120 submitted to the IRS.

Federal Form 5471. An information return filed with the IRS for foreign corporations owned by taxpayers domiciled in the U.S.

Federal Form 8858. An information return filed with the IRS for foreign disregarded entities owned by taxpayers domiciled in the U.S.

Federal Form 8865. An information return filed with the IRS for foreign partnerships owned by taxpayer domiciled in the U.S.

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Federal Form M-3. Corporations and other entities file Schedule M-3 to answer questions about the financial statements and reconcile financial Statement net income (loss) for the corporation to net and taxable income on the federal Form 1120. Corporations and Partnerships with 10 million in total assets are required to file form M-3.

Fifty-one State Breakdown of Sales/Receipts. This is a breakdown of the sales by the 50 states and the District of Columbia. This should be part of the initial IDR.

Foreign Corporation. Any corporation incorporated outside of SC. This can also refer to a corporation that is incorporated outside of the United States.

Foreign-Derived Intangible Income (FDII). The TCJA created an incentive for exporters and service providers performing services for non-U.S. persons in the form of a deduction for FDII. Domestic corporations, including domestic corporate U.S. shareholders of a controlled foreign corporation, are entitled to a deduction of the domestic corporation's portion of intangible income that is derived from serving foreign markets. For tax years beginning after December 31, 2017 and before January 1, 2026, the deduction is 37.5% of the FDII. For tax years beginning after December 31, 2025, the FDII deduction is reduced to 21.875% (IRC §250(a)(1)(A)).

Foreign Dividends. Dividends received from foreign corporations (located outside of the United States). There are other offshore receipts reported as dividends (line 4 of the federal Form 1120) that are not foreign dividends per se, including IRC §965(a) inclusion, Subpart F inclusion, Global Intangible Low-Taxed Income (GILTI), and IRC §78 Gross up for foreign taxes paid.

Foreign exchange losses/gains. A foreign exchange gain/loss occurs when a company buys and/or sells goods and services in a foreign currency, and that currency fluctuates relative to their home currency. It can create differences in value in the monetary assets and liabilities, which must be recognized periodically until they are ultimately settled. IRC §988 requires the taxpayer to include the foreign gains/losses in the Federal taxable Income.

Foreign Sales Corporation (FSC). An FSC acts as a middleman between U.S. Corporations and foreign corporations. FSCs are granted certain tax incentives for export activity. Most of these corporations have been phased out.

Gig worker. A person that earns income providing on-demand work, goods, or services, often through digital platforms. Examples of gig work include, but are not limited to, driving a car for booked rides or deliveries, renting out property, running errands or completing tasks, selling goods online, providing creative or professional services, or providing other temporary, on-demand, or freelance work.

Digital platforms are apps or websites used by businesses to match workers' services or goods with customers. Examples of digital platforms include, but are not limited to, ridesharing services, delivery services, crafts and handmade item marketplaces, on-demand labor and repair services, and property and space rentals.

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Global Intangible Low-Taxed Income (GILTI). GILTI is the income earned by foreign affiliates of US companies from intangible assets such as patents, trademarks, and copyrights. The TCJA enacted a new IRC §951A. This section requires US shareholders of controlled foreign corporations to include in gross income the shareholder's GILTI for years in which they are US shareholders of CFCs. GILTI is determined on Schedule I-1 of federal Form 5471.

Gross-up (IRC §78). The amount of income the domestic parent is required to include in its gross income on Schedule C of the federal Form 1120. This amount is equal to the amount of "deemed paid" foreign taxes. The deemed paid foreign taxes are a portion of the foreign taxes actually paid by the foreign subsidiary.

Horizontal integrated companies. The primary focus of Supreme Court cases involving horizontal companies has been the economies of scale resulting from centralized purchasing rather than centralized management. The court has also considered other issues such as intercompany financing, common use of facilities, interflow of personnel, common identity, and common benefit agreements. Other aspects of horizontal companies that may indicate a unitary business relationship may be company advertising, standardized marketing and operating systems, and common layouts. Examples of such companies are McDonalds, Wal-Mart, and Safeway.

Imputed Intercompany Interest Income/Expense. Each month, the IRS provides various prescribed rates for federal income tax purposes. These rates, known as Applicable Federal Rates (or AFRs), are regularly published as revenue rulings and are available on the IRS website. AFRs are used for loans that are considered to be below-market loans, which are defined as loans in which the stated interest rate is lower than the rate required for tax purposes. Various types of below-market loans exist, such as gift loans, compensation-related loans and corporation-shareholder loans. As noted above, AFRs are used for a number of federal tax provisions to determine the appropriate amounts under a multitude of provisions such as: Loans with below-market interest rates, under IRC §7872 (such as gift loans, compensation-related loans, corporation/shareholder loans and tax avoidance loans). SC will impute interest on corporation/shareholder loans pursuant to IRC §7872, which SC has adopted, if no interest is charged or the interest is below market. (SC CD #94-44)

Income Producing Activity (IPA). The event that generates the income. Receipts are sourced to SC if the IPA occurs within SC pursuant to SCCL §12-6-2295(A)(5).

Information Document Request (IDR). Written requests that the Department sends to the taxpayer to request the information needed to complete the audit.

Information to Attach in DORWAY. No hard copies of audits are maintained so it is necessary for the auditor to attach all audit schedules, returns and other relevant information under the audit in DORWAY. The audit program/checklist shows the relevant information which should be attached in DORWAY.

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Initial Annual Report. An initial annual report and a license fee of $25 must be filed with the Secretary of State with the articles of incorporation filed by a domestic corporation or with the application for certificate of authority filed by a foreign corporation. The Secretary of State sends the initial annual report to the Department. A foreign corporation that does not file an application for certificate of authority with the Secretary of State must file the initial annual report and pay the initial license fee of $25 to the Department on or before 60 days after initially doing business or using a portion of its capital in SC. The initial annual report of corporations is filed on Form CL-1, "Initial Annual Report of Corporations." (SCCL §§33-1-220 and 12-20-40)

Initial IDR and audit confirmation Letter. Once an audit has been confirmed an audit confirmation letter and initial Information Document Request (IDR) is sent to the taxpayer. Refer to the foreign audit SharePoint site for information to be included in the audit confirmation letter and initial IDR.

Insurance Company. A company that offers insurance policies to the public, either by selling directly to an individual or through another source such as an employee's benefit plan. An insurance company is usually comprised of multiple insurance agents. An insurance company can specialize in one type of insurance, such as life insurance, health insurance, or auto insurance, or offer multiple types of insurance. Insurance companies are exempt from paying the SC income tax and license fee. (SCCL §12-6-550)

Intangibles. Not tangible, incapable of being perceived by the sense of touch. Some of the intangibles we deal with include intellectual property such as royalties, patents, goodwill. Other intangibles include services, fees, interest, dividends and gains/losses from the sale of intangibles and gains/losses from the sale of stock.

Intercompany Contracts/Agreements. If the taxpayer has intercompany transactions between affiliates (domestic and foreign), the intercompany contracts/agreements should be requested in the initial IDR along with transfer pricing studies (also called IRC §482 studies). If there is shifting of income, these agreements will be helpful in documenting the shifting. (See Transfer Pricing)

Intercompany Eliminations. SC is a separate entity state so there are no intercompany eliminations to income, expense deductions, and SC and everywhere sales/receipts. However if the taxpayer files or is required to file on a unitary combined basis, all intercompany income, expenses deductions and SC and everywhere sales/receipts are eliminated from the unitary combined return.

Intercompany Financing. Loans between Affiliates (Domestic and Foreign). These loans should be at arm's length. The initial IDR should request the loan agreements, a breakdown of interest and principal payments by audit year and entity paid to/received from along with the 482 studies and evidence that the taxpayer has paid the interest and principal and the business purpose of the loans.

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Intercompany Management. Management Services between related entities (Domestic and Foreign). The Initial IDR should include a request for the Intercompany Management Agreements along with a yearly breakdown of the intercompany payments and receipts by entity and audit year. The intercompany management charges should be closely examined to determine if the taxpayer is engaged in tax planning which shifts income from one entity to another.

Intercompany Sales. Sales (usually tangible property or services) between related entities (Domestic and Foreign). The Initial IDR should include a request for the Intercompany Sales Agreements along with a yearly breakdown of the intercompany Sales and payments by entity and audit year. The intercompany Sales should be closely examined to determine if the taxpayer is engaged in tax planning which shifts income from one entity to another.

Interest Charge Domestic International Sales Corporations (IC-DISCs). SC conforms to the federal treatment of IC-DISCs and exempts them from its corporate income tax. An IC-DISC offers a significant federal income tax savings for making or distributing U.S. products for export. It is not a tax shelter but creates permanent tax savings by transferring income from the exporter to the tax-exempt IC-DISC through an export sales commission. IRC §992. (SCCL §12-6-40)

Interest on underpayment and overpayment. The interest rate to be applied to underpayments and overpayments of taxes is computed the same as the IRS (SCCL §12-54-25). The rate is compounded daily except simple interest applies to the underpayment of declaration of estimated tax.

NOTE: Reduction of interest rate on refunds. For fiscal year 2020-2021 (July 1, 2020 through June 30, 2021), Budget Provisos 41.2 and 117.85 directs the Department to reduce the rate of interest paid on eligible refunds by a total of three percentage points from the above listed rates. 2020 S.C. Act No. 135, Provisos 41.2 and 117.85. In each state legislation session, a budget proviso is generally issued to reduce the overpayments by 3%. The policy section publishes an Information Letter every three months that provides the most recent update to the federal interest rate on over and under payments.

Interstate Motor Carriers. An interstate carrier provides transportation services across state borders and is required to register with the US Secretary of Transportation. Motor carriers of property and passengers source its SC and Everywhere Receipts using a fraction in which the numerator is vehicle miles within this State during the taxable year and the denominator is total vehicle miles everywhere during the taxable year. (SCCL §12-6-2310 (2))

IRC §382 Limitation. SC generally conforms to IRC §382 if the loss corporation conducted business entirely within SC. However, limitation amount will depend on whether the loss corporation conducts its entire business within SC, or conducts its business partly within and partly without SC, during the taxable year that the ownership change occurs. (SCCL §§12-6-40(A)(1)(a) and 12-6-50(5B); SC RR #16-7)

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IRC §482 Study. This study supports the transfer pricing between affiliated entities (Domestic and Offshore). The purpose of the study is to support the requirement of IRC §482. Refer to Transfer Pricing and 482 Study.

IRC §965. Deemed repatriations of cash and cash equivalents are subject to an effective federal rate of tax at 15.5%; any remaining earnings are subject to an effective rate of 8%. A U.S. shareholder is allowed a participation exemption deduction that varies in amount to achieve the desired effective rates of 15.5% and 8% instead of directly imposing these rate on the deemed repatriated amounts. (IRC § 965(c)(1))

Legal Domicile of an entity. This is the state or country where the entity is incorporated or organized.

License Fee. The license fee is $15 plus $1 for each $1,000, or fraction, of capital stock and paid-in or capital surplus shown on the corporate records on the first day of the tax year. The minimum license fee is $25.

Line of Business. Line of business (LOB) is a general term that refers to a product or a set of related products that serve a particular customer transaction or business need. In some industry sectors, like insurance, "line of business" also has a regulatory and accounting definition to meet a statutory set of insurance policies. Determining the taxpayer's business activity or LOB within SC is important part of the audit. The LOB will determine how Sales/Receipts will be sourced to SC and if the taxpayer has affiliates if the LOB among the affiliates is unitary.

Location of Income Sourcing. With Regard to sourcing of receipts if the Income is produced in SC then the location of the income producing activity would be SC pursuant to SCCL §12-6-2295(A)(5).

Management Fee Company. A company that is generally a member of the unitary business group that provides general management services to related operating companies for a fee. This fee may be calculated as a percentage of gross profits from the operation companies. Per SC RR #15-5, the department has required or approved combined unitary reporting as a reasonable alternative apportionment method in situations involving management fee companies within a unitary group.

Market Sourcing. Service revenue is allocated to the state in which the benefit of the service is received. SC has not adopted market sourcing (see income producing activity).

Matching Principle. The principle of matching income not taxable in SC since it was generated wholly outside SC with the expenses that generated that non-taxable income is firmly established as the law in SC. Refer to the Matching Principle section for more information.

Modifications. Changes made on the SC 1120 to the corporation's federal gross income to arrive at SC gross income.

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Multistate Tax Commission (MTC). An entity charged with studying state and local tax systems, developing and recommending proposals for improvement and increased uniformity of state and local tax laws, and administering the Multistate Tax Compact. States join the MTC by enacting the Multistate Tax Compact.

Multistate Tax Compact. An agreement among participating states to facilitate the uniform administration of state taxes for multistate taxpayers. The Compact incorporates UDITPA, and establishes the Multistate Tax Commission (MTC).

Negligence Penalties. If part of an underpayment of tax or part of a claim for refund of tax paid is due to negligence or disregard of regulations, there must be added to the tax an amount equal to the sum of five percent of the underpayment or claimed refund and an amount equal to fifty percent of the interest payable under SCCL §125425. (SCCL §12-54-43(E))

Net Capital Losses. For federal purposes, corporations must include capital gains in gross income but only to the extent that capital gains exceed capital losses. Generally, a corporation that has a net capital loss in a given year may carry that loss back three years and forward five years. (IRC §1211) For SC purposes, however, capital loss carrybacks for corporations are disallowed. Capital losses for federal and SC purposes may be carried forward for five years. (SCCL §12-6-1130(5))

Nexus. A sufficient connection with a state and a taxpayer which allows the state to subject the taxpayer to its taxing jurisdiction.

NOLs. Net Operating Losses. The result when a company's allowable deductions exceed its taxable income within a tax period. The net operating loss may be carried over. In SC, the carryforward is 20 years. Refer to Computation of Net Income.

Non-Business Income. All income other than business income.

Non-Refundable Credit. A tax credit that applied to tax due that only reduces that tax liability to zero. The tax liability cannot below zero and any excess credit cannot be refunded to the taxpayer.

Office of the Comptroller of the Currency. The Office of the Comptroller of the Currency (OCC) is an independent bureau of the U.S. Department of the Treasury. The OCC charters, regulates, and supervises all national banks, federal savings associations, and federal branches and agencies of foreign banks. There are search engines in the website that may be helpful in determining the activity of banks, savings and loans and bank holding companies along with mergers with other entities.

Organization Structure. We in audit refer to the organization structure, within an enterprise, at which entities are C Corps, Banks, Partnerships, disregarded entities and who owns the various entities. The auditor must understand the organization structure to properly complete an audit. In the initial IDR, a flow chart of the organization structure is requested.

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Orphan Drug Credit. Drug Companies can claim an "orphan drug credit" for clinical testing expenses for the development of certain drugs pursuant to IRC §45C (b). If the taxpayer claims the credits on their federal return, the clinical expenses that were used to calculate the credit cannot be deducted on the federal return. Since the federal credits do not apply to SC, the taxpayer can take a deduction (report as a modification on Schedule B of the SC 1120), for the deductions disallowed on the federal return pursuant to SCCL §12-6-1130 (7).

Participation. An agreement between lenders to share a commitment to extend funds (if any), the extension of funds, and the credit risk for one or more credit facilities to a borrower. Usually evidenced by a written agreement.

Preliminary Draft of Audit Adjustments. This is the initial Draft of the audit adjustments which is sent to the taxpayer before the Final Audit Adjustments (Proposed Assessment) is sent to the taxpayer. The purpose of the preliminary draft is to make the taxpayer aware of audit adjustments and allow time for the taxpayer to respond with additional information that may result in audit adjustments. The taxpayer has one month from the date the preliminary draft was sent out to respond.

Private Letter Rulings (PLR). The primary vehicle for responding to advisory opinion requests from outside the Department. A PLR is an official advisory opinion issued by the Department to a specific person. A PLR may only be relied upon by the person to whom it is issued for the transaction to which it relates. A PLR has no precedential value.

Proposed Assessment. This is the Final Audit Assessment sent to the taxpayer by the auditor. Pursuant to SC RP #20-1, the taxpayer has 90 days to pay the assessment or appeal the assessment.

Public Law 86-272. Public Law 86-272 (15 USCA 381) was enacted by the United States Congress in 1959 to limit a state's ability to tax interstate commerce. It provides that a state cannot impose a net income tax on a business if the only business activities within the state are limited to solicitation of sales of tangible person property, which orders are sent outside of the state for approval or rejection, and if approved, are filled shipment or delivery from a point outside of the state.

Purchasing Company. A company that is generally a member of the unitary business group that handles all, or substantially all, inventory purchases for a related retail company which in turn sells the inventory to customers in SC. Per SC RR #15-5, the department has required or approved combined unitary reporting as a reasonable alternative apportionment method in situations involving purchasing companies within a unitary group.

Qualified Subchapter S Subsidiaries. Only one SC S Corporation Income Tax Return (SC1120S) is needed for the S Corp and the QSSS. Do not file a separate SC1120S for each entity. Compute the items of income, deduction, and credit using the apportionment ratio(s) of the "composite" S corporation. In other words, the items of income, deduction, and credit of the

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subsidiary are treated as if the subsidiary was a division of the S Corporation. Refer to SC RP #98-1. SC RP #98-1 was modified by SC RR #05-11 to require the S Corp and the QSSS to pay only one license fee.

RAR. Revenue Agent Reports are the documents sent to the taxpayer by the IRS detailing and explaining the audit adjustments.

Refundable Credit. A tax credit that is applied to the tax liability in an amount below zero. The difference in the amount of the credit and tax owed is refundable and can be paid the taxpayer in form of a refund.

Reinsurance. A means by which an insurance company can protect itself against the risk of losses with other insurance companies. Individuals and corporations obtain insurance policies to provide protection for various risks (hurricanes, earthquakes, lawsuits, collisions, sickness and death, etc.) Reinsures, in turn, provide insurance to insurance companies.

REIT. A real estate investment trust. Files the federal Form 1120-REIT. (See section on Captive REITs)

REIT Holding Company. The company that owns most of the stock in the REIT and is required to report the dividends without a dividends received deduction.

Related Expense Addback. SC allocates certain items of income (less related expenses) both to and away from the state. Items of income that are directly allocated to the state are excluded from the apportioned income and the apportionment factors[7]. (SCCL §12-6-2220) After allocation, the balance of the income is apportioned. (SCCL §12-6-2240) (See also Matching Principle)

Representative Nexus. Refer to Nexus through Agency Relationship or Activity of a Third Party.

Revenue Procedure (RP). Intended to provide procedural guidance to the general public and Department personnel. It is a written statement issued to assist in the administration of laws and regulations by providing procedural guidance that may be followed in order to comply with the law. A Revenue Procedure does not have the force or effect of law, and is not binding on the public. It is, however, binding on agency personnel until superseded or modified by a change in statute, regulation, court decision, or advisory opinion.

Revenue Ruling (RR). Intended to provide guidance to the public and to department personnel. It is written statement issued to apply principles of law to a specific set of facts or a general category of taxpayers. A Revenue Ruling does not have the force or effect of law, and is not binding on the public. It is, however, the Department's position and is binding on agency personnel until superseded or modified by a change in statute, regulation, court decision, or advisory opinion.

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[7] From Checkpoint

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Royalty Deductions. Deduction to an affiliate or third payment allowing the entity to use intangible property (trademarks, patents etc.). The auditor should request a copy of the royalty licensing agreement. If the intangible personal property which the royalty fee is paid on is used in SC, the auditor should determine, pursuant to *Geoffrey* (SC), if the taxpayer has filed or should be filing in SC. If the intangible property which the royalty is paid on is licensed by a foreign affiliate and the intangible property is used in SC, the auditor should determine if nexus could be asserted on the foreign affiliate. If the foreign affiliate is exempt from filing a federal return (SCCL §12-6-1200) an addback of the royalty deductions pursuant to the matching principle should be considered.

Royalty Income. Income receive by the Licensor or Sub-Licensor from Licensee of Sub-Licensee allowing the Licensee or Sub-Licensee to use intangible property (trademarks, royalties). The auditor should request a copy of the royalty licensing agreement and determine if the intangible property has a situs. If so, the royalty income attributed to the intangible property should be included in SC Income and the amount of receipts with a SC situs should be sourced to SC.

S Corporation. A corporation that elects to file under Subchapter S for federal income tax purposes. If an entity is filing as an S Corporation for federal purposes, it must file as an S Corporation for SC purposes, unless its election was made before January 1, 1985. An S Corporation can own a C Corporation but a C Corporation cannot own an S Corporation.

Savings and Loan Associations. Any mutual or stock-chartered corporation insured by the Federal Savings and Loan Insurance Corporation or any corporation subject to regulatory supervision by the Federal Home Loan Bank, or the Savings and Loan Division of the SC Board of Financial Institutions, other than banks taxed under Chapter 11 of Title 12 of the SC Code, or employees' credit unions. Refer to Savings and Loans.

SC Consolidated Corporate Income Tax Return. SCCL §1265020. Authorizes the filing of a consolidated corporate income tax return with a parent and an eighty percent or more controlled subsidiary or subsidiaries. A consolidated return is a single return for two or more corporations where income or loss is separately determined and includes the following: (1) allocable income and (2) apportionable income/loss using separate apportionment for each entity without eliminating intercompany transactions.

All corporations must be on the same accounting year and are subject to tax under SCCL §12-6-530. If the corporations are entitled to one or more of the income tax credits, including carryover, the income tax credits must be determined on a consolidated basis. Limitations on credits that refer to income must be determined for the consolidated group. The election to consolidate must be made on a timely filed original return and cannot be changed after the return is filed. Once the election is made to consolidate, the election must be followed until permission is granted by the department to file separately. A multi-state corporation must compute and use a separate apportionment ratio in arriving at the SC taxable income and License Fee for each entity included in the consolidation.

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SEATA. Southeastern Association of Tax Administrators was Organized in 1951, SEATA's membership consists of the twelve (12) tax administration agencies of the states of Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, Virginia and West Virginia. As a 501(c)(6) organization, the purpose of the Association is to promote cooperation among the Southeastern states in taxation and tax related matters, to exchange ideas on tax administration and to share information which might be of benefit to the members of the Association.

Securitization. The process and the result of pooling financial assets together and issuing liability and equity obligations backed by the resulting pool of assets to convert those assets into marketable securities. The underlying assets are usually, but always, non-marketable by themselves. Any type of financial asset can be securitized. Securitized mortgage obligations may be called mortgage-backed securities or collateralized mortgage obligations. Securitized non-mortgage assets are typically called asset-backed securities however; the term collateralized debt obligation is increasingly used to refer to securitized corporate debts. A single loan or groups of similar loans may be securitized. Loans to be securitized must usually be underwritten with terms and documents that conform to wholesale market standards. For some securitizations, additional credit support, called credit enhancement, may be obtained through insurance, a letter of credit, over collateralization or other means. Many securitizations use multi-tranche structures that allocate the principal and interest cash flows from the underlying assets in patterns that create higher and lower risk securities. See collateralized debt obligation, collateralized mortgage obligation, mortgage-backed security, special purpose vehicle and waterfall.

Separate Company (Single Entity) Returns. Each company that has nexus in the state is required to file an income tax return. SC is, by statute, a separate entity state.

Situs. The place to which, for purposes of legal jurisdiction or taxation, a property belongs. For example, real property located in SC would have a SC situs. Loan Receivables (intangible Property) where the borrower is located in SC would have a SC situs.

SOS - Secretary of State. An initial annual report and a license fee of $25 must be filed with the SC Secretary of State with the articles of incorporation filed by a domestic corporation or with the application for certificate of authority filed by a foreign corporation. The SCSOS sends the initial annual report to SCDOR.

Sourcing. The determination used to assign sales to a specific state or location. There are different sourcing methods based on what is generating the revenue (e.g. sale of tangible products, services, etc.)

Special Apportionment Formulas. Refer to the definition of Sourcing for Specific Industries for certain type businesses that use a different method than Gross Receipts/Sales to source income to SC. Also, refer to the SC Alternative/Equitable apportionment SCCL §12-6-2320 which allows a different method (including a unitary combination pursuant to Media General) other than the statutory apportionment method to source income to SC if the statutory method does not fairly reflect the SC Income.

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Statute of Limitations. A period of time established by the Department of Revenue for assessing taxes. Generally, the SC Statute of Limitations is limited to three years from the date the return was filed or due to be filed (SCCL §12-54-85(A)) whichever is later. However, if a return is filed and it is determined that the tax is understated by 20% or more the statute of limitations is extended up to an additional three years. (SCCL §12-54-85(C)(3)) There is no statute of limitations if the taxpayer had a fraudulent intent to evade the tax (SCCL §12-54-85(C)(1)) or the taxpayer failed to file a required return (SCCL §12-54-85(C)(2)). For administrative purposes, the Department limits audits of non-filers to ten years.

Strong Central Management. Strong Centralized Management is one of the indicators of a Unitary Business activities which might otherwise be considered as part of more than one unitary business may constitute one unitary business when there is a strong central management, coupled with the existence of centralized departments for such functions as financing, advertising, research, or purchasing. Strong centralized management exists when a central manager or group of managers makes substantially all of the operational decisions of the business. For example, some businesses conducting diverse lines of business may properly be considered as engaged in only one unitary business when the central executive officers are actively involved in the operations of the various business activities and there are centralized offices which perform for the business activities the normal matters which a truly independent business would perform for itself, such as personnel, purchasing, advertising, or financing.

Substantial Understatement of Tax. SCCL §12-54-155 (B)(1)(a) is imposed if there is a substantial understatement of tax for a taxable period if the understatement of tax exceeds more than ten percent of the tax required to be shown on the return for the period or five thousand dollars. For an S Corporation or personal holding company defined by IRC §542, it is ten thousand instead of five thousand.

Substantial understatement penalties. If there is an underpayment attributable to either a substantial understatement of tax for a taxable period or a substantial valuation misstatement, there must be added to the tax an amount equal to twenty-five percent of the amount of the underpayment. (SCCL §12-54-155(A)(1))

Subpart F Income. Certain types of foreign source income is taxable at the federal level on Schedule C of the federal Form 1120. The amount of subpart F income includable in the domestic corporation gross income is limited to the domestic corporation's pro rata share of the earnings and profits of the foreign subsidiary. This is the case regardless of whether the foreign subsidiary makes any distributions to the domestic corporation. (See Federal Schedule C)

Tangible Personal Property. Personal property which may be seen, weighed, measured, felt, touched, or which is in any other manner perceptible to the senses. The selling price of inventory (tangible personal property) less returns and allowances received in SC is included in the numerator (SCCL §12-6-2280(B)). Sale of inventory to the United States Government is not included in either the numerator of denominator (SCCL §12-6-2280(C)).

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Tax Credits. An amount of money that can be offset against a tax liability. The credits dealt with in foreign audit are nonrefundable. The main credits which the auditor will audit will be job tax credits, capital investment credits and research expenses credits. There is a separate section in this manual discussing each of these credits.

NOTE: There are many other credits the auditor may deal with and will have to research the code of laws to determine what records and information are needed for verifying the credits.

Taxpayer. An individual or business entity that is obligated to file and pay taxes.

TCJA. Tax Cuts and Jobs Act (TCJA) of 2017 (P.L. 115-97).

Transfer Pricing. Transfer pricing refers to the pricing of transactions between controlled entities. For example, when an US parent (USP) sells a product to its controlled foreign corporation (CFC), IRC §482 requires USP to sell that product at an arm's length price to its CFC. Under IRC §482, controlled entities should price transactions in the same way that uncontrolled entities would under similar circumstances. This is the "arm's length standard", which means the price of the product that USP charges its CFC should be the same as it would charge to an unrelated party for the same product under similar circumstances.[8] Refer to the Transfer Pricing and 482 Study section.

UDITPA. The Uniform Division of Income for Tax Purposes Act provides a uniform method for attributing the interstate income of corporate entities amount the various states that have jurisdiction to tax the entity.

Unitary Business. A single economic enterprise that is made up either of separate parts of a single entity or of a commonly controlled group of entities that are sufficiently interdependent, integrated and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value amongst them and a significant flow of value to the separate parts. A unitary business is characterized by significant flows of value evidenced by factors such as those described in *Mobil Oil Corp. v. Vermont, 445 U.S. 425 (1980):* functional integration, centralization of management and economies of scale.[9] A business among the various components of which there exists flows of value which make it impossible to determine just how much the total income of the business was produced by each component. *Container Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983)* Such of flows of value will exist when the components "contribute to or are dependent upon each other, regardless of whether the business conducts its operations through one corporation or through several corporations. *Edison California Stores v. McColgan, 30 Cal. 2d (1947)*[10]

Unitary Net Adjustments. These are all the intercompany eliminations that have been made to the Federal Taxable Income, Intercompany Income, Expense Deductions, Numerator, and Denominator and are commonly called the Unitary Combined Workpapers.

[8] From seminar presented at SCDOR by MTC August 2019
[9] From MTC definitions
[10] From MT Reference Manual

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Utilities. Utilities is a catch all phrase for entities that are regulated by Public Service Commission of SC and the SC Office of Regulatory Staff. The regulated entities include electric utilities, electric cooperatives, gas companies, water and sewer entities and household goods carriers, hazardous waste carrier, certified passenger carrier, and transportation Network Carriers (ex Lyft and Uber).

Vertically integrated companies. The US Supreme Court has pointed out that vertically integrated companies usually constitute unitary businesses. The primary reason the court has given for treating vertically integrated companies as a unitary business is that they benefit from an umbrella of centralized management and controlled interaction. For example, the focus of the cases involving vertically integrated companies has been on the interaction between the various components in the long range planning rather than daily operations. In addition, the focus of these cases has also been on the development of functional policies and procedures. Other central management activities that have received attention include financing, accounting systems, legal advice, public relations, and personnel. Examples of companies that have these characteristics are large oil and gas companies and those such as Kennecot Copper, which uses production from its mines to produce various products.

Voluntary Filer. The Nexus Section handles all Voluntary filers. The SC Department of Revenue offers a voluntary compliance procedure for taxpayers who have nexus with SC but are not registered with the Department to collect or remit SC taxes. The procedure is designed to encourage non-filers to come forward voluntarily and begin paying taxes without incurring penalties, and to allow the Department to maximize compliance with its limited audit resources. (SC RP #20-2)[11]

Waivers. SCCL §12-54-85(A)(C)(4) permits the taxpayer to sign a waiver to extend the statute of limitations beyond thirty-six months if additional time is needed to complete the audit for assessing additional tax. Waivers are a SCDOR form, the auditor and the taxpayer sign to waive the statute of limitations for assessing taxes. The foreign audit toolbox has a blank waiver of the statute of limitations form. The waiver must be executed before the statute of limitations has expired.

Water's Edge. A method of combined filing including the nationwide income of a unitary business group. SC will generally use a "water's edge" approach for determining the apportionable income of a combined unitary business group per SC RR #15-5. Refer to Unitary Combinations.

White Pages. These are the federal consolidating workpapers that show the breakdown of Income, expense deductions and Net taxable income and beginning and ending balance sheet for each entity included in the federal consolidated return. It is probably the most important item to review in an audit of a federal consolidated return.

[11] From Checkpoint

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Worldwide Combination. A filing method to include any entities in a unitary relationship with its domestic and foreign subsidiaries. All income and apportionment factors include all members of the unitary group. This method is not used in SC unless the taxpayer requests it.

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State of South Carolina

C Corporation Income Tax Return

Form SC 1120

Part I – Computation of Income Tax Liability

The taxable income as shown on the federal tax return is the basis of the SC return, with certain adjustments for federal and state differences. The SC gross income and taxable income of a corporation is the corporation's gross income and taxable income as determined under the Internal Revenue Code subject to the modifications required by state law. (SCCL §12-6-580)

Line 1. Federal taxable income from federal tax return – For separate entity returns, this will be Line 30 of the proforma federal Form 1120. When comparing the federal proforma and the federal consolidated white pages, there may be some discrepancy due to differences in state limitations for items such as capital gains and losses, contributions, dividends, etc.

For consolidated returns, line 1 is the sum of each entity's line 30, without intercompany eliminations.

For combined returns, the beginning point usually is line 30 of the consolidated federal Form 1120, unless a different unitary business group is used.

Line 2. Net adjustment from Schedule A and B, line 12. SC income tax laws conform substantially to the federal income tax laws, with some exceptions (see SCCL §12-6-50 for the list of IRC sections specifically not adopted by SC). State modifications are the adjustments needed to reconcile federal taxable income to state taxable income (SCCL §12-6 Article 9). See Schedule A and B for details on additions to, and deductions from, federal taxable income.

For consolidated returns, line 2 is the sum of each entity's net adjustments.

For combined returns, line 2 is the unitary net adjustments.

Line 3. Total net income as reconciled. It's the sum of line 1 and line 2. Also known as income subject to *allocation* and *apportionment*.

Line 4. If multi-state corporation, enter amount from Schedule G, line 6; otherwise, enter amount from line 3. Income/losses subject to direct allocation, net of related expenses (Schedule F) is subtracted from the net income as reconciled to arrive at total net income subject to apportionment, which is then multiplied by the SC apportionment ratio to calculate the SC proportion (Schedule G). Net amounts allocated directly to SC are added to the SC proportion to arrive at SC net income.

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For consolidated returns, line 4 is calculated separately for each corporation.

Line 5. SC Net operating loss (NOL) carryover, if applicable. The SC NOL is computed for each applicable year. SC recognizes the federal NOL with modifications as provided in SCCL §12-6-1130(4) and it is subject to allocation and apportionment in the year the loss is incurred. SC follows the federal NOL carryforward period, but no carrybacks are allowed. The NOL carryover from previous years is entered on line 5.

SC NOLs may be limited under IRC §§269, 381, and 382. IRC §269 limits certain NOL deductions obtained through the acquisition of stock or property where the taxpayer's principal purpose was tax avoidance. IRC §§381 and 382 limit the use of NOL carryovers when there has been a substantial change in the corporation's ownership. SC has not, however, adopted the IRC consolidated return sections or regulations. (SCCL §12-6-50(15))Therefore, the "separate return limitation year" or "SRLY" rules and the rules with respect to the application of IRC §382 to consolidated groups do not apply to limit NOL deductions.

The IRC §382 limitation for SC purposes depends on whether the loss corporation conducts its entire business within SC or conducts its business partly within and partly without SC during the taxable year the ownership change occurs. If the loss corporation conducted its entire business within SC, the federal 382 limitation and the SC 382 limitation generally will be the same. However, if for the taxable year the ownership change occurs, the loss corporation conducted its business partly within and partly without SC and apportioned its SC income/losses, the SC 382 limitation is calculated by apportioning the federal 382 limitation using the SC apportionment ratio for the taxable year that the ownership change occurs. (SC RR #16-7)

For consolidated returns, the NOLs are calculated on a separate entity basis. NOLs are allowed to offset income from other members in the SC consolidated return. However, the NOLs must be tracked on a separate entity basis. If there are any entities that were sold or their assets disposed of to a third party, the losses are no longer available for this SC consolidated group. They may be available by the third party but may be limited by IRC §382.

For unitary combined returns, all members will be allowed to use the SC NOLs of all members of the combined unitary group.

Line 6. SC net income subject to tax. The SC NOL (line 5) is subtracted from the SC net income (line 4) to arrive at the SC income subject to tax (line 6).

For consolidated returns, the net income of all the entities is added together to determine the taxable income for the whole group.

Line 7. Tax. Multiply line 6 by .05 (5%). The SC corporate income tax is imposed annually at the rate of five percent (5%) on the SC taxable income of every corporation, unless specifically exempted (SCCL §§12-6-530, 12-6-540 and 12-6-550). SC does not provide for a minimum tax liability or an alternative tax.

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For consolidated returns, the tax rate is applied to the taxable income of the whole group, not separately to each corporation.

Line 8. Tax deferred on income from foreign trade receipts. Election by a corporation who has receipts from invoices issued by a seller directly to an unrelated purchaser outside the United States (foreign trade receipts) and wishes to defer state Income Tax. Computation done by using SC Schedule TD-1. **This is not common**.

Line 9. Balance. Subtract line 8 from line 7.

Line 10. Nonrefundable Credits/Credit carryover. Amount of nonrefundable credits being taken against income tax this year. This amount comes from part I, line 13, column C of the SC 1120-TC. Any credits that are not being used this year but are carried forward to future years are entered as the credit carryover. Corporations must attach the SC 1120-TC and all supporting tax credit schedules to their tax return.

The most common credits that can be taken against income tax are New Jobs Tax Credit, Capital Investment Credit and Research and Development Expenses Credit.

For consolidated returns, the tax credits, including the carryover of unused credits, must be determined on a consolidated basis. Limitations on credits which refer to the income or the income tax liability of a corporation are deemed to refer to the consolidated group. Credits reduce the consolidated group's tax liability regardless of whether or not the corporation entitled to the credit contributed to the tax liability. (SCCL §§12-6-3480(2) and 12-6-5020(F))

For unitary combined returns, the eligibility for and calculation of a tax credit amount is determined at the separate entity level, but can be used against the unitary group income.

Line 11. Balance of tax. Difference between line 9 and line 10, but not less than zero. This is the amount used as **"Paid per return"** to be compared to the audit results in order to determine any underpayment (balance due) or overpayment (refund) of income tax by the Taxpayer.
For audit purposes, we typically don't use information on lines 12 through 19, unless there is a question regarding actual payment of the tax reported on the original return being audited.

Part II – Computation of License Fee

The SC license fee is a tax imposed on the privilege of doing business as a corporation in the state. The license fee is paid in advance of the taxpayer's income tax year. The measure of the license fee is usually based upon the capital stock and paid-in or capital surplus (SCCL §12-20-50), except for certain companies, such as waterworks companies, power companies, electric cooperatives, gas companies, telephone companies, and express companies, which pay the license fee based on gross receipts and property (SCCL §12-20-100) (see License Fee).

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Line 20. Total capital and paid in surplus. Multi-state corporations multiply their capital by their apportionment ratio. See Schedule E.

NOTE: The amount of capital stock and additional paid-in capital can be verified with either page 5 of the proforma federal Form 1120, Schedule L "End of tax year" column, or with the federal consolidated white pages, Sch. L – Ending schedules, in the column for the specific corporation.

Line 21. License Fee. The annual license fee is $15 plus one dollar for each thousand dollars of capital stock and paid-in or capital surplus of the corporation. Multiply line 20 by .001 (0.1%) then add $15. The minimum license fee is $25.

Line 22. Credits taken this year/Credit carryover. Amount of nonrefundable credits being taken against the license fee this year. This amount comes from part II, line 7, column C of the SC 1120-TC. Any credits that are not being used this year but are carried forward to future years are entered as the credit carryover. Corporations must attach the SC 1120-TC and all supporting tax credit schedules to their tax return.

Credits that can be taken against income tax are Research and Development Expenses Credit, Corporate Headquarters Credit (SCCL §12-6-3410) and Infrastructure Credit.

Line 23. Balance of tax. Difference between line 21 and line 22, but not less than zero. This is the amount used as **"Paid per return"** to be compared to the audit results in order to determine any underpayment (balance due) or overpayment (refund) of license fee by the Taxpayer. For audit purposes, we typically do not use information on lines 24 through 30, unless there is a question regarding actual payment of the tax reported on the original return being audited.

Combined reporting does not affect the license fee, because combined reporting is allowed under Chapter 6 of the SC Code of Laws (SC Income Tax Act) and the license fee is regulated by Chapter 20 (Corporation License Fees).

Schedule A and B

SC gross income of a business is the business' gross income as determined under the Internal Revenue Code (SCCL §§12-6-580 and 12-6-1110) subject to certain modifications (SCCL §§12-6-1120 and12-6-1130), to arrive at gross income subject to allocation and apportionment.

Additions to Federal Taxable Income

Line 1. Taxes on or measured by income. There is no deduction for state and local Income Taxes, or any taxes measured by, or with respect to, net income. SC RR #09-10 provides a summary of selected taxes which are allowed or disallowed as deductions, assuming they are allowed as a deduction under IRC §164.

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NOTE: This addition can be verified with the federal return by reviewing either the related statement for line 17 of federal Form 1120 (Taxes and Licenses) or page 3 of Schedule M-3 line 3(d), whichever is available.

Line 2. Federal net operating loss. A federal NOL is never automatically used for SC income tax purposes. All items of income and deductions used in computing the NOL deduction are subject to modification, and the NOL is subject to allocation and apportionment. Therefore, the federal NOL must be added back.

NOTE: The federal NOL to be added back is the amount reported on line 29a of federal Form 1120.

Lines 3-5. Other additions. Other additions which must be made to federal taxable income to arrive at SC's taxable income include:

- Interest on other states' obligations. SC requires an addition to federal taxable income for interest received from obligations of other states to the extent the interest was excluded from federal taxable income.

  NOTE: Review federal Form 8916-A, part II, line 1, or federal Schedule K, line 9, to see if any tax-exempt interest exist, but be aware that maybe not all, or none, of that tax-exempt interest is from state's obligations.

  NOTE: Interest on obligations from this state and any of its political subdivisions is exempt, so no addition is necessary.

- Expenses related to income that is exempt for SC income tax purposes.

- Special depreciation allowances, including bonus depreciation. A taxpayer electing one or more of the special depreciation allowances must have a separate depreciation schedule for SC purposes. The difference between federal depreciation and SC depreciation is added back for the tax year in which the property was placed in service. The taxpayer will be able to claim an additional depreciation deduction for each remaining tax year of the property's depreciable life.

- Foreign exchange losses. SC has not adopted IRC §988 (SCCL §12-6-50(12)), so foreign exchange losses are an addition to federal taxable income. Note: Foreign exchange losses are usually included in other deductions (Line 26 of federal Form 1120), but can also be found as negative amounts in other income (Line 10 of federal Form 1120).

- Interest expense carryforward. Since SC no longer adopts IRC §163(j), the carryforward provisions in IRC §163(j) are no longer adopted for tax years beginning after December 31, 2017. As a result, any federal interest expense carryforward allowed for federal income tax purposes is disallowed for SC income tax purposes and is treated as an addition to SC taxable income.

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NOTE: See Interest Deductions Federal Form 8990 – §163(j) Adjustments under "Other deductions".

Summary. For tax years beginning after 2017, there is no SC business interest tax limitation and no carryforward. Any federal interest expense carryforward allowed for federal income tax purposes is disallowed for SC income tax purposes and is treated as an addition to SC taxable income.

NOTE: Federal Form 8990 is where the taxpayer reports excess interest deductions.

- Related Expense Addback. Taxpayers use Federal Form 1118 to claim tax credits for foreign taxes paid. It includes an adjustment for allocable and apportioned deductions that are used in the calculation of the foreign tax credits. We use the allocable deduction and apportioned deductions to determine the amount of expenses that are added back to the SC apportionable income for foreign dividends and other foreign income excluded from SC income. See Worksheet that shows the calculation for adding back the expenses that apply to income excluded from SC tax.

- FDII deduction under IRC §250(a)(1)(A) – SC has not adopted IRC §250 (SCCL§12-6-50(12)), so the federal FDII deduction is an addition to SC taxable income.

- GILTI deduction under IRC §250(a)(1)(B) – SC has not adopted IRC §250, so the federal GILTI deduction is an addition to SC taxable income. (See GILTI inclusion later under other deductions).

  NOTE: Taxpayers use Federal Form 8993 to calculate the FDII and GILTI deductions. These deductions ("Section 250 deductions") are reported on line 22 column (c) of Schedule C of federal Form 1120.

- Income from Discharged Debt. SC conforms substantially to the federal treatment of discharge of indebtedness except for the deferral and ratable inclusion allowed by IRC §108(i) for business debts discharged in reacquiring debt instruments. The IRS allows the Discharge of Debt income to be reported ratably over a 5-year period. Such amounts deferred under IRC §108(i) at the federal level must be added back to determine SC taxable income in the first year. The amounts included in federal income in subsequent years are then subtracted.

- IRC §965(c) federal deduction needs to be added back to SC income (see IRC Section 965 in Definitions and Federal Schedule C).

  NOTE: Taxpayers use federal Form 965 to calculate the inclusion and deduction of deferred foreign income. The total 965(c) deduction then is reported on Schedule C, line 15(c) of federal Form 1120.

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- Charitable contributions in excess of 10% of adjusted net taxable income. SC generally conforms to the federal deduction for charitable contributions under IRC §170, including the limitation to 10% of taxable income imposed by IRC §170(b)(2)(A). However, SC does not conform to the amendments to IRC §170 made by the CARES Act of 2020 (Pub. L. No. 116-136), which increased the limitation to 25% of the corporation's taxable income.

  NOTE: Since SC is a separate entity state, the deduction is limited to 10% of each entity's taxable income. Subtract the charitable contribution reflected on the federal return from the Net Taxable Income. Multiply the adjusted Net Taxable Income by 10%. If this amount exceeds the charitable contribution, add back the excess to SC taxable income.

- For other additions, see SC1120 instructions.

Line 6. Total additions. Add lines1 through 5.

Deductions from Federal Taxable Income

Line 7. Interest on U.S. Obligations – Interest from obligations of the United States is exempt from tax.

Lines 8-10. Other deductions – Some of the other deductions from federal taxable income are:

- Foreign Dividends. SC treats foreign dividends and domestic dividends the same for the purposes of the dividends received deduction, so dividends received from foreign corporations (located outside of the United States) that are included in federal taxable income may be reduced in the same manner that dividends received from domestic corporations are deducted under IRC §243.

  NOTE: This is the amount reported on Schedule C, line 14, column (a), of federal Form 1120.

- IRC §965(a) Inclusion needs to be subtracted from SC income (see IRC Section 965 in Definitions and federal Schedule C).

  NOTE: Taxpayers use federal Form 965 to calculate the inclusion and deduction of deferred foreign income. The total 965(a) inclusion is reported on Schedule C, line 15(a) of federal Form 1120.

- Subpart F inclusions.
  NOTE: Line 16a, 16b, 16c, column (a) of Schedule C of the federal Form 1120.

- GILTI inclusion under IRC §951A. SC does not conform to the federal treatment of global intangible low-taxed income (GILTI) under IRC §951A (SCCL § 12-6-50(12)) for taxable

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years beginning after Dec. 31, 2017. Thus, the GILTI federal inclusion needs to be deducted from SC taxable income.

NOTE: If the taxpayer had any GILTI federal inclusions, they would be shown on line 17 column (a) of Schedule C of the federal Form 1120. The computation of the GILTI federal inclusion is shown on Form 8992, schedule B.

- Gross-up for foreign taxes paid. The gross-up of dividends received from a foreign corporation located outside of the US required by a domestic US corporation electing the foreign tax credit, as provided for in IRC §78, is subtracted from federal net taxable income.

  NOTE: This gross-up is reported on line 18, column (a), of Schedule C of the federal Form 1120.

- Foreign exchange gains. SC has not adopted IRC §988 (SCCL §12-6-50(12)), so foreign exchange gains are a deduction to the federal taxable income. Note: The foreign exchange gains are usually included in Other Income (Line 10 of federal Form 1120).

- Interest Deductions Federal Form 8990 – IRC §163(j) Adjustments. For tax years beginning before January 1, 2018, IRC §163(j) limited business interest expense deductions only for certain interest paid or accrued by corporations. For tax years beginning after 2017, a taxpayer's deduction for net business interest is limited to 30% of adjusted taxable income. The limitation applies to all taxpayers who have business interest expense, other than certain small businesses that meet the gross receipts test in IRC §448(c) ("exempt small business"). SC did not adopt the changes to IRC §163(j) (SCCL §12-6-50(5)(B)) and, as a result, for tax years beginning after 2017, SC does not limit the business interest expense deduction. Eligible taxpayers may deduct 100% of their business interest expense, without regard to IRC §163(j), in calculating their SC taxable income each year.

  NOTE: See Interest Expense Carryforward under "Other additions".

- For other deductions, see SC1120 instructions.

Line 11. Total deductions. Add lines 7 through 10.

Line 12. Net adjustment. It's the difference between "Total additions" (line 6) and "Total deductions" (line 11). The result is carried to line 2, on page 1 of form SC 1120.

Schedule C - Summary of Income Tax Credits (From SC1120TC)

Line 1. Credit carryover from previous years

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Schedule D - Annual Report to be Completed by All Corporations

This schedule is to be completed by each entity. If the taxpayer is filing a consolidated return in SC, this schedule needs to be completed by each entity included in the consolidated return.

Line 1. Name – The name of the entity.

Line 2. Incorporated under the laws of the state of – This is the state that the entity incorporated in.

Line 3. Location of the registered office of the corporation in South Carolina in the city – This is the address of the registered agent in SC.

Line 4 – Location of principal office (street address) – This is usually where the headquarters are located. *Nature of principal business in SC* – This is the address of the principal of business occurring in SC. This can help with determining nexus or the income producing activity.

Line 5. Total number of authorized share of capital stock, itemized by class and series, if any, within each class – This is needed for the SC Secretary of State.

Line 6. Total number of issued and outstanding shares of capital stock itemized by class and series, if any, within each class - This is needed for the SC Secretary of State.

Line 7. Names and business addresses of the directors (or individuals functioning as directors) and principal officers in the corporation – If the auditor is having issues with the taxpayer responding, this is a good source for additional names to contact. Correspondence can be sent to an officer listed in this part.

Line 8. Date incorporated, Date commenced business in South Carolina – This is the date the entity was incorporated. The date commenced business is the date the entity starting conducting business in SC. If there is a difference in dates, the auditor will need to review to determine if there is a reasonable explanation.

Line 9. Date of this report and FEIN – This is the date the return was completed and the FEIN of the entity. Make sure the FEINs match the other pages.

Line 10. If foreign corporation, the date qualified to do business in South Carolina – This is the date a foreign corporation qualified to do business with the SC Secretary of State. If this date is different from the commenced dated on line 8, the auditor will need to ask the taxpayer why.

Line 11. Was the name of the corporation changed during the year? Previous name – If the entity changed the name of the entity, the taxpayer needs to provide the previous name.

Line 12. The corporation's books are in the care of and Located at (street address) – The name of the person that is responsible for the books so the auditor can contact them to set up an audit.

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Also, the location needs to be provided so the auditor knows where the audit will most likely be conducted.

Line 13. If filing consolidated, complete and attach Schedule J for each corporation included in the consolidation – The auditor needs to verify that Schedule J has been provided when the taxpayer files a consolidated return.

Line 14. Total amount of stated capital per balance sheet: A. Total paid in capital stock (cannot be a negative amount), B. Total paid in capital surplus (cannot be negative amount) and C. Total amount of stated capital (cannot be a negative amount) – These amounts are the calculation of line 1 of Schedule E. The auditor can verify the amounts based on the federal Schedule M-3 or lines 22 and 23 of the federal Schedule L. None of the amounts can be negative. If the entity is reporting a large negative amount for any of these lines, the auditor will need to ask the taxpayer.

Schedule E - Computation of License Fee of Multi-State Corporations

This schedule is to be completed by multi-state corporations only.

Line 1. Total capital and paid in surplus at end of year – This is the amount for line 14c of Schedule D.

Line 2. SC Proportion: (multiply line 1 by the ratio from Schedule H-1, H-2, or H-3, as appropriate). Also enter on SC 1120, line 20 – This is the SC's portion of the capital and paid in surplus at the end of the year.

Schedule F - Income Subject to Direct Allocation

This schedule is to be completed by multi-state corporations only.

For each of the line items subject to direct allocation, the taxpayer must complete columns 1 through 4 for each applicable line. The taxpayer should also provide an explanation for each type of income not allocated to SC. If this explanation is not provided, the auditor will need to ask the taxpayer.

Column 1. Gross Amounts – This is the gross amount of the item subject to direct allocation. The auditor needs to determine if the item(s) should be directly allocated or if the items need to be apportioned.

Column 2. Less: Related Expenses – The expenses related to the income item subject to direct allocation also must be removed. The auditor will need to verify that all the expenses have been removed.

Column 3. Net Amounts Allocated Directly to SC and Other States – This column is column 2 subtracted from column 1.

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Column 4. Net Amounts Allocated Directly to SC – This is the amount of the item subject direct allocation that is allocated directly to SC. If the allocation is SC is zero, the auditor needs to determine if this is the correct allocation.

Schedule G – Computation of Taxable Income of Multi-State Corporations

This schedule is to be complete by multi-state corporations only.

Line 1. Total net income as reconciled from SC 1120, page 1, line 3 – This amount needs to equal line 3 on page 1 of the SC110. If page 1 is missing, you can use this amount.

Line 2. Income subject to direct allocation to SC and other states from Schedule F, line 7 – This amount needs to equal column 3, line 7 of the Schedule F.

Line 3. Total net income subject to apportionment (subtract line 2 from line 1) – Subtract line 2 from line 1.

Line 4. Multiply line 3 by appropriate ratio from Schedule H-1, H-2, or H-3 – The auditor needs to verify the correct ratio is used.

Line 5. Income subject to direct allocation to SC from Schedule F, line 8 – This amount needs to equal column 4, line 8 on Schedule F.

Line 6. Total SC net income (add lines 4 and 5). Also enter on SC 1120, page 1, line 4 – This amount is the sum of lines 4 and 5 and it needs to be entered on line 4, page 1. If page 1 is missing, you can use this amount.

Schedules H-1, H-2, and H-3

Schedule H-1 – Computation of Sales Ratio

This ratio should be used if the entity is (a) manufacturing or any form or collecting, buying, assembling or processing goods and materials within SC or (b) selling, distributing or dealing in tangible personal property within SC pursuant to SCCL §12-6-2295.

The term "sales in this state" includes sales of goods, merchandise, or property received by a purchaser in this state. The place where goods are received by the purchaser after all transportation is completed is considered as the place at which the goods are received by the purchaser. Direct delivery into this state by the taxpayer to a person designated by a purchaser constitutes delivery to the purchaser in this state.

NOTE: Sales do not include (1) repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument; (2) the principal

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amount received under a repurchase agreement or other transaction properly characterized as a loan; (3) proceeds from the issuance of the taxpayer's stock or from sale of treasury stock; (4) damages and other amounts received as the result of litigation; (5) property acquired by an agent on behalf of another; (6) tax refunds and other tax benefit recoveries; (7) pension reversions; (8) contributions to capital, except for sales of securities by securities dealers; (9) income from forgiveness of indebtedness; or (10) amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code.

Line 1. Total sales within South Carolina – The total sales in SC needs to be entered on this line. Tangible personal property destined to SC need to be included in this line. The auditor needs to verify the correct amount of sales are being reported to SC. This can be verified by requesting a 51-state breakdown of sales by each revenue stream. If the entity also has services, the services will be sourced to SC differently (see Schedule H-2 – Gross Receipts). Sales to the U.S. government are not included in this amount. Only sales for which the U.S. government makes direct payment to the seller pursuant to the terms of a contract constitute sales to the U.S. government. (See Sourcing for more details)

Line 2. Total sales everywhere – The total sales of the entity everywhere needs to be entered on this line. The auditor needs to verify the correct amount of sales are reported on this line by comparing the amounts to the federal Form 1120 and making sure additional items are not included in the calculation. Sales to the U.S. government are not included in this amount.

Line 3. Sales ratio (line 1 divided by line 2) – This is the entity's sales ratio in SC and is used to calculate SC's share of net income (loss) and license fee. The auditor will need to verify it is calculated correctly. The ratio should be rounded to 6 decimal places.

Partnership Receipts

If the taxpayer owns an interest in a partnership that is in a unitary business with another business conducted directly, or indirectly, by the taxpayer, then the partnership's sales/receipts are included in the taxpayer's other business' sales/receipts factor to the extent of the taxpayer's interest in the partnership. The income/loss from the flow through partnership is included in the corporation's apportionable income. If the partnership income is not unitary to the business of the corporation which owns a percentage of the partnership, the flow through income/loss income is allocated and no flow through receipts are included in the either the SC or Everywhere sales/receipts factors. (SCCL §12-6-600)

Schedule H-2 – Gross Receipts

This ratio should be used if the entity is not a public service corporation or utility and electric cooperative and is not deriving profits or income from sources listed under Schedule H-1 pursuant to SCCL §12-6-2295.

NOTE: Gross receipts do not include (1) repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument; (2) the principal amount received under a repurchase agreement or other transaction properly characterized as a loan; (3) proceeds from the issuance of the taxpayer's stock or from sale of

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treasury stock; (4) damages and other amounts received as the result of litigation; (5) property acquired by an agent on behalf of another; (6) tax refunds and other tax benefit recoveries; (7) pension reversions; (8) contributions to capital, except for sales of securities by securities dealers; (9) income from forgiveness of indebtedness; or (10) amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code.

Line 1. South Carolina gross receipts – This amount is the total gross receipts sourced to South Carolina, based on the income producing activity (IPA). The auditor needs to verify the correct amount of gross receipts are be sourced to South Carolina. The auditor can verify the South Carolina gross receipts by requesting a 51-state breakdown of gross receipts by each revenue stream and needs to have a good understanding of each revenue stream. Each revenue stream can be sourced differently. If the entity also has the manufacturing or selling of tangible personal property, the sales will be reported to South Carolina differently (see Schedule H-1 – Computation of Sales Ratio). (See Sourcing for more details)

Line 2. Amounts allocated to South Carolina on Schedule F - Any amounts reported on Schedule F, column 4, for this entity and are included in the calculation of the gross receipts calculation must be removed from the South Carolina gross receipts.

Line 3. South Carolina adjusted gross receipts (subtract line 2 from line 1) - This amount is the net amount of South Carolina gross receipts after the removal of any allocations directly to South Carolina.

Line 4. Total gross receipts – This is the total gross receipts for the entity everywhere. The auditor needs to verify the correct amount of gross receipts are reported on this line by comparing the amounts to the federal Form 1120 and making sure additional items are not included in the calculation.

Line 5. Total amounts allocated on Schedule F – Any amounts reported on Schedule F, column 3, for this entity and are included in the calculation of the gross receipts calculation must be removed from the everywhere gross receipts.

Line 6. Total adjusted gross receipts (subtract line 5 from line 4) – This amount is the net amount of everywhere gross receipts after the removal of any direct allocations.

Line 7. Gross receipts ratio (line 3 divided by line 6) – This is the entity's gross receipts ratio in South Carolina and is used to calculate South Carolina's share of net income (loss) and license fee. The auditor will need to verify it is calculated correctly.

Partnership Receipts
Refer to information under Schedule H-1.

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Schedule H-3 – Public Service Corporations

This ratio should be used if the entity is (1) railroad company, (2) motor carrier of property or passengers, (3) telephone service company, (4) pipeline company, (5) airline company or (6) shipping line. Refer to SCCL §12-6-2310 and the instructions for more details on type of company listed above. The auditor will need to verify that the taxpayer is calculating the ratio correctly by asking for a 51-state breakdown of specific calculation (e.g. miles, revenue ton miles, tons loaded and unloaded, etc.). (See Sourcing for more details)

Schedule J – Corporation Included in Consolidated Return Affiliated Corporation No. __

This schedule is to be completed by each entity included in the South Carolina consolidated return.

Line 1. Name – The name of the entity.

Line 2. Incorporate under the laws of the state of – The state under which the entity incorporated under can help determine where some sales or receipts items are being sourced.

Line 3. Location of the registered office of the corporation in South Carolina – All entities with activity in the state of South Carolina are required to register with the South Carolina Secretary of State and pay the minimum annual license fee of $25. When a taxpayer initially files with the Secretary of State, the taxpayer must file the CL-1 and pay $25.

Line 4. Location of principal office (street address) and *Nature of principal business in SC* – The street address and nature of principal business can help an auditor have a better understanding of the taxpayer's activities in the state, including how to determine the sourcing of sales or receipts.

Line 5. Total number of authorized shares of capital stock, itemized by class and series, if any, within each class: - This information is for the Secretary of State.

Line 6. Total number of issued and outstanding share of capital stock itemized by class and series, if any, within each class: - This information is for the Secretary of State.

Line 7. Names and business addresses of the directors (or individuals functioning as directors) and principal officers in the corporation: - This information can help determine the taxpayer's activities in the state and it can help with determining centralized management of a unitary business when looking at doing a unitary combination under SC RR #15-5.

Line 8. Date incorporated and *date commenced business in South Carolina* – If you are asserting nexus or if there is a 20% understatement, the dates will determine what back years to assess.

Line 9. Date of this report, FEIN and *SC file #* - The FEIN and SC file # can be used to find accounts in DORWAY. Also, if there are name changes or any reorganizations, the FEIN is

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important to follow the same entity from period to period to see if the taxpayer is being consistent.

Line 10. If foreign corporation, the date qualified to do business in South Carolina – This information helps determine when they started in the state and if they are filing with the Secretary of State.

Line 11. Was the name of the corporation changed during the year? – This information helps follow the same entity from period to period to see if the taxpayer is being consistent.

Line 12. The corporation's book are in care of and *located at (street address)* – This information helps determine where the audit will be conducted and who the contact will be.

Line 13. Corporate mailing address – This information helps determine where you send any correspondence if needed. Generally, you will send it to the same address for all of the entities.

Line 14. Total amount of state capital per balance sheet: - The amount of capital is the starting point for calculating the license fee for each of the entities included in the consolidated South Carolina return. This information should tie to the by-company breakdown of the ending balance sheet, Schedule L of the consolidated federal Form 1120.

Schedule L – Disregarded LLCs Included in Return

This schedule is to include the name, FEIN and SC file # (if applicable) for all disregarded entities (DREs) that are doing business in South Carolina and are part of a C Corporation filing for tax purposes. These DREs may have separate accounts in DORWAY to file their withholding, sales and use tax, etc.

For consolidated and combined returns, the auditor needs to know which entity owns the DREs to determine if their activities are included properly. The taxpayer will need to provide a schedule or other support for this information since it is not available on the consolidated federal Form 1120 or federal Form 851.

Schedule M – Consolidated Return Affiliations Schedule

This schedule needs to be completed for all corporations included in the South Carolina consolidated return. This information is very important for the auditor to be able to audit those corporations that are filing as part of the South Carolina consolidated return. This schedule provides a by-corporation breakdown of the amounts reported on the previous pages or schedules of the SC 1120.

Part 1 – General Information

Is the common parent corporation included in the return? Information on the common parent corporation is important for the auditor to have a better understanding of the structure of the consolidated group and who the taxpayer is filing under for federal purposes.

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Name of each corporation included in this consolidated return. The taxpayer needs to list all of the corporations, including their FEIN, which they are including in the South Carolina consolidated return.

Part 2 – Income Tax Information
Federal Taxable Income. The total of the corporations equals page 1, line 1. Refer to the line 1 for more information.

Amounts Directly Allocated. The total of the corporations equals Schedule F, line 7. Refer to line 7 of Schedule F for more information.

Amounts Allocated to SC. The total of the corporations equals Schedule F, line 8. Refer to line 8 of the Schedule F for more information.

SC Adjustments. The total of the corporations equals page 1, line 2. The auditor will need to request a more detailed breakdown of all the entities from the taxpayer if it is not included in the return as filed. Refer to line 2 of page 1 for more information.

SC NOL Prior Year Carryovers. The total of the corporations equals page 1, line 5. The auditor will need to request a net operating loss (NOL) carryover schedule for all entities with NOL carryovers from the taxpayer if it is not included in the return as filed. Refer to line 5 of page 1 for more information.

Part 3 – License Fee, Allocation, and Apportionment Information
Tax Credited on Return. The total of the corporations equals page 1, line 15. Line 15 is the total of the payment made and refundable credits claimed for each corporation filing as part of the South Carolina consolidated return. The refundable credits are not commonly claimed by corporations audited by the Foreign Tax audit group.

Total Capital and Paid in Surplus. The total of the corporations equals page 2, line 20. Refer to line 20 of page 2 for more information.

Apportionment Percentage. This percentage is the South Carolina sales/receipts divided by the everywhere sales/receipts. Refer to Schedule H-1, H-2 or H-3 for more information.

License Fee. The total of the corporations equals page 2, line 21. Refer to line 21 of page 2 for more information.

Schedule N – Property Information

This schedule is to list out the property located in South Carolina. If the taxpayer has property in South Carolina, the taxpayer has nexus and needs to be filing returns. This information can also help with determining the sourcing of the sales.

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For consolidated and combined filers, the auditor will need to ask for a by-entity breakdown of this schedule from the taxpayer if it is not included with the return as filed.

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C Corporation Income Tax Return

Federal Form 1120

This section only discusses parts of the federal Form 1120 used for review of the SC 1120.

Page 1, Federal Form 1120

The middle top of the US Corporation Income Tax Return will indicate the period reported. Fiscal taxpayers or short year returns will provide the beginning and ending dates. A calendar year taxpayer will be blank. This information is helpful when determining statute of limitations, changes in corporate structure/ownership (short year return), or if another federal Form 1120 (FF1120) return may be filed for this taxpayer (short year return). The SC 1120 is required to be the same reporting period of the FF1120.

Box A. This box will indicate the type of return filed (Consolidated Return with Form 851 (affiliate schedule) and Schedule M-3 attached).

Box B. Employer Identification Number

Box C. Date Incorporated

Box D. Total consolidated assets

Box E. Indicates if the return is a final return (changes in ownership/corporate structure), initial return (new entity), or name change (can happen with change of ownership).

NOTE: For income and expense items shown on lines 1a – 37, intercompany transactions are presumed eliminated. Request the "white pages" along with intercompany eliminations on the initial Information Document Request (IDR).

Line 1c – Gross Receipts. Gross receipts net returns and allowances is the amount used to determine SC and everywhere receipts (sales and service income).

NOTE: The gross receipts used for the apportionment workpaper (51 state apportionment) are the same used for tax, no book adjustments. Ensure the taxpayer provides a breakdown of gross receipts from all income streams, a description of each income stream (including primary customers/clients), indicating the sourcing method used for all income streams for each entity reporting on the consolidated return under audit.

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Line 2 – Cost of Goods Sold. Review the Form 1125-A. This is an important item to review on a separate entity basis (entities filing in SC vs entities not filing or sourcing receipts to SC) and can indicate shifting strategies.

Line 3 – Gross Profit. On a separate entity basis, compare the gross profit margin from white pages or proforma or FF1120 to determine gross profit before eliminations. For intercompany purchases, the procurement company may have large profit margin in relation to the retail company or the distribution company. The entities with the larger profit margins will most likely not be filing in South Carolina. This can indicate income shifting via intercompany purchases.

Line 4 – Dividends. All dividends received from sources, including dividends received from affiliates not included in the consolidated return. All intercompany dividends are eliminated. Review white pages and proforma FF1120 for audit entities to determine income before eliminations. Foreign Dividends and Dividends of affiliates are not included in the apportionment ratio. These amounts are deducted from any dividends included in the apportionment calculation. A dividend situs is the location of the taxpayer's headquarters. For foreign corporations, this typically is not SC. Intercompany dividends not eliminated and/or deducted may indicate the existence of REITS. Information regarding intercompany dividends is requested on the initial IDR.

Line 5 – Interest. Interest received from all sources, including interest received from affiliates not included in the consolidated return. Review white pages and the proforma FF1120 for audit entities to determine income before eliminations. Information regarding intercompany interest is requested on the initial IDR. Large intercompany interest deductions on the entities filing in SC vs large intercompany receipts by taxpayers not filing in SC is indicative of possible shifting strategy. These interest shifting strategies can involve not only domestic to domestic, but also domestic to foreign entities. A comparison of the return to the parent's 10-K can indicate domestic and offshore shifting.

Line 6 – Gross Rents. Rents received from all sources, including rents received from affiliates. Review the white pages and the proforma FF1120 for income before eliminations. Information regarding intercompany transactions and eliminations are requested on the initial IDR.

Line 7 – Gross Royalties. Payments received for the use of intangibles. Intangibles include patents (processes) and trademarks. Review the white pages and the proforma FF1120 for the income before eliminations. The auditor needs to determine substantial receipt or payment of royalties. If domestic royalties are paid and received, the auditor must determine if the proper amount of royalties are sourced to SC. Refer to the *Geoffrey* (SC) case for more details. If the entity pays royalties to an offshore entity, the auditor must determine if any of the royalties can be sourced to SC. Ask the taxpayer for the Foreign Entities Federal Return, (federal Form 1120-F) and assert nexus on the foreign entity, if applicable, and source royalties to SC. If the offshore entity is exempt from federal taxation pursuant to a treaty, consider a royalty expense addback using a matching adjustment. Initial request regarding royalties is requested on the Information Document Request.

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Line 8 – Capital gain net income (from schedule D).

Line 9 – Net gain or (loss). A loss (negative) is not included in the calculation of the apportionment ratio, only net gain. At times the taxpayer attempts to include the gross sales price of the business asset. This is not proper treatment.

SCCL §12-6-2295(A)(4) the net gain from the sale of property used in the trade of business for the apportionment calculation. Included in the terms "sales" and "gross receipts" is the net gain (not gross proceeds) from the sale of property used in the trade or business. The term does not include net losses.

Line 10 – Other Income. Watch for income categories such as the following potentially indicating intercompany transactions requiring additional information:

Professional Fees
Management Fees
Misc. Income
Intercompany Income
Allocated Income
Administrative Income
Other Income

In addition, other income/deductions can include foreign exchange gains/losses not adopted by SC (i.e. 986 foreign exchange loss/gain). (SCCL §12-6-50)(12), State law decoupling from IRC)

Pass Through/Partnership/S Corp Income/(Loss). Request all partnership returns (US 1065s and SC 1065s), business purpose and description of operations, K-1s, and a reconciliation of the K-1s to the income/(loss) reported on the return. Consider having the taxpayer explain the customers of the entities or the entities involved in any related entity transactions.

Gain/Loss from the sale of Receivables. This can indicate a factoring /securitization company. If the entity purchasing the receivables does not file in SC, this creates nexus in SC and the taxpayer should provide the receivables of the SC customers. If this amount is not provided by the taxpayer, the apportionment ratio of the seller should be used to determine the apportionment ratio for the factoring/securitization entity. The factoring agreement should be requested and reviewed.

NOTE: Substantial intercompany receipts and expenses among the entities is a sign of possible income shifting and could result in an alternative apportionment method as provided by SC RR #15-5. If utilizing an alternative apportionment method, the auditor should summarize the intercompany transactions, agreements, and 482 studies in the write-up of the audit.

Line 18 – Interest Expense. Interest paid to all sources, including interest paid to affiliates not included in the consolidated return. Review white pages and the proforma FF1120 for audit entities to determine expense before eliminations. Information regarding intercompany interest

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is requested on the initial IDR. Large intercompany interest deductions on the entities filing in SC vs large intercompany receipts by taxpayers not filing in SC is indicative of possible shifting strategy. These interest shifting strategies can involve not only domestic to domestic, but also domestic to foreign entities. A comparison of the return to the parent's 10-K can indicate offshore shifting.

Line 20 – Depreciation. The taxpayer will need to provide the support for the Bonus Depreciation Adjustment. This would include the federal and state depreciation schedules along with a reconciliation to the Schedule AB adjustment.

Line 21 – Advertising. On a separate entity basis, this can indicate the owner of the intangible trademarks.

Line 26 – Other Deductions. Watch for income categories such as the following potentially indicating intercompany transactions requiring additional information:

Professional Fees
Management Fees
Misc. Expenses
Intercompany Expenses
Allocated Expenses
Administrative Expenses

In addition, other income/deductions can include foreign exchange gains/losses not adopted by SC (i.e. 986 foreign exchange loss/gain). (SCCL §12-6-50)(12), State law decoupling from IRC)

Expense from Pass Through/Partnership/S Corp. Request all partnership returns, business purpose and description of operations, K-1s, and a reconciliation of the K-1s to the income/(loss) reported on the return. Consider having the taxpayer explain the customers of the entities or the entities involved in any related entity transactions.

NOTE: If intercompany transactions are indicated based on the review of the FF1120, determine the entity providing the cash management/treasury functions. Request a copy of the cash management/treasury functions agreement. This is important when considering forced combination. The fact one entity manages all the money of a taxpayer (especially without an agreement) is a strong indication of unitary operations.

Line 29a – Net Operating Losses. NOLs are added back as a Schedule A adjustment on the SC 1120.

Line 29b – Special Deductions. Dividends Received Deduction does not need to be included as a Schedule AB adjustment because the Line 1 of the SC 1120 starts with Line 30 of the FF1120, where the special dividend deduction is already considered.

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Schedule C

Corporations filing a consolidated return. Corporations filing a consolidated return must not report as dividends on Schedule C any amounts received from corporations within the tax consolidation group. Such dividends are eliminated in consolidation rather than offset by the dividends-received deduction. (See Treasury Regulations 1.1502-13, 1.1502-26, and 1.1502.27)

Notes for Schedule C:

Dividends received related to the taxpayer's business are apportionable as provided by SCCL §12-6-2220(2), dividends received from corporate stock not connected with the taxpayer's business, less all related expenses, are allocated to the state of the corporation's principal place of business as defined in SCCL §12-6-30(9) or the domicile of an individual taxpayer. This amount is still included in everywhere receipts/sales when determining the apportionment ratio.

Generally, South Carolina treats foreign dividends in the same manner as domestic dividends for the purpose of the dividends received deduction under IRC §243. Therefore, Federal Taxable Income is reduced by dividends received from foreign corporations located outside the United States for purposes of computing state taxable income, SCCL §12-6-1130(11). This amount is not included in everywhere receipts when determining the South Carolina apportionment ratio. Refer to Schedule H-1, H2 and H-3.

SCCL §12-6-50 provides a list of IRC sections specifically not adopted by State. Included in this list and related to this schedule includes SCCL §12-6-50(12), IRC §§861through 908, 912, 931 through 940, and 944 through 989 relating to the taxpayer of foreign income. This means, State does not adopt IRC §965, which provides an elective one year 85% dividends received deduction for cash dividends paid by controlled foreign corporations. At the taxpayer's election, the federal deduction is available for dividends received either during (1) the taxpayer's first year beginning on or after Oct. 22, 2004 or (2) the taxpayer's last year beginning before that date. Review the taxpayer's A&B adjustments to determine the taxpayer's treatment of IRC §965 election on the SC 1120. The IRC §965 deduction should be added back to Federal Taxable Income to determine apportionable income and everywhere receipts to calculate the South Carolina apportionment ratio.

Further, SCCL §12-6-1120(4) provides that South Carolina gross income is determined without regard to IRC §§78 (Gross-up of Dividends received from Certain Foreign Corporations), 86 (Social Security Tier 1 Rail Road Retirement Benefits), and 87 (Alcohol Fuel Credit). SCCL §12-6-50(4) provides decoupling from IRC §§ 78, 85(c), 86, 87, 168(l),168(m), 168(n), 196, and 280C relating to dividends received from certain foreign corporations by domestic corporations, unemployment compensation, taxation of social security and certain rail road retirement benefits, the alcohol fuel credit, bonus depreciation, deductions for certain unused business credits, and certain expenses for which credits are allowable; Therefore, if the foreign dividends received were increased for federal purposes pursuant to IRC §§ 78 and 956-964, the taxpayer should deduct the amounts (IRC §§78 and 956-964) that increased the foreign dividends reported on the

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FF1120 from the SC 1120 as SC has not adopted those sections of the IRC. This amount is also deducted from everywhere receipts to calculate the South Carolina apportionment ratio.

Line 23, Total dividends and inclusions
From this amount subtract the following:
Line 15, IRC §965(a) inclusion
Line 16b, Subpart F inclusion derived from hybrid dividends
Line 16c, Other inclusions from CFCs under Subpart F
Line 17 GILTI
Line 18 Gross up Foreign taxes deemed paid
Line 24, Total Special Deductions

20% ownership test. Entries on Lines 1 through 7 depend on whether the dividend-receiving corporation owns at least 20%, by vote and value, of the stock of the dividend-paying corporation.

Line 1. Enter dividends from less than 20% owned domestic corporations subject to income tax, and qualified for the 50% deduction under IRC §243(a)(1). Also included in this line are taxable distributions from an IC-DISC or former DISC that are designated as eligible for the 50% deduction and certain dividends of Federal Home Loan Banks and dividends from regulated investment company (RIC). The amount of dividend eligible for the DRD under IRC §243 is limited by IRC §854(b). The corporation will receive a notice from the RIC specifying the amount of dividends that qualify for the deduction.

Line 2. Dividends that are same type as line 1 except they are received form a 20% or more owned Domestic Corporation. This includes taxable distributions from IC-DISCs or former DISCs that are eligible for the 65% deduction as provided by IRC §243 (c).

Line 3. Dividends on debt-financed stock of domestic or foreign corps. Debt-financed stock is stock that the corporation acquired by borrowing money or incurring some other form of debt. These are dividends not included in lines 1 & 2, or included in IRC §245.

Line 4. Dividends received on preferred stock of less than 20% owned public utility and allowed the 23.3% deduction as provided in IRC §§244 & 247 for dividends paid.

Line 5. Dividends received on preferred stock of a more than 20% owned public utility and allowed the 26.7% deduction as provided in IRC §§244 & 247 for dividends paid.

Line 6. Dividends from less than 20% owned foreign corporations and certain FSC. To qualify for the 50% deduction, the corporation must own at least 10% of the stock of the foreign corporation by vote and value, and the foreign corporation cannot be a foreign personal service corporation or passive foreign investment company. This can also include dividends from less than 20% owned foreign sales corporation (FSC) that are attributed to income treated as effectively connected with the trade or business within the US and qualify for a deduction under IRC §245(c)(1)(B).

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Line 7. Dividends from 20% or more owned foreign corporations and certain FSCs. Column A is the US sourced portion of the dividends that are received from 20% or more owned foreign corporation and qualify for the 65% deduction under IRC §243 and §245(a). Also, dividends received from a less than 20% owned foreign sourced corporation that are attributed to income treated as effectively connected with the conduct of a trade or business within the US and qualify for the 65% deduction under IRC §245(c)(1)(B).

In both lines 6&7, the US source portion of a dividend is determined by multiplying the dividend by a fraction whose numerator is the paying corporation's post 1986 undistributed US earnings, and whose denominator is its posts 1986 total undistributed earnings.

Line 8. Dividends from wholly owned foreign subsidiaries. Column (a) are the dividends received from a foreign corporation, owned directly or indirectly, all the stock of the corporation paying the dividend, and all of the paying corporation's gross income from all sources is effectively connected with the trade or business in the United States. Column (c) is the amount entered in column (a) (the deduction percentage for dividends entered on line 8 is 100%) (IRC §245(d).

Line 9. Column (c) the total of lines 1 through 8, subject to a limitation from the worksheet included in instructions. If an NOL occurs, the limitation does not apply even if the loss is created by the DRD (IRC §172(d) and §246(b).

Line 10. Dividends from domestic corporations received by a small business investment company. Small business investment companies enter dividend that are received from domestic corporations subject to income tax, even though a deduction is allowed for the entire amount of such dividends. Claim the 100% deduction on line 10 column (c), the company must file with its return a statement that is was a federal licensee under the Small Business Investment Act at the time when the dividends were received.

Line 11. Dividends from affiliated group members. The members of an "affiliated group" of corporations that file separate returns can deduct the full amount of qualified dividends received from other group members. This permits corporations in the group to receive qualifying intercompany dividends tax-free, without having to file a consolidated return. Enter dividends that qualify under IRC §243(b) for the 100% dividends-received deduction in IRC §243(a)(3). Corporations taking this deduction are subject to provisions of IRC §1561.

Line 12. Dividends from certain foreign sales corporations (FSC) attributed to foreign trade income and that are eligible for the 100% deduction provided in IRC §245(c)(1)(A).

Line 13. Foreign sourced portion of dividends received that are from specified 10% owned foreign corporations (defined by IRC §245A (b)), including gain from the sale of stock of a foreign corporation that is treated as a dividend under IRC §1248(a) & (j) and qualify for the 245A deduction.

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Line 14. Other dividends of foreign corporations not reportable in lines 3, 6, 7, 8, 11, 12, or 13. Include on line 14 the foreign-source portion of any dividend that does not qualify for the section 245A deduction (for example, hybrid dividends, ineligible dividends within the meaning of IRC §245A(e), ineligible amounts of dividends within the meaning of Treasury Regulations 1.245A-5(b), and dividends that fail to meet the holding period requirement under IRC §246(c)(5), etc.). Also include here the corporation's share of distributions from IRC §1291 fund from Form 8621, to the extent that the amounts are taxed as dividends under IRC §301. Attach a statement identifying the amount of each dividend reported on Line 14 and the provision pursuant to which a deduction is not allowed with respect to such dividend.

Line 15. Column (a) includes the 2020 IRC §956(a) inclusion amount from Form 965, line 3. Review completed forms 965, 965-B and any applicable schedules. In column (c), enter the 2020 IRC §965(c) deduction from Form 965, Line 17.

Line 16. Income from controlled foreign corporations under subpart F (Review Form 5471). This is used if the corporation is a shareholder in a CFC. Line 16(a) is the foreign sourced portion of any subpart F inclusion attributed to the sale or exchange by a CFC of stock in another foreign corporation described in IRC §964(e)(4). Not included is any portion of subpart F inclusion that is not eligible for the section 245A deduction pursuant to Treasury Regulation 1.245A-5(g)(2). Line 16 b is the total subpart F income attributable to tiered hybrid dividends. This will equal the sum of the amounts reported by the US shareholder on Form(s) 5471. Line 16c is all other inclusions from CFCs under subpart F not included on lines 15, 16a, 16b, or 17. This will equal the US shareholder's pro rata share of the sum of the amounts reported on Form 5471, schedule I line 1(c) – 1(h), 2, and 4.

Line 17. Global Intangible Low-Taxed Income (GILTI). This is amounts included in income under IRC §951A. Review Forms 8992 and 5471. Consider the applicability of IRC §951A with respect to CFCs owned by domestic partnerships in which the corporation has an interest.

Line 18. This is the gross-up for taxes deemed paid under IRC §§902 and 960.

Line 19. These are taxable distributions from an IC-DISC (Domestic International Sales Corporation) or former DISC that are designated by the payer as not being eligible for a dividends-received deduction. No deduction is allowed for a dividend from an IC-DISC or former DISC to the extent the dividend: (1) is paid out of the corporation's accumulated IC-DISC income or previously taxed income, or (2) is treated as a deemed distribution under IRC §995(b)(1).

Line 20. Other dividends are reported taxable dividends (other than capital gain dividends) not properly reportable on lines 1 – 16. This includes: (1) dividends, other than capital gain distributions reported on Schedule D 1120 and exempt-interest dividends, that are received from RICs and that are not subject to the 50% deduction, (2) dividends from tax-exempt organizations, (3) dividends from real estate investment trusts (IRC §§856 and 860), (4) dividends not eligible for dividends-received deduction, including: (a) dividends received on any share of stock that the recipient corporation held for less than 46 days during the 91-day period beginning 45 days

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before the ex-dividend date IRC §246(c)(4) and Reg. 1.246-5, (b) dividends attributed to periods totaling more than 366 days that the corporation received on any share preferred stock held for less than 91 days during the 181-day period that began 90 days before the ex-dividend date (IRC §246(c)(4) and Reg. 1.246-5), or (c) dividends on any share of stock to the extent the corporation is under an obligation (including a shore stale) to make related payments with respect to positions in substantially similar or related property, and (5) any other taxable dividend income not properly reported elsewhere on Schedule C.

Line 21. Deduction for dividends paid on certain preferred stocks of public utilities. Before its repeal at the end of 2014, IRC §247 allowed a public utility to deduct 40% of the lesser of (a) dividends paid during the year on its preferred stock or (b) taxable income without regard to this deduction. If there was a net operating loss for the year, this taxable income limitation does not apply. Despite the repeal, FF1120, Schedule C, Line 21 still accounts for the deduction.

Line 22. This is the IRC §250 deduction claimed for FDII and GILTI, which should equal the sum of the amounts on Form 8993, Part IV, lines 8 and 9.

Line 23. Total dividends received listed in lines 9 through 20, Column (a). This amount will equal the amount reported on line 4 (Dividends) on FF1120, Pg. 1.

Line 24. Total amounts from Column (c) of Lines 9 through 22 to arrive at the total dividends-received deduction. The amount reported will equal Line 29b on FF1120, Pg. 1.

Schedule J

Line 5a Foreign Tax Credit (attach Form 1118). Ensure the taxpayer provides all Forms 1118. This is needed if a matching adjustment is necessary.

Schedule K

Line 2a. Provides the business activity code (NAICS)

Line 2b. Provides the business activity – compare to the written description provided by the taxpayer as requested in the initial Information Document Request.

Line 2c. Provides the product sold or service provided by the entity.

Line 3. Provides information about the structure of the entity – this is compared to the organization structure provided by the taxpayer from the initial Information Document Request.

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Schedule L

Other investments. This is generally only needed if the auditor is determining a related expense addback on foreign dividends or other foreign income not reported to SC. There are various methods that can be used to calculate the related expense addback on foreign income not reported to SC: Matching adjustment, Federal Form 1118 addback, and the DC Formula.

Schedule M-3 - Net Income (Loss) Reconciliation for Corporations with Total Assets of $10 Million or More

The auditor will review this form for each year under audit to determine related entities and domestic corporate changes of affiliates for each year. The Department will accept this form if all corporations filing in South Carolina are from the consolidated return are included (if the SC1120-T is not filed).

Note: Part I Line 11 should equal Part II, Line 30, column (a) of the consolidated schedule M-3.

Part I – Financial Information and Net Income (Loss) Reconciliation
Generally, this part will only be completed on a consolidated basis for federal income tax purposes.

If (3) Mixed 1120/L/PC group box is checked, the taxpayer has insurance companies included in its group. Generally, Part II and Part III will be blank except the bottom lines in each part for the consolidated group amounts. Also, the taxpayer may continue this for each entity's Schedule M-3.

Line 1a. This tells you if the ultimate parent files Form 10-K with the SEC. If the taxpayer does file the Form 10-K, the auditor needs to review it. If the taxpayer does not file the Form 10-K, the taxpayer may file Form 20-F for its foreign parent or the group is privately owned.

Line 4a. This is the book net income (loss) of the worldwide consolidated group. This amount should tie to the net income on income statement of the Annual Report. If it does not tie, questions 1-3 can help determine why.

Line 4b. The box check tells you which standards to taxpayer used to arrive at the amount on line 4a.

Line 5a. This is the total amount of foreign entities with net income. The taxpayer should have a by-company schedule of the entities included in this line. Generally, the amounts reported on that schedule will tie to net income after taxes reported on Schedule C of the federal Forms 5471 for each of those entities. These amounts are book income. If there is a lot of foreign income, look at the by-company schedule to see if one or a few entities are making up most of the income. The income may be shifting from the U.S. to that foreign entity or few foreign entities.

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Line 5b. This is the total amount of foreign entities with net loss. The taxpayer should have a by-company schedule of the entities included in this line. Generally, the amounts reported on that schedule will tie to net income after taxes reported on Schedule C of the federal Forms 5471 for each of those entities. These amounts are book income.

Line 6a. This is the total net income amount of U.S. entities that are not included in the consolidated filing and our filing their own returns. These entities can be domestic partnerships, domestic disregarded entities treated as a partnership or unconsolidated corporations filing a separate return with the IRS. The taxpayer should have a by-company schedule of the entities included in this line. An adjustment for the flow-through of a partnership(s) will be made on the Schedule M-3 for the corporate partners. If there is a lot of income for non-includable U.S. entities, look at the by-company schedule to see if entity is making up that income. If it is a partnership or DRE taxed as a partnership, verify if the partnership is unitary with the owner or group and if so, the amounts are reported correctly in the everywhere sales/gross receipts. If it is an unconsolidated corporation, the auditor will need to determine if the entity has activity in SC. If unitary combination is going to be made, this entity will need to be included in unitary combination group if it is unitary with that group.

Line 6b. This is the total net loss amount of U.S. entities that are non-included in the consolidated filing and our filing their own returns. These entities can be domestic partnerships, domestic disregarded entities treated as a partnership or unconsolidated corporations filing a separate return with the IRS. The taxpayer should have a by-company schedule of the entities included in this line. An adjustment for the flow-through of a partnership(s) will be made on the Schedule M-3 for the corporate partners.

Part II – Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return

Line 13 – Interest Income. If there is an amount in column (c) Permanent Difference, it is most likely to be tax exempt issue and must be added back on the SC 1120 Schedule A. You can also find the tax exempt interest on federal Schedule K and federal Form 8916-A.

Part III – Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return – Expense/Deduction Items

Line 3 – State and local current income tax expense. If there is an amount in column (d) Deduction per Tax Return, it must be added back in positive or deducted if negative on the SC 1120 Schedule A/B pursuant to SCCL §12-6-1130(2). You can also find this amount on breakdown of line 17, Taxes, of page 1 of the federal Form 1120. Taxpayer may include amounts from states that do not base their taxes on income (e.g. Texas Gross Receipts Tax). This may be the reason for the difference.

Line 5 – Foreign current income tax expense (other than foreign withholding taxes). If there is an amount in column (d) Deduction per Tax Return, it must be added back in positive or

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deducted if negative on the SC 1120 Schedule A/B pursuant to SCCL §12-6-1130(2). You can also find this amount on breakdown of line 17, Taxes, of page 1 of the federal Form 1120.

Line 35 – Research and development costs. If there is an amount in column (d) Deduction per Tax Return and the amount is material, the auditor needs to look into it further for possible disallowance of R&D expense if the entity is taking a majority of the expenses and are not receiving the royalty income.

Schedule N – Foreign Operations of U.S. Corporations

This form will let you know how many foreign disregarded entities (Form 8858), foreign partnerships (Form 8865) and foreign corporations (Form 5471) owned directly or indirectly by any of the U.S. corporations included in the consolidated federal Form 1120.

Form 851 – Affiliation Schedule

The auditor will review this form each year under audit to determine related entities and domestic corporation changes of affiliates within the consolidated federal return. Check for South Carolina filings for each entity listed on the Form 851. The Form also provides the principle business activity and code (NAICS) of the parent and affiliates. The business activity listed does not replace the taxpayer providing a detailed description of each entity filing in South Carolina.

Form 965 – Inclusion of Deferred Foreign Income

The taxpayer uses this form to compute section 965(a) inclusion amounts, section 965(c) deductions, and to make certain elections under section 965.

NOTE: This adjustment mainly applies to the 2017 and 2018 tax years.

Form 1118 – Foreign Tax Credit – Corporations

This form is used to determine the related expenses to foreign dividends that need to be added back for South Carolina purposes.

For periods 2017 and older, the auditor needs to pick up the information for both General (GEN) and Passive (PAS) categories. All the amounts on the Form 1118 are on Schedule A. The total expenses are from lines 9e and 10 for the Form 1118. Take the total of lines 13, 14 and 15 of the Schedule C of the federal Form 1120 divided by the total foreign income reported on line 8 of the federal Form 1118. Then multiply that percentage by the total expenses. This is the amount of the expenses attributed to foreign dividends not reported to South Carolina and is your related expense addback. Refer to the template for 2017 and older.

For 2018 and forward, the Form 1118 was changed and now includes more categories. The auditor needs to pick up the information for the General (GEN), Passive (PAS), Income Re-

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Sourced by Treaty (RBT), Foreign Branch (FB), and 951A. **NOTE:** there may be more than one form for the foreign branch category. All the amounts on the Form 1118 are on Schedule A. The total expenses are from lines 14j and 15 of the Form 1118. Take the total of lines 14, 16c, 17 and 18 of the Schedule C of the federal Form 1120 divided by the total foreign income reported on line 13 of the federal Form 1118. Then multiply that percentage by the total expenses. This is the amount of the expenses attributed to foreign dividends not reported to South Carolina and is your related expense addback. Refer to the template for 2018 and forward.

Form 1125-A – Cost of Goods Sold

Line 1 - Beginning Inventory. Review the prior year 1125-A to ensure ending inventory matches the beginning inventory.

NOTE: Inventory of an entity in SC typically creates Nexus, creating a filing requirement. If there is a question regarding Nexus, ensure the question is asked regarding if there is inventory stored in SC, who are the parties involved, what is their role, where is the inventory located, and when does the title transfer from the seller to the buyer.

Line 2 Purchases. Merchandise or materials used for resale.

NOTE: When reviewing on a separate entity basis, this line typically has intercompany purchases (therefore, will have eliminations on a consolidated basis). Request intercompany purchase agreements, eliminations, and 482 studies. Pay attention if the purchase agreement allows for the use of trademarks or processes royalty free and if residual profits Request the details of this line item and question the taxpayer on unusual items.

Line 5 Other Costs. Other costs associated with the manufacturing or merchandising process, including shipping, direct overhead, or supplies used directly in manufacturing or resale.

NOTE: Other costs can contain intercompany cost allocations and royalties. Royalty and other intercompany agreements, 482 studies, and intercompany eliminations should be reviewed. Request the details of this line item and question the taxpayer on unusual items.

Line 7 Ending Inventory. Review the subsequent year 1125-A to ensure beginning inventory matches the ending inventory.

Form 5471 – Information Return of U.S. Person With Respect to Certain Foreign Corporations

This is an informational return that needs to be complete for foreign corporations owned by domestic entities. The taxable income does not flow to any domestic returns. If a taxpayer does not have a federal Form 1120-F, you can use this form to determine the taxable income. Below is some additional information if you are going to use the 5471:

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- Be sure to watch the ownership percentage on page 1. Depending on the adjustments you are making, you may not be able to include the 5471 income if the ownership percentage is under 50%.

- Schedule C is the book income both in the foreign currency and U.S. Dollars.

- Schedule H is the book to tax adjustments in the foreign currency. Divide the amount on line 5c by the exchange rate (also on Schedule H) to get to U.S. Dollars. Schedule H is generally a better number since it is a tax number.

  NOTE: Regarding the Use of Schedule H

  If you use Schedule H, you will need to reverse the taxes based on income from Schedule C in the foreign currency and the taxes line on Schedule H. You will need to watch how the taxpayer presents the taxes based on income on Schedule C. Sometimes, they will show it as a negative number and add the amounts and other times, they will show it as a positive number and subtract it from net income before taxes.

  Also, you will need to review the other adjustments on Schedule H to see if there are any state adjustments.

- If you are looking at several 5471s, they may flow up to each other so you have to watch for counting the same income more than once.

- Schedule M, if completed will show the intercompany transactions. The first column is with the US parent, the second is with US subsidiaries within the group and the third column is with other foreign entities owned by the group.

- Schedule I does show Subpart F Income but it is not clear how it flows to the Schedule C of the federal Form 1120.

Refer to Worldwide Combinations for additional information on calculating income and gross receipts using the federal Forms 5471.

Foreign corporations incorporated in countries that can be considered as tax havens could be where taxpayers are shifting their income to avoid the high taxes in the U.S. and some European countries, such as U.K. and France. Some of the common countries that you may see are Luxembourg, Netherlands, Ireland, Bahamas, Barbados, Bermuda and Cayman Islands. A few countries that are a little less common are Aruba, British Virgin Islands, Cyprus, Gibraltar, Malta and Mauritius.

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Form 7004 - Application for Automatic Extension of Time to File Certain Business Income Tax, Information, and Other Returns

The auditor will review this form for each year under audit to determine related entities and domestic corporate changes of affiliates for each year. The Department will accept this form if all corporations filing in South Carolina are from the consolidated return are included (if the SC1120-T is not filed).

Form 8858 – Information Return of U.S. Person With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs)

This form is an information return for foreign disregarded entities owned by a domestic entity or foreign entities required to file a federal form. Generally, this information will already flow to its owners return. In some rare cases, the taxpayer will not flow the disregarded entity income to its foreign entity owner.

Form 8865 – Return of U.S. Persons With Respect to Certain Foreign Partnerships

This form is for foreign partnerships owned by domestic entities or foreign entities required to file a federal form. This form is very similar to the federal Form 1065 and K-1s. Note that taxpayers may have additional partnerships that are not required to file any federal forms.

Form 8916-A - Supplemental Attachment to Schedule M-3

Part II Interest Income

Line 1. Provides information on tax exempt interest income

Line 4a. Provides information on intercompany interest income from outside tax affiliated group.

Line 4b. Provides information on intercompany interest income from the tax affiliated group.

Line 5. Provides information on other interest income.

Part III Interest Expense

Line 3a. Provides information on intercompany interest expense from outside tax affiliated group.

Line 3b. Provides information on intercompany interest expense from inside tax affiliated group.

Line 4. Provides information on other interest expense.

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Form 8990 – Limitation on Business Interest Expense Under Section 163(j)

This form is used to calculate the amount of business interest expense the taxpayer can deduct and the amount to carry forward to the next year.

SC did not adopt the changes to IRC §163(j) (SCCL §12-6-50(5)(B)) and, as a result, for tax years beginning after 2017, SC does not limit the business interest expense deduction. Eligible taxpayers may deduct 100% of their business interest expense, without regard to IRC §163(j), in calculating their SC taxable income each year.

The auditor will review this form to determine the SC1120 Schedule A addition of any interest expense that is a carryforward from previous years (line 2) and the Schedule B deduction of any interest expense that was disallowed in the current year (line 31).

Form 8992 – U.S. Shareholder Calculation of Global Intangible Low-Taxed Income (GILTI)

The Tax Cuts and Jobs Act of 2017 enacted section 951A, which requires U.S. shareholders who own a CFC to include GILTI in gross income. Form 8992 is used to calculate the amount of GILTI inclusion. For U.S. shareholders that are members of a U.S. consolidated group, schedule B is completed and attached to a consolidated Form 8992.

The result on line 5 of Form 8992 will transfer to line 17 column (a) of Schedule C of the federal Form 1120. This amount is a deduction from SC taxable income.

Form 8993 – Section 250 Deduction for FDII and GILTI

The Tax Cuts and Jobs Act of 2017 enacted section 250 for the allowance of a deduction for the eligible percentage of FDII and GILTI. Form 8993 is used to calculate the amount of the eligible deduction.

The sum of the results on lines 28 and 29 of Form 8993 will transfer to line 22 column (c) of Schedule C of the federal Form 1120. This amount is an addition to SC taxable income.

Form 1120-F – U.S. Income Tax Return of a Foreign Corporation

This form needs to be filed with the IRS when you are a foreign corporation that has activities in the U.S. to pay federal taxes. You will need to ask for this form if you want more information on a foreign corporation. Ask for the federal Form 5471 to see all of the worldwide income. On page 2 of Form 1120-F, question w asks if the corporation is taking a position on 1120-F that a U.S. tax treaty overrules or modifies the IRC causing a reduction of tax. In several cases, this

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box will be checked yes and there will not be information reported on page 3. The taxpayer is saying that due to the tax treaty with the federal government, they are not required to pay taxes in the U.S.

SCCL §12-6-1200 states South Carolina taxable income does not include amounts excluded from federal income tax by reason of a treaty of the United States.

Form 1120 IC-DISC

A description of an Interest Charge Domestic International Sales Corporation (IC-DISC) from the Tax Advisory: Corporations & Shareholders

Taxpayers can use an interest charge domestic international sales corporation (IC-DISC) to obtain a tax incentive available to manufacturers, producers, resellers, and exporters of goods that are produced in the United States with an ultimate destination outside the United States.

Taxpayers can also use IC-DISCs to defer the recognition of income related to foreign sales; however, this item focuses primarily on using IC-DISCs to reduce the income tax liability of a corporation's shareholders by converting ordinary income into qualified dividend income.

The number of IC-DISCs has seen a resurgence for a couple of key reasons. The repeal of the foreign sales corporation provisions 14 years ago and the extraterritorial income exclusion in 2005—both of which generally provided larger tax benefits—have made the IC-DISC an attractive tax incentive once again. The "fiscal cliff" in 2012 and the American Taxpayer Relief Act of 2012, P.L. 112-240, that followed it also held the qualified dividend tax rates well below the ordinary income tax rates, meaning that IC-DISCs could still be used effectively to reduce income taxes. Therefore, tax professionals will likely come across more of these when working with manufacturers or producers.

An IC-DISC reduces its shareholders 'income tax liability by converting ordinary income from sales to foreign unrelated parties into qualified dividend income. An IC-DISC must be set up as a corporate entity separate from the related producer, manufacturer, reseller, or exporter.

Once the IC-DISC structure is in place, the related supplier can pay the IC-DISC a tax-deductible commission that is calculated based on the related supplier's foreign sales or foreign taxable income for the year. The IC-DISC then can distribute that commission to its shareholders in the form of qualified dividends under IRC §995(b) (1). These calculations and payments are generally made once the tax year is complete and the related supplier's taxable income can be accurately determined or estimated. In this situation, the IC-DISC entity exists solely on paper and does not actually act as an intermediary between the related supplier and customer. This setup is common; however, "buy/sell" IC-DISCs operate much like a distributor of goods in foreign countries. This item focuses on the former type of IC-DISC.

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Specific Topics

Bank Audits

An audit of a bank should not be done without the review of the bank Code of Laws and Draft Policy Document which is the most comprehensive information we have along with a recent Synovus Administrative Court Case. [redacted]

Two main federal agencies supervise Banks:
The Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC).

1. OCC- Charters, regulates, and supervises all national banks and federal savings associations as well as federal branches and agencies of foreign banks. The OCC is an independent bureau of the U.S. Department of Treasury.

2. FDIC – The Federal Deposit Insurance Corporation is an independent agency created by Congress to maintain stability and public confidence in the nation's financial system. To accomplish this mission, the FDIC insures deposits; examines and supervises financial institutions for safety, soundness, and consumer protection; makes large and complex financial institutions resolvable; and manages receiverships.

Both the OCC and the FDIC have research tools and may have information helpful to your audit. The OCC generally has detail information about the operation of the Bank and affiliates. Go to the OCC website and search for the bank you have questions on. The FDIC has the best information which may be helpful. Go to the FDIC website to find the Bank you are researching. From the link, you can find various information which may be helpful to the audit. Some of the information includes:

1. Net Income and Balance Sheet Statements for various reporting periods
2. Deposits and locations by State
3. Type of Bank Charter

The deposits and locations by State could be a helpful research tool to determine if the taxpayer may be sourcing the correct receipts to South Carolina. Review the apportionment data reflected on the SC Bank Return and determine if you think the apportionment ratio is correct. If not, compute the ratio by relating the SC Deposits or SC locations (from the FDIC website) to the total deposits and locations to see if this ratio is in line with the apportionment ratio reported on the SC return. Keep in mind, the bank may not have any locations or deposits in South Carolina but still have SC Nexus.

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Bank Return and how Banks are taxed. Banks are required to report its SC Bank Income for SC on Form SC1101 B. The bank return starts with federal taxable income and there are Schedule A and B modifications to arrive at the book net income reported on schedule M-3 of the taxpayer's federal return. The Bank's book net income is called "net income as reconciled" on the bank return. Total net income as reconciled is adjusted for everywhere allocation to get the net income subject to apportionment. The net income subject to allocation is multiplied by the SC Gross Receipts Apportionment ratio to get the SC apportioned income. The SC apportioned income is added to the direct allocations to SC to get the total SC net income. The SC net income is multiplied by 4.5% to get the bank tax due. Banks cannot be included in a SC consolidated return, cannot take a dividends received deduction and do not pay a corporate license fee. Refer to the following information for additional details:

1. SC Code of Laws for Banks Title 12, Chapter 11
2. Synovus Bank vs. SC Department of Revenue before the Administrative Law Court
3. Public Draft Of Bank Tax Overview dated 8/25/2016. (This draft was never issued but, to the knowledge of the foreign audit Supervisor, it currently is, and has always been, the position of the Department regarding Bank Tax.)

SCCL §12-11-40 of the bank income tax code provides that for purposes of allocation and apportionment, the provisions of Chapter 6, Title 12 are adopted for the bank tax. Since banks' primary business does not involve tangible personal property, banks must use the gross receipts method for apportioning income using a fraction in which the numerator is gross receipts from within this State during the taxable year and the denominator is gross receipt from everywhere during the taxable year. Use SCCL §§12-6-2290 and 12-6-2295 to source receipts within and outside SC.

SC1101B

Line 1. Federal Taxable Income form line 30 of the federal Form 1120 Proforma.

Line 2. Total modifications reflected on schedule A and B of the Bank Return. The state modifications for banks are not the same as the modifications for corporations filing the SC 1120.

Line 3. Total Net Income as Reconciled – Line 1 plus or minus Line 2. (From Line 6 of schedule D). Note: the Federal Taxable Income plus or minus the net modifications should be Bank's Book income reported on line 1 on Schedule M-1 of the federal Form 1120 and Line 30 (a), Part II of the Schedule M-3 and balance to the Total Net Income as Reconciled. If the Bank's Book income does not balance to Line 3, there will be an audit adjustment.

Line 4. Apportioned Net Income Plus direct allocations to SC (amount form line 6 of schedule D).

Line 5. Tax (Line 4 X 4.5%).

Line 6. Non Refundable Credits.

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Line 7. Balance of Tax (Line 5- Line 6)

Schedule A and B
Line 1-8 (additions to federal taxable Income), Line 9 (Total of all additions); Lines 10-17 (deductions from federal taxable Income), Line 18 (total of all deductions), Line 19 (net adjustments from Line 9 and Line 18).

Schedule C
Lines 1 through 6 – Everywhere and Direct Allocations (less related expenses).

Schedule D
Line 1. Total Net Income as Reconciled (total of Line 3, Page 1 of SC1101B) – Should balance to Line 1 of Schedule M-1 of federal Form 1120 and line 30(a) of Part II of the Schedule M-3.

Line 2. Everywhere Allocations (from Schedule C, line 7).

Line 3. Total net income subject to apportionment (Line 1, schedule G plus or minus line 2 schedule G).

Line 4. Apportioned net income (line 3, schedule D times line 4, schedule E).

Line 5. Direct Allocations to SC (from line 8 of Schedule C).

Line 6. SC Net Income (line 4, schedule D plus or minus line 5, schedule D).

NOTE: If the everywhere allocations is a negative amount, it increases the total net income as reconciled. If the everywhere allocations is a positive amount, it reduces the total net income as reconciled. If the direct allocations to SC is a negative amount, it reduces the apportioned income reported on Line 4 of Schedule D. If the direct allocations to SC is a positive amount, it increases the apportioned income reported on Line 4 of Schedule D.

Some typical Bank Adjustments:

1. *Numerator Adjustment.* Adjust SC numerator to provide representation for loans sold/securitized. Some banks will dilute the SC apportionment ratio by including the loans sold/securitized in the denominator but without any representation in the numerator for the loans sold/securitized. It seems almost all real property loans are sold/securitized. The purpose is so the bank can have more available cash to make loans. Also, when the banks sale/securitize the loans they generally retain management of the loans and receive a fee for managing the loans. They generally make more money from the management of the loans than they do from interest if they retain the loan. Here is an adjustment made on a recent audit. The amounts have been changed:

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EXAMPLE:
The taxpayer did not source any receipts from the sale of loans despite including all the sale of loans of 250,000,000,000 in the denominator. The SC numerator was adjusted to include representation for loans sold with a SC situs in the numerator.

Amounts included in denominator from the Sale/Securitization of loans:

12/31/2015: 250,000,000,000
12/31/2016: 175,000,000,000
12/31/2017: 165,000,000,000

SC numerator adjusted to include representation of loans sold with a SC situs:
Addition to numerator:

12/31/2015: 4,375,000,000
12/31/2016: 2,537,500,000
12/31/2017: 2,557,500,000

Refer to SCCL §12-6-2295 (A) (3), and (5).

2. *Numerator Sourcing.* Some banks report receipts using cost of performance instead of the location of the income producing activity. Interest on loans, swipe charges and various fees are sourced to the location of the customer because that is what produces the income. Here is an adjustment made on a bank audit for fees received from checking account holders located in SC:

EXAMPLE:
It was determined that the following sub-account receipts were not properly sourced to SC:

[redacted]

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The taxpayer maintained that the income producing activity was located out-of-state for these accounts. We disagreed and determined that if the receipts were received from SC checking account holders, the income producing activity was located in SC pursuant to SCCL §12-6-2295(A)(5).

3. *Numerator Sourcing.* The taxpayer sourced its receipts to South Carolina utilizing cost of performance. Service providers, like the taxpayer, do not use either market or cost of performance to source their SC gross receipts. Instead, they use the location of the income producing activity to source their receipts to SC.

EXAMPLE:
The SC sourcing was changed as follows:

SC Receipts as filed:

12/31/2016: 250,000
12/31/2017: 175,000
12/31/2018: 185,000

SC Receipts as adjusted to the location of the income producing activity:

12/31/2016: 133,427,493
12/31/2017: 119,636,929
12/31/2018: 118,545,066

With regard to fees and interest, the taxpayer should use the location of the customer to source their receipts to SC. This is where the income is produced.

Sourcing of interest, yearly credit card fees, late fees, swipe charges of banks:
Banks must use the gross receipts method of apportionment. The department's longstanding administrative policy is that banks will comply with sourcing principles similar to those used by multistate non-bank financial businesses, such as finance companies. SC Information Letter #94-35 and SCCL §12-11-40. Based on the Department's longstanding administrative practices, the department sources income from loans to where the borrower is located. Accordingly, payments on loans are receipts from within South Carolina when paid by a borrower located in South Carolina. See Lockwood Greene (SC). For banks that issue credit cards, interest paid by credit card users is sourced to the location of the credit card customer. Similarly, yearly credit card fees and late fees charged to customers are sourced to the location of those customers since the production of that income is most significantly associated with the customer.

Merchants are charged a fee each time a credit card is "swiped" for a customer to purchase a product or services. These fees are sourced to South Carolina if the merchant is located in South Carolina since the source of the income is the in-state merchant and the purchase of goods or services which generates the swipe fees is from within the state.

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4. *Book Income Adjustment.* The modified taxable income reported on the bank return (Form SC1101 B) must agree with the book income reported on Line 1 of Schedule M-1 or Line 30 (a) of Part II of the Schedule M-3 filed with the federal Form 1120. If the net income as reconciled on the SC1101B does not agree with the book income this will be a positive or negative adjustment to the net income as reconciled.

5. *Book Income Adjustment.* If the book income includes an equity adjustment shown on Line 1 (a) of Part II from the Schedule M-3 of the federal Form 1120, the Equity adjustment must be subtracted from the book income shown on line 30(a) of Part II of the Schedule M-3 from the federal Form 1120. Remember banks report book income on the cost method, not the equity method.

6. *Book Income Adjustment.* Generally, the federal Schedule M-3 is provided on a consolidated basis; thus, the intercompany dividends will not be shown on Line 7(a) of part II of the Schedule M-3 from the federal Form 1120. Since intercompany dividends are included as part of the bank's book income, you will have to ask for the intercompany dividends received by the bank. These dividends will be added to the bank's book income and added to the everywhere denominator.

   NOTE: If the commercial domicile of the bank is located in SC, the intercompany dividends will be added to the numerator and denominator.

7. *Book Income Adjustment.* Review the Permanent differences shown on Line 8 (c), Line 9 (c), Line 10 (c), and Line 11 (c) of the federal Schedule M-3 and determine what these are for. If these are minority investments in subs or flow through adjustments (partnerships and disregarded entities) that have not been booked as income, they need to be added to the bank's book income.

Allocations. If the banks have any allocated income, please review closely to determine that the items are nonbusiness. As a rule, banks almost never have nonbusiness income since part of the bank's normal business operations is to invest in equities and other financial instruments to earn income, gains and interest.

SC NOLs. Banks cannot take a SC NOL. Disallow any SC NOLs taken by banks.

Captive REITs

How to Qualify as a REIT[12]. To qualify as a REIT, a company must comply with certain provisions in the Internal Revenue Code (IRC). These requirements include to primarily own income-generating real estate for the long term and distribute income to shareholders. Specifically, a company must meet the following requirements to qualify as a REIT:

[12] https://www.investopedia.com/terms/r/reit.asp

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- Invest at least 75% of total assets in real estate, cash, or U.S. Treasuries,
- Derive at least 75% of gross income from rents, interest on mortgages that finance real property, or real estate sales,
- Pay a minimum of 90% of taxable income in the form of shareholder dividends each year,
- Be an entity that's taxable as a corporation,
- Be managed by a board of directors or trustees,
- Have at least 100 shareholders after its first year of existence ,
- Have no more than 50% of its shares held by five or fewer individuals.

There are three types of REITs:

- *Equity REITs*. Most REITs are equity REITs, which own and manage income-producing real estate. Revenues are generated primarily through rents (not by reselling properties).

- *Mortgage REITs*. Mortgage REITs lend money to real estate owners and operators either directly through mortgages and loans, or indirectly through the acquisition of mortgage-backed securities. Their earnings are generated primarily by the net interest margin—the spread between the interest they earn on mortgage loans and the cost of funding these loans. This model makes them potentially sensitive to interest rate increases.

- Hybrid REITs. These REITs use the investment strategies of both equity and mortgage REITs.

All the taxable income reported on the Form 1120-REIT is deducted out as a dividends-paid deduction. SC Net Income is apportioned only on the modifications (schedule A and B of the SC 1120). Generally, there is not an issue with any of the three type of REITs as long as the REIT is dealing with third parties. What we see on audit are captive REITs, which could result in a substantial audit adjustment.

Captive REIT that owns real property and leases the Real Property to affiliates. If any of the real property is located in SC, the REIT will generally be filing in SC. They pay License Fee to SC if they are organized as a corporation. If they are organized as a trust, they are not required to pay license fee.

Captive REIT that owns mortgage loans. Generally, they will not be filing in SC even though they own intangible property (real estate loans) with a SC situs.

NOTE. Captive REITs are generally not included in the Federal Consolidated Return, so you will have to ask for the REIT Returns (Form 1120-REIT). When reviewing the federal consolidated return you can tell if they own a REIT if the taxpayer is reporting a substantial amount of intercompany dividends that are not deducted out on line 29 B of the federal consolidated return.

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How to cure the distortion.

Forced Combination for owners of real property

For REITs that own real property, a forced combination is the best approach. Include the REIT and the REIT holding company in the forced combination. You will have to add the REIT return to the federal consolidated return. The REIT holding company is already included in the federal consolidated return.

Assert Nexus on the REIT Holding Company and the REIT if the REIT owns intangible property (mortgage loan receivables)

For REITs that own intangible personal property (mortgage loans), assert nexus on the REIT and the REIT holding company. Do a ten-year audit period. A forced combination will not work on REITs that own mortgage loans because their largest affiliates are banks and, because the banks have a different tax rate and report on book income, cannot be forced combined.

The Department will not consider the dividends received by the REIT holding company to be dividends, but flow through interest from the REIT. Source the dividends received by the REIT holding company from the REIT using the same apportionment ratio used for the REIT.

It is unusual to find captive REITs now as most states have changed their statute (combined reporting or required addbacks of REIT Dividends). Unfortunately, SC has not changed its statute.

No SC cases have been taken to court but we do have a Department Determination.

XXX and XXX's Captive REITs: The REITS were filing in SC, but not the REIT Holding Companies. The captive REIT owned the real property that was leased to the operating companies. We asserted nexus on the REIT holding companies back ten years and required sourcing of the dividends, which were considered flow through receipts from the lease of real property.

Excerpts of the Department Determination.

Income from property located in South Carolina is taxable in South Carolina. A taxpayer who transacts business within and without of this state is subject to South Carolina income tax on a basis which reasonably represents the proportion of the trade of business carried on within the state (SCCL §12-6-2210(B) (2000)). Rent from real property is generally allocated to the state in which the property is located (SCCL §12-6-2220 (2000)). It has long been held that income arising from business or property within a state is subject to state taxation (*International Harvester Co. v. Wis. Dep't of Taxation*, 322 U.S. 435, 441-42 (1944)). Indeed, the Supreme Court has held that the taxpayer need not be a resident of the state for the income in question to be taxable by the state authorities (Id).

Here, the taxpayers have created a multi-layered corporate structure whereby income escapes taxation in the state of South Carolina. Revenues from South Carolina consumers flow into the XXX corporate structure through its various retail stores. The money then flows out of these stores to XXREBT and XXXREBT in the form of rent payments. To avoid being taxed at the REIT level, these payments are distributed to XX and XXX, two non-resident entities which pay

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no tax in South Carolina. Ultimately, the money has not changed hands or form in any appreciable way since entering the XXX structure, yet the income escapes taxation in South Carolina. Thus, the basis upon which these taxpayers pay tax in South Carolina does not reasonably represent the proportion of their trade or business carried on within the state. The Department therefore asserts jurisdiction to tax the income of the REIT beneficiaries, XX and XXX.

The purpose of a REIT is not to avoid all taxation.

The REIT structure was created by Congress in 1960 to provide a flow through mechanism for investments in real estate similar to a mutual fund for investments in stocks (*BankBoston Corp. v. Comm'r of Revenue*, 861 N.E.2d 450, 451 (Mass. Ct. App. 2007)). It was not intended to permit income to escape all taxation, but rather to avoid the double taxation that was occurring where corporations were created to purchase and hold real estate and paid out corporate dividends to shareholders (Id.) In other words, REITs were designed for "single taxation", not "no taxation" (Id.)

REITs have been used improperly as tools of income shifting and tax avoidance strategies almost since their inception (Id.) Congress eventually closed loopholes in the federal law which had previously allowed corporations implementing a REIT to avoid tax on the REIT by employing the dividends paid deduction and simultaneously claiming a dividend received deduction for the REIT beneficiary (*BankBoston* at 451 (citing 26 U.S.C. § 243(d)(3) which specifically denied REIT distributions "dividend" status for purposes of the dividend received deduction). This strategy had allowed REIT income to go entirely untaxed, and was clearly not what was intended by Congress.

Due Process Clause[13]

Section 1 of the Fourteenth Amendment to the U.S. Constitution provides that no state may "deprive any person of life, liberty, or property without due process of law." The Due Process Clause protects taxpayers against arbitrary state action. The U.S. Supreme Court has ruled that a tax statute that is so arbitrary that it amounts to the confiscation of property violates the Due Process Clause (*A. Magnano Co. v. Hamilton (1934)* 292 US 40). Double taxation does not violate Due Process unless it is arbitrary (*Shaffer v. Carter (1920)* 252 US 37).

Procedural due process. Due Process requires that a taxpayer be given notice of the tax and an opportunity to be heard (*Nickey v. Mississippi (1934)* 292 US 393). In addition, due process requires a state to provide relief to taxpayers who, for purposes of challenging the validity of a tax, are required to pay, under protest, a tax that is ultimately held to be unconstitutional (*McKesson Corp. v. Division of Alcoholic Beverages and Tobacco (1990)* 496 US 18). However, aggrieved taxpayers are not necessarily entitled to a tax refund, as long as the taxing state provides relief that is consistent with due process (*Harper et al v. Virginia (1993)* 509 US 86).

[13] From Checkpoint

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Nexus requirement: In two leading cases, decided by the U.S. Supreme Court in 1959, the Court held that, where a tax was levied only on that part of a taxpayer's net income arising from its activities within a taxing state, imposition of the tax did not violate the Due Process Clause, because the taxpayer's activities within the state formed a sufficient nexus between the taxpayer and the taxing state (*Northwestern States Portland Cement Co. v. Minnesota (1959)* 358 U.S. 450, and *Williams v. Stockham Valves and Fittings, Inc. (1959)* 358 U.S. 450). In a 1992 use tax case, the U.S. Supreme Court ruled that physical presence within the taxing state is not required to satisfy Due Process nexus (*Quill Corp. v. North Dakota (1992)*, overturned by *South Dakota v. Wayfair, Inc. (2018))*

Apportionment issues. Although most states use a three-factor apportionment formula, a one-factor apportionment formula has been held by the U.S. Supreme Court not to violate Due Process (*Moorman Manufacturing Co. v. Bair (1978)* 437 US 267). South Carolina is now a single sales factor state.

In two companion cases decided in 1992, *ASARCO, INC. v. Idaho State Tax Commission (1982)* 458 US 307, and *F.W. Woolworth Co. v. New Mexico (1982)* 458 US 354, the U.S. Supreme Court ruled that Due Process considerations prohibited Idaho and New Mexico from including in the apportionable tax base of a non-domiciliary parent company dividends received from overseas subsidiaries that operated as discrete businesses and were not part of a unitary business.

License Fee

SCCL §12-20-50 imposes an annual license fee on the capital and paid-in surplus of a corporation. The license fee is $15 plus $1 for each $1,000, or fraction, of capital stock and paid-in or capital surplus shown on the corporate records on the first day of the tax year. The minimum license fee is $25. The license fee is computed in advance of the taxpayer's income tax year. If a "consolidated" return is filed, then the license fee is measured by the capital stock and paid-in or capital surplus of each corporation considered separately without offset for investment of one corporation in the capital or surplus of another corporation in the consolidated group. The minimum license fee applies to each corporation in the consolidated group. SCCL §12-20-60 provides that the license fee imposed by SCCL §12-20-50 must be apportioned in accordance with the ratio prescribed for income tax purposes. The $25 minimum license fee; however, may not be apportioned. SCCL §12-20-50(A) defines "paid-in or capital surplus" and "earned surplus".[14]

For unitary combinations, the license fee is still calculated on a separate entity basis and it is not adjusted unless there is also sourcing adjustments being made.

[14] Excerpt from Policy Section Manual

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The following entities do not pay the license fee: banks, REITs organized as a trust, Savings and Loan Company, cooperatives, insurance companies, foreign corporations excluded under SCCL, community development entity, nonprofits, volunteer fire department and HOA.

See SC RR #05-11 for a detailed question and answer document on computing and prorating the license fee based on capital stock and paid in or capital surplus as provided in SCCL §12-20-50.

NOTE: SCCL §12-20-100 imposes a license fee on every express company, street railway company, navigation company, waterworks company, power company, electric cooperative company, light company, gas company, telegraph company, or telephone company in lieu of the license fee imposed by SCCL §12-20-50. This license fee is based on gross receipts from services rendered from regulated business in South Carolina and South Carolina property used in the conduct of business. The fee is $1 for each $1,000, or fraction, of fair market value of property owned and used within South Carolina in the conduct of business as determined for property tax purposes for the preceding tax year and $3 for each $1,000, or fraction, of gross receipts from services rendered from regulated business within South Carolina during the preceding tax year. The minimum license fee is $25.

Prorated License Fee. Partial Year License fee is prorated pursuant to SCCL §12-20-80. If a corporation's taxable year is changed and results in the filing of an income tax return for less than twelve months, the license fee due with the short period return must be prorated by dividing the annual license fee by twelve and multiplying the result by the number of months in the short period. Each part of a month is considered a full month for purposes of this section. This prorated fee may not be less than the minimum license fee provided in SCCL §12-20-50(A) as provided by SCCL §12-20-80(A). The proration provided in this section applies only to short periods due to a change in accounting period and does not apply to short periods due to initial or final returns (SCCL §12-20-80(B)).

Nexus

Nexus is the minimum connection or contact between a taxpayer and a state sufficient to subject the taxpayer to the taxing jurisdiction of a state. The Due Process and Commerce Clauses of the United States Constitution, 15 U.S.C. §381 (Public Law 86-272) and other federal statutes provide limitations on a state's powers to tax out-of-state businesses.

Over the years, courts have provided limitations and guidelines in determining whether certain activities create nexus with a taxing state. For example, see *Quill (U.S.)*, *Wrigley (U.S.)*, *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985), *Helicopteros Nacionales de Columbia, S.A. v. Hall*, 466 U.S. 408 (1984), *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977), and *Geoffrey (SC)*.

In *Geoffrey (SC)*, the South Carolina Supreme Court determined that the licensing of trademarks and symbols to a South Carolina retailer and the maintaining of accounts receivable in South

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Carolina by a nonresident taxpayer creates nexus for South Carolina income tax purposes even though the taxpayer lacked physical presence in South Carolina. The Court determined that Geoffrey purposely directed its activities toward South Carolina, and that Geoffrey owned intangible property in South Carolina. Each of these activities was sufficient to satisfy the nexus requirements of the Due Process Clause and the Commerce Clause.

Public Law 86-272, as codified at 15 U.S.C. Section 381, places certain limits on the power of a state to impose a tax on the income derived from within its borders. It reads, in pertinent part:

> (a) No State, or political subdivision thereof, shall have power to impose... a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:
>
> (1) The solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and
>
> (2) The solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).
>
> (b) The provisions of subsection (a) of this section shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to -
>
> (1) Any corporation which is incorporated under the laws of such State; or
>
> (2) Any individual who, under the laws of such State, is domiciled in, or a resident of, such State.
>
> (c) For purposes of subsection (a) of this section, a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance, of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.
>
> (d) For purposes of this section –
>
> (1) The term "independent contractor" means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for the sale of, tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and
>
> (2) The term "representative" does not include an independent contractor.

- RR16-11 Nexus Creating Activities for Income Tax.pdf
- RR18-14 Retailers Without a Physical Presence.pdf
- RR97-15 PL86-272.pdf

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Nexus through an Agency Relationship or Activity of a Third Party. Nexus can be asserted on the taxpayer if they have an agency relationship or if the in state activity performed by the third parties allow the taxpayer if maintain a SC market. Excerpts of *Travelscape (SC)*, Respondent before the SC Supreme Court: In *Tyler Pipe (U.S.)*, the State of Washington imposed a sales tax on a corporation that manufactured products outside of Washington for in-state sale. 483 U.S. at 249, 107 S.Ct. at 2821. The Supreme Court found the corporation had a physical presence in Washington even though it manufactured all of its products outside the State, maintained no offices in the State, owned no property within the State, and had no employees residing in the State. 483 U.S. at 249, 107 S.Ct. at 2821. The Supreme Court reached this conclusion in light of the services provided by non-employee in-state sales representatives. Id. The sales representatives provided services that were essential to the corporation's ability to make sales in Washington, including calling customers, soliciting orders, maintaining contacts, and providing information. Id. at 250, 107 S.Ct. at 2821. Based on these facts, the Supreme Court found the corporation had a physical presence in the state for tax purposes. Id. In a similar case, the Supreme Court found a Georgia corporation was subject to a use tax imposed by the State of Florida in spite of the fact the corporation had no offices or employees in Florida. *Scripto, Inc. v. Carson (U.S.)*. There, the corporation used independent contractors to sell its products in Florida. Id. at 211, 80 S.Ct. at 621-22. Although these "salesmen" were not technically employees of the corporation, the Supreme Court found their activities within Florida on behalf of the corporation were sufficient to satisfy the physical presence requirement. Id. The Court further found that the corporation's disclaimer of an agency relationship with the independent contractors was insignificant for constitutional purposes. Id. at 211, 80 S.Ct. at 622.

Economic Nexus. State nexus (Corporate income and license fee, sales and use) nexus created through the economic presences of taxpayer.

Factor Presence Nexus. Many states (SC is not one of them) have established a factor presence standard that establishes Corporate Income Nexus and required sourcing or Income to the state based on the amount of property or payroll or Sales/receipts in the state for Nonresident taxpayers. South Carolina does have a nexus standard for sales tax. The sales nexus standard is 100,000 of sales into SC per calendar year (SC RR #18-14)

The Department has never argued that merely obtaining a certificate of authority creates nexus.

Non-Business Income[15]

Allocation

Allocation assigns certain classes of income, less related expenses, to specific locations. Allocation is an attempt to attribute revenue to the geographical source of particular items of net income. In South Carolina, the statutory provisions authorizing specific allocation generally, but not always, apply to nonbusiness items of net income.

[15] Old South Carolina Corporate Income Taxes 2005

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In South Carolina the following items of income and their related expenses must be directly allocated and excluded from apportioned income and the apportionment factors (SCCL §12-6-2220). For the purposes of this list, the term "related expenses" mean any cost incurred, directly or indirectly, in connection with investments for the production of income or future income which is or will be specifically and directly allocable (SC Reg. §117-700.1); and a corporation's principal place of business is the domicile of the corporation unless none of the business is conducted in the state of domicile in which case the Department will determine the principal place of business based upon the available evidence (SCCL §12-6-30(9)). Items allocated are:

1. Interest received from intangible property not connected with the taxpayer's business, less all related expenses, is allocated to the state of the corporation's principal place of business.

2. Dividends received from corporate stocks owned, less all related expenses, are allocated to the state of the corporation's principal place of business whether or not they are related to the taxpayer's trade or business.

NOTE: During settlement negotiations some taxpayers have claimed that this section violates the discrimination prong of the Commerce Clause, but the issue has never been raised formally in an appeal or case. In accordance with *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), a tax will survive challenge under the Commerce Clause if it does not violate any of the four prongs of the Commerce Clause. The four prongs are:

1. The tax is applied to an activity with a substantial nexus with the taxing state;

2. The tax is fairly apportioned;

3. The tax does not discriminate against interstate commerce; and

4. The tax is fairly related to the services provided by the state.

NOTE: This section of the law was changed for tax years beginning in 2005 to require allocation of dividends only when the dividends are not business related:

SCCL §12-6-2220(2):
Dividends received from corporate stocks not connected with the taxpayer's business, less all related expenses, are allocated to the state of the corporation's principal place of business as defined in SCCL §12-6-30(9) or the domicile of an individual taxpayer'.

2005 Act No. 145, Section 12.B, provides as follows:
"Section 12-6-2220(2) of the 1976 Code, as amended by this section, applies for taxable years beginning after 2004."

3. Rents and royalties received from the lease or rental of real estate or tangible personal property, less all related expenses, are allocated to the state where the property is located at the time the income is derived, providing the property was not used in or connected with the taxpayer's trade or business during the taxable year.

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4. Gains and losses from the sale of real property less all related expenses are allocated to the state in which the real property is located except to the extent that gain represents the return of amounts deducted as depreciation. The amount of gain which represents the return of amounts deducted as depreciation is allocated to South Carolina to the extent of depreciation previously deducted in computing South Carolina taxable income. Gain in excess of recaptured depreciation is allocated to the state where the real property is located whether or not the real property was used in or connected with the taxpayer's trade or business.

NOTE: The South Carolina depreciation deduction for each year for the real property sold may not be available or may be excessively time consuming to obtain. Many taxpayers seem to apportion the recapture based on the current or previous year's apportionment percentage. This approach is subject to challenge, but may be economically expedient.

5. Gains and losses from sales of intangible personal property not connected with the business of the taxpayer and not held for sale to customers in the regular course of business, less all related expenses, are allocated to the state of the corporation's principal place of business. All income from personal services received by a South Carolina resident by a nonresident individual for services rendered in South Carolina is allocated to South Carolina.

NOTE: In SC CD #91-5, the Department held that gain on the sale of a partnership interest was allocated. Given the cases discussed in "Matching Deductions to Income" of this portfolio, this decision is open to question. Also see, Matching Principle.

Another allocation provision for all income not allocated by the above provisions and not connected with a business that is at least partially transacted or conducted in South Carolina provides:

"Any income, less all related expenses, which is not allocated under SCCL §12-6-2220 and not properly includable in the net apportionable income of taxpayers engaged in interstate commerce under the Constitution of the United States because it is unrelated to the business activity of the taxpayer conducted partly within and partly without this State, is allocated to the state in which the business situs of the investment is located. If the business situs of the investment is partly within and partly without South Carolina, the investment is apportioned using the same formula used for apportioning the net income of the corporation.",(SCCL §12-6-2230).

NOTE: Although the purpose of this provision has been the subject of some question, it is rarely used. The authors believe that it refers, at least in part, to any income no part of which is apportionable to South Carolina and which is not contained in any of the specific allocation provisions of SCCL §12-6-2220.

Business vs. Nonbusiness Income

In order to determine whether interest, rents, royalties, and gains and losses from the sale of intangible personal property are allocable, it must be determined if the income is used in, or connected with, the taxpayer's trade or business.

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In *Geoffrey (SC)* the South Carolina Supreme Court concluded that in order for a corporation to be taxed in South Carolina the corporation must be "transacting, conducting, doing business, or having an income within this State." (SCCL §12-7-230 recodified as SCCL §12-6-530) The Court construed this language as extending to the limits of the Constitution South Carolina's authority to tax foreign corporations. Thus, the controversy surrounding the definition of business income in the Uniform Division of Income for Tax Purposes Act (UDITPA) is the following:

[I]ncome arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

There is a dispute over whether this definition creates one or two tests; a transactional test, or a transactional and a functional test. Some courts have held that there is only a transactional test and income which is not earned in the regular course of business is not business income.[16]

Although South Carolina does not have to deal with this issue, the Department's auditors are instructed that if the answer to either of the following two tests is yes, the income is business income[17]:

- Transactional test — Does the income arise from transactions or activities conducted in the regular course of the taxpayer's trade or business operations?
- Functional test — Does the income come from property where the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business? Under the functional test, all gain from property is business income if the property was used by the taxpayer in its regular trade or business.

Negative answers to both questions do not necessarily mean that the income is nonbusiness income.

However, for South Carolina income tax purposes this is irrelevant. South Carolina treats as business income any income that is part of the taxpayer's unitary business. See the discussion on the unitary business doctrine, especially the discussion on *Kodak (SC)* for some insight into the business/nonbusiness issue in South Carolina.

Both tests do not have to be met; if either one of the tests is met, the income will be characterized as business income. Income that does not meet either one of the tests will be characterized as nonbusiness income. The District Court in *Gannett (MT)* also ruled that the taxpayer bears the burden of proving an item of income is properly classified as nonbusiness.

[16] BNA Multistate Tax Portfolio #1140, Income Taxes: The Distinction between Business and Nonbusiness Income.
[17] BNA Multistate Tax Portfolio #1140:0046, Income Taxes: The Distinction Between Business and Nonbusiness Income.

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When applying the "transactional test" the controlling factor is the nature of the particular transaction or activity that generates the income. The transaction or activity must be in the regular course of the taxpayer's business and the relevant considerations include frequency and regularity of similar transactions. For example, income from the sale of inventory in the regular course of the taxpayer's business would be "business income" under the transactional test.

In contrast to the transactional test, which focuses on the income-producing transactions and activity, the "functional test" focuses on the nature of the property, not the transactions or activities. The critical inquiry here is the relationship between the property under consideration and the taxpayer's business operations. For example, the gain from the sale of an asset used in the taxpayer's regular trade or business operations would be "business income" under the functional test.[18]

Matching Deductions to Income

Expenses incurred in earning allocable income are matched and offset against the income they generate (SC Reg. §117-700.1). These expenses may not be used to offset apportionable income. Also taxpayers that have business deductions for businesses which are not transacted or conducted in South Carolina, must use those deductions against those businesses' income. The deductions are not available to use against South Carolina income. The importance of matching income and deductions in South Carolina is demonstrated by the following South Carolina Supreme Court decisions:

1. In *Avco Corporation v. Robert C. Wasson, 267 S.C. 581 (1976).* The Supreme Court held that interest expenses incurred by a corporation in connection with debentures issued to finance acquisitions of stock in other corporations could not be allowed as a deduction against the corporation's apportioned income.

Avco owned and operated a manufacturing plant in Charleston County, South Carolina. Avco is incorporated in Delaware and its principal office is in Connecticut. Avco issued and sold debentures to finance the purchase of stock in two finance companies. In preparing its South Carolina income tax returns, Avco deducted the interest expense incurred in connection with the issuance of these debentures in arriving at apportionable income.

The issue was whether or not the expenses incurred in connection with the issuance of debentures used to finance the acquisition of stock in the finance companies should be allowed as a deduction against Avco's income. It was stipulated that Avco's income must be apportioned. The SC Code provides that the dividends which a corporation receives are to be allocated to the state of a corporation's principal place of business and are taxable by that state. It further provides that all related expenses must be allocated to that state (SCCL§12-6-2220(2)).

NOTE: This section of the law was changed for tax years beginning in 2005 to require allocation of dividends only when the dividends were not business related:
SCCL §12-6-2220(2):

[18] From the Montana Reference Manual

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Dividends received from corporate stocks not connected with the taxpayer's business, less all related expenses, are allocated to the state of the corporation's principal place of business as defined in SCCL §12-6-30(9) or the domicile of an individual taxpayer.

2005 Act No. 145, Section 12.B, provides as follows:
"Section 12-6-2220(2) of the 1976 Code, as amended by this section, applies for taxable years beginning after 2004."

The parties stipulated that the interest expense involved was incurred for the sole purpose of purchasing stock. They also agreed that any dividend income received by Avco from the stock ownership in the corporations is not taxable in South Carolina. Therefore, the Court held that the interest expense incurred solely for the purpose of purchasing stock was related to the stock and allocable to Connecticut where the dividend income is taxable.

Avco argued that the allocation sections do not require the allocation of a net loss, which would be the result here as the related interest expenses exceeded the dividends received from the stock. The allocation of a net loss results in a higher figure for the income apportionable to South Carolina than Avco reported in its returns. The Court held that the net loss must be allocated. The actual receipt of dividends is not required before a related expense adjustment can be made.

NOTE: SC RR #98-14 recognizes an argument that may be useful in appropriate cases for distinguishing *Avco.* This advisory opinion upholds the deduction of commissions paid to a subsidiary, a properly formed and operated foreign sales corporation (FSC). This advisory opinion distinguished *Lowenstein (SC),* which denied the deduction of commissions paid to a domestic international sales corporation (DISC) because the DISC lacked economic substance. To allow the deduction of the commission paid to the FSC the advisory opinion reasoned that the payments were legitimate business expenses, and therefore, not expenses related to the generation of a dividend.

2. In *Seward v. South Carolina Tax Commission, 236 S.E.2d 198 (SC 1977)* the South Carolina Supreme Court held that the taxpayers could not claim deductions arising from operating losses incurred by the taxpayers in an out-of-state cattle operation. They bought cattle for breeding purposes and hired a management company to run the business. The Court ruled that the deductions could not be taken against South Carolina income because the deductions were expenditures incurred in connection with cattle having a situs outside of South Carolina, the sales of which would not be taxed in South Carolina. Secondly, under South Carolina apportionment statutes, income from an out-of-state business is not taxed by South Carolina and, conversely losses from such a business are not deductible.

3. *Ellis v. South Carolina Tax Commission 280 S.C. 65, 309 S.E.2d 761(1983)* involved South Carolina residents who incurred losses as limited partners in an out-of-state oil and gas limited partnership. The Court held that since the losses in question were incurred by taxpayers from out-of-state limited partnership interests, those losses retained the character of out-of-state losses when distributed to taxpayers by reason of a statutory "pass through" provision. Thus, the

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taxpayers could not deduct the losses on their South Carolina income tax returns. The Court held that gains from a partnership which conducts no business in South Carolina would be passed through the partnership to the partner in South Carolina. Pursuant to South Carolina statutes, none of these gains are included in the base to which South Carolina income tax is applied. Therefore, if no gains are included in the base by reason of the statutes involved, then no losses would be included in the base.

The Court reasoned that partnerships and limited partnerships are not taxed on their income or losses. Although partnerships file information returns, the income or losses are passed through and distributed to the partners and reported in their income tax returns (Cited by the Court as SCCL §12-7-300, but since recodified as SCCL §12-6-600).

The Court made it clear that the "pass through" rule is equally applicable to limited partnerships. South Carolina does not distinguish between general and limited partnerships or partners.

"By reason of the 'pass through' rule, the character of any item of income, gain, loss, deduction or credit included in a partner's distributive share of gains and losses shall be the same as if such item was realized directly from the source from which realized or incurred by the partnership. In other words, each item of income, gain, loss, deduction or credit is treated as if it were realized or incurred by the partner directly from the source without ever having passed through the partnership....

"Since the losses in question were incurred by the taxpayer from out-of-state partnership interests, these losses retained the character of out-of-state losses when distributed to the taxpayer by reason of the 'pass through' provision...." (*Ellis v. South Carolina Tax Commission 280 S.C. at 68; 309 S.E.2d at 762-3)*

NOTE: Some publications have reported that South Carolina taxes resident individuals on their world-wide income. This statement appears to be based upon a negative inference from SCCL §12-6-1720 (1)(b) which provides that a nonresident individual is only taxed on his apportioned share of business conducted in South Carolina. The authors suggest that it is incorrect to infer from this section that South Carolina residents are taxed on their worldwide income. South Carolinians are taxed on their worldwide personal service income, (SCCL §12-6-2220(6)) but nothing has overruled the *Seward* and *Ellis* cases. The Department has never attempted to tax South Carolina residents on their world-wide (non-personal service) business income.

4. In *Hercules v. South Carolina Tax Commission, 279 S.C. 177, 304 S.E.2d 815 (1983),* the Court held that the matching principle can take precedence over the literal reading of a statute. When *Hercules* was decided, South Carolina's allocation statutes provided that gains and losses from the sale of real property located in South Carolina are allocable to South Carolina, and gains and losses from the sale of real property located outside South Carolina are allocated to the state in which the real property is located.

> SCCL §12-7-1120(4). SCCL §12-7-1120(4) has since been recodified as SCCL §12-6-2220(4) and amended consistent with the holding in Hercules to read:

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> Gains and losses from the sale of real property less all related expenses are allocated to the state in which the real property is located except to the extent that gain represents the return of amounts deducted as depreciation. The amount of gain which represents the return of amounts deducted as depreciation is allocated to this State to the extent of depreciation previously deducted in computing South Carolina taxable income.
> It did not matter whether or not the real property was connected with the taxpayer's trade or business.

The South Carolina Tax Commission argued that the Code provides that the gain or loss from sales of real estate located in South Carolina is allocated to South Carolina and that such income is not income that can be apportioned.

The Court responded that this argument overlooked the fact that the Tax Commission allowed Hercules to apportion depreciation of the real property for income tax purposes throughout the many states in which it did business. This caused South Carolina to receive greater income tax revenues from Hercules during this period of time than would have been received had all the depreciation been allocated to South Carolina. Further, the Court reasoned, other states that allowed Hercules a tax deduction for this apportioned depreciation are entitled to recapture this depreciation upon the sale of the plant.

"If we were to hold that SCCL §12-7-1120(4) [since amended and then recodified as SCCL §12-6-2220(4)] allows South Carolina the sole benefit of recapturing all of the depreciation taken, one of two gross inequities would result. Either all other states which allowed depreciation would be denied the right to recapture or Hercules would be subjected to double taxation. It cannot be seriously argued that the legislature intended such a result." *Hercules v. South Carolina Tax Commission, 279 S.C. at 181-182, 304 S.E.2d at 818*

Therefore, if a taxpayer claims that some of its income is not apportionable to South Carolina because it is not connected with a business that is conducted or transacted in South Carolina, auditors will generally look to see whether any of the expenses incurred in that business were deducted against South Carolina apportionable income.

There is no statute, regulation, or formal Department policy on how general expenses (interest expenses, salaries, etc.), should be allocated and/or apportioned between business and non-business income. The Department will trace funds where possible and apportion expenses which cannot be traced. Generally, the Department's auditors use the "DC Formula." (CD I.D. 309 (June 30, 1982) The DC Formula segregates expenses used to carry investment (nonbusiness) assets, the income from which is allocated, using the following formula:

Related Expenses = Attributable Expenses x Investment assets ÷ Total Assets

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Related Expenses: the interest and general and administrative expenses which will be associated with the investment assets and allocated to the state to which the income from the investment assets is allocated.

Attributable Expenses: all interest and general and administrative expenses that cannot be directly traced to a business or nonbusiness activity.
Investment Assets: the book value of investment assets, the income from which would be allocable or nontaxable.

Total Assets: the book value of all assets of the corporation.

Although the DC Formula is generally used by South Carolina auditors, taxpayers may suggest using other reasonable methods, including apportioning the attributable expenses using a ratio of allocable and tax exempt income to total income, or the method the Internal Revenue Service uses in IRS Rev. Proc. 72-18 to divide interest expenses between taxable and excludable income.

NOTE: These cases call into question SC CD #91-5 which held that gain on the sale of a partnership interest was allocated. The business of the partnership was not unitary with a business otherwise being conducted by the partners, and it was a limited partnership interest. The authors cannot predict what the Department's position may be in a future case where the partnership interest is owned by a corporation and the business of the partnership is not unitary with the business of the corporation (except to the extent the corporation may be deemed to be conducting the partnership's business). It is sometimes argued that the gain or loss should be allocated as the sale of an intangible not connected with the taxpayer's trade or business. On the other hand, it is argued that the gain or loss should be apportioned because the pass through nature of partnership makes it the equivalent of the sale of business assets by the person in business, or it should be at least partially apportioned because the gain or loss on the sale of the partnership interest should be matched with the apportioned pass through income and losses of the partnership which affected the partner's basis in his partnership interest. The authors do, however, believe that the Department will take the position that gain or loss from the sale of a partnership interest should be apportioned where the business of the partnership is unitary with the business of the corporation.

IRC §338(h) 10 gain.
SC RR #99-4 states a purchasing company making a qualified stock purchase (at least 80% of the voting power and value of the stock of a corporation during a 12 month acquisition period) of a target corporation can elect to make a joint election under IRC §338, to treat the stock purchase as an asset acquisition. The internal elective recognition gain/loss of the target corporation, along with the non-recognition gain/loss on stock sold by the seller allows the target corporation that was a member of the selling consolidated group before the transaction to be treated as a member of the consolidated group with the stock sale transaction treated as if the target corporation has sold all of its assets at the close of the acquisition date at fair market value in a single, fully taxable transaction, distributed the proceeds of the sale to the seller (the corporation that owns the target, e.g. another member, parent, or Q Sub) in tax free deemed liquidation under

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IRC §332 and treated as a new corporation which purchased all the assets as of the beginning of the day after the acquisition date (i.e., repurchased its own assets in a hypothetical sale).

As a result, the purchasing corporation receives a stepped up (or stepped down) basis in the assets acquired from the target corporation and a gain or loss on the deemed sale of assets is recognized by the target on its old consolidated return if the target is a member of the selling consolidated group, or the old target's separate return if the target was a member of an affiliated group filing separate returns or an S corporation. An IRC §338(h)(10) election can be made until the 15th day of the 9th month after the month in which the acquisition date occurs. The election must be made jointly by both the seller and the purchaser. SCCL §12-6-2220 specifically lists items of income that must be directly allocated.

This statute is generally applicable to nonbusiness items of net income. SCCL §12-6-2240 provides that all income remaining after allocation is apportioned. Accordingly, the proper sourcing and the amounts used in the apportionment factors depend on the facts and circumstances. Based on the above statute, the target subsidiary's gain from the deemed sale of assets used in the business is generally apportionable business income. However, the target subsidiary's gains and losses from the sale of real property less all related expenses are allocable income and are allocated to the state in which the real property is located except to the extent that gain represents the return of amounts deducted as depreciation. The amount of gain which represents the return of amounts deducted as depreciation is allocated to South Carolina to the extent of depreciation previously deducted in computing South Carolina taxable income. Gain in excess of recaptured depreciation is allocated to the state where the real property is located whether or not the real property was used in or connected with the taxpayer's trade or business. The target subsidiary's gain from the deemed sale of assets not used in the business is allocable income.

Oil & Gas Companies[19]

The oil and gas industry can be divided into three activity groups: upstream, downstream, and chemical. Some companies will be involved in all activities and others will only be involved in one step of the process.

Upstream. Upstream activities include exploration, development, production, and gas and power marketing. The activities are to find, develop, produce, and market crude oil and natural gas. There are specific pipelines for crude oil in the U.S.

Downstream. Downstream activities include refining and supply, lubes, and fuels. The activities are to refine, store, transport, supply, and market refined products. There are different pipelines to transport refined products in the U.S.

[19] From Oil & Gas – IRS Presentation

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Chemicals. The activities are to produce, store, transport, supply, research, develop, and market chemical products.

End Products from Crude Oil. Below is a list of products that are created from crude oil:

- Adhesives: Base Polymers and hydrocarbon tackifier resins.
- Agriculture: Pesticides, herbicides, and films.
- Manufacturing: Adhesives, solvents, and lubricants.
- Packaging: Films, molded bottles, adhesives, and garbage bags.
- Construction: Roads, roofing, house paint, floor and wall coverings, and wire and cable jacketing.
- Transportation & Shipping: Gasoline and diesel, jet fuel, tires, lubes, crates, pallets, sacks, and bins.
- Medical/Health: Surgical gloves, test tube covers, tubing, vitamin capsules, antiseptics, and aspirin.
- Household Goods: Cleaning fluids, golf balls, toothpaste, toys, diapers and compact discs.

Companies in the oil and gas industry have additional items that need to be reviewed.

Royalties. Most of the royalties for oil and gas companies that are part of the exploration process will be from mineral royalty rights. Those royalties are sourced to the location of the rights. It is a common industry practice to not charge a specific royalty for use of the intangibles, such as to gas stations or other chemicals or products. However, the royalty may be imbedded. Generally, any royalty income earned on intangibles is minimal and it would not be material to pursue.

Buy/Sell Agreements. A common industry practice is to have buy/sell agreements. These agreements are with third party oil and gas companies to exchange oil or gas in one pipeline for oil or gas in a different pipeline based on need and availability. Generally, these transactions make little to no income. These transaction should not be included in the calculation of everywhere gross receipts since they cause the everywhere gross receipts to be overstated and not fairly reflect the activities occurring in South Carolina. The auditor will specifically need to ask for any amount of buy/sell agreements included in the calculation of everywhere and South Carolina gross receipts.

Alaska MAPA tax. MAPA is the More Alaska Production Act and it is a production tax based on net value of oil and gas, which is the value at the point of production, less all qualified lease expenditures. MAPA replaced the ACES (Alaska Clear and Equitable Share) production tax. Per Alaska, ACES was a production tax based on income. MAPA is very similar to ACES. Therefore, it needs to be added back for South Carolina. The production tax may be included in taxes, cost of goods sold or other deductions. Generally, a company will only have a few entities with activity in Alaska. Therefore, this adjustment may only be applicable if there is a unitary combination. Also, the adjustment may not be material if the price of oil is down or the factor is small in South Carolina.

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Below, the distribution of motor fuels in relation to South Carolina is outlined.

NOTE: This information is not for any other oil products or natural gas and information is as of December 2019. Also, this is a general overview and may vary for specific companies.

1. Crude oil is extracted from the earth.

2. It is then sent to a refinery through crude oil pipelines or vessels.
    a. South Carolina does not have any refineries or crude oil pipelines.
    b. Note that some companies are only in business of exploration and sell the crude to a company with refineries (e.g. ConocoPhillips after they spun of Phillips 66 in 2012).

3. Gas and diesel are then sent to terminals through pipelines or vessels.
    a. South Carolina has two marine terminals in Charleston, which are the busiest in South Carolina, and 14 other terminals in North Augusta, Spartanburg and Belton.
    b. Gas and diesel on the vessels can be from Canada, Aruba, Venezuela and other locations.
    c. In South Carolina, the supplier, the company that owns the product in the terminal, must be licensed with the state when the product gets to the terminal.

4. Pipelines
    a. There are two pipelines in South Carolina, Colonial and Plantation, and both are owned by Colonial.
    b. From the refineries, different fuel types will be sent separately in the same pipe.
        i. For example: If they are sending a lower grade fuel, they will stop the fuel that is currently in the pipe and start sending the lower grade fuel.
    c. When fuel is purchased from a refinery and it enters the pipeline, it is owned by a petroleum company that may be the same or different from both the refinery and the supplier. A company may only be in the business of transporting fuel and do not have a refinery or not be a supplier.
    d. Fuel in the pipeline can be sold while it is in the pipeline.
    e. The company may also have agreements (see below) to exchange the fuel with another company that is in a pipeline or terminal.
    f. A South Carolina Motor Fuel License is not required for the purchase or sale of fuel within the pipeline.
    g. Agreements:
        i. If two companies exchange the oil/gas in one location with the oil/gas in another location with no payment, they will setup an exchange agreement.
        ii. If two companies exchange the oil/gas in one location with the oil/gas in another location with payments, they will setup a buy/sell agreement.

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iii. These agreements are very common in the industry.
iv. If the taxpayer has these agreements, the taxpayer may include them in the everywhere sales at gross but this will overstate the factor since they make little to no money on these transactions.
v. Since South Carolina does not have any refineries, there may not be any exchange or buy/sell agreements in South Carolina from the pipeline. There may still be agreements for fuel in the terminals.

5. The carrier will pick up the fuel from the terminal (supplier) to take it to a retailer.
   a. When the fuel goes into the carrier, the title passes and it is taxed at this point for motor fuel purposes:
      i. When the supplier's customer hires the carrier.
      ii. When the carrier hired by the supplier delivers the fuel to their customer.
   b. Permissive Suppliers do not have any property or inventory in South Carolina but have consumers in South Carolina. They are still required to get a license in South Carolina but they are subject to the motor fuel tax.
   c. A Motor Fuel Vendor License is required of a company that purchases fuel directly from a Motor Fuel Supplier at the terminal and has fuel delivered into SC.
   d. If we want to see the actual return, ask Carol Player in Miscellaneous Tax – Motor Fuel Tax. Only the amounts paid are shown in DORWAY.
   e. The current tax rate is 22 cents per gallon (11/13/19).
   f. As the fuel is added to the semi-truck, additives for specific companies will also be added at the same time (e.g. when Shell advertises on TV that their fuel is better for your vehicle because of the additives they include in their fuel, those additives are added to fuels that are purchased from the terminals and sold as Shell fuel.)
   g. In some instances, the company that owns the fuel at the terminal will own the trucks that transport it to a retailer or the retailer with own the trucks that transport it. Pilot and Marathon own the trucking company.

6. The retailer sells the gas to the consumer.

The retailer may be owned by the same company of the supplier (e.g. Marathon, Shell, etc.), they may be a franchisee and advertise the name of the company of the terminal (e.g. Exxon, etc.) or they may be a third party (e.g. Costco, etc.).

Related Expense Addback

With regard to foreign audits, there is a related expense addback on expenses incurred to produce exempt interest, and allocated income. The foreign section also requires that related expenses that apply to Foreign Dividends be added back.

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South Carolina allocates certain items of income (less related expense). (SCCL §§12-6-2220 and 12-6-2230)

SCCL §12-6-2220:
The following items of income must be directly allocated and excluded from the apportioned income and the apportionment factors:

(1) Interest received from intangible property not connected with the taxpayer's business, less all related expenses, is allocated to the state of the corporation's principal place of business as defined in SCCL §12-6-30(9) or the domicile of an individual taxpayer.

(2) Dividends received from corporate stocks, not connected with the taxpayer's business, less all related expenses, are allocated to the state of the corporation's principal place of business as defined in SCCL §12-6-30(9) or the domicile of an individual taxpayer.

(3) Rents and royalties received from the lease or rental of real estate or tangible personal property, less all related expenses, are allocated to the state where the property was located at the time the income was derived providing the property was not used in or connected with the taxpayer's trade or business during the taxable year.

(4) Gains and losses from the sale of real property less all related expenses are allocated to the state in which the real property is located except to the extent that gain represents the return of amounts deducted as depreciation. The amount of gain which represents the return of amounts deducted as depreciation is allocated to this State to the extent of depreciation previously deducted in computing South Carolina taxable income.

(5) Gains and losses from sales of intangible personal property not connected with the business of the taxpayer and not held for sale to customers in the regular course of business, less all related expenses, are allocated to the state of the corporation's principal place of business as defined in SCCL §12-6-30(9) or the domicile of an individual taxpayer.

(6) All income from personal services received by a resident individual is allocated to this State. All income from personal services received by a nonresident individual for services rendered in this State is allocated to this State. (SCCL §12-6-2220)

SCCL §12-6-2230:
Any income, less all related expenses, which is not allocated under SCCL §12-6-2220 and not properly includable in the net apportionable income of taxpayers engaged in interstate commerce under the Constitution of the United States because it is unrelated to the business activity of the taxpayer conducted partly within and partly without this State, is allocated to the state in which the business situs of the investment is located. If the business situs of the investment is partly within and partly without South Carolina, the investment is apportioned using the same formula used for apportioning the net income of the corporation. (SCCL § 12-6-2230)

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Deductions required by IRC §265 are disallowed if the income is exempt for SC purposes.

SC §12-6-2230(1):

South Carolina taxable income is computed by making modifications to deductions provided in the IRC as follows:

(1) The disallowance of deductions relating to tax-exempt income required by IRC §265 applies if the related income is exempt for South Carolina income tax purposes, whether or not the income is exempt for federal purposes. If an expense or interest is disallowed under IRC §265 for federal purposes, but is related to income taxed in South Carolina, that expense or interest may be deducted for South Carolina income tax purposes.

NOTE: IRC §265 requires that the deductions that generate federally exempt interest be added back.

The foreign audit section also requires a related expense addback on foreign dividends reported for federal purposes but not reported for State purposes.

Refer to the following sections in this manual for information which describes the foreign dividends, why they are excluded from SC Corporate income tax, and how to compute a related expense addback on the foreign dividends:

1. Definitions of Dividends and Foreign Dividends
2. Schedule A & B modifications from Form SC 1120
3. Schedule C and Form 1118 discussion from federal Form 1120
4. Nonbusiness section of this manual

Savings and Loan Companies

What is a savings and loan association (S&L)?
A savings and loan association - also called an S&L, a thrift, or simply a savings and loan - is a financial institution similar to a bank that specializes in helping people get residential mortgages. Savings and loan associations can be owned either by their customers or by shareholders, but they were primarily meant to let the average person pool his money so that members could purchase homes.[20]

Refer to Chapter 13, Income Tax on Building and Loan Associations, of Title 12 of SCCL.

[20] https://www.bankrate.com/glossary/s/savings-and-loan-association/

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Deeper definition
In the early 20th century, the U.S. government wanted to encourage people to buy a home, and Congress passed the Federal Home Loan Bank Act to charter savings and loan associations. These institutions are mutually owned, letting working-class people pool their money in order to help members finance mortgages. By the 1950s, S&Ls had dramatically expanded in order to accommodate the mass migration of baby boomers into the suburbs.

In the mid-1980s to mid-1990s, nearly a third of S&Ls became insolvent after a steep rise in interest rates exceeded their ability to cover deposits and customers moved their money into other savings instruments like money market accounts. The ensuing savings and loan crisis cost taxpayers $132.1 billion.

Savings and loan associations were insured by the Federal Savings and Loan Insurance Corp. until the crisis. Since 1989, S&Ls have come under the purview of the Federal Deposit Insurance Corp (FDIC).

Mortgages comprise the majority of the financial products sold by S&Ls, and generally they offer a wider variety of mortgage types than commercial banks. However, savings and loan associations have unique legal restrictions as to how their assets can be used: they may only lend up to 20 percent of their assets in commercial loans and must lend at least 65 percent of their assets as mortgages.

Regulators allowed S&Ls to offer personal credit and checking accounts for the first time in 1980. Those that survived the savings and loan crisis offer more competitive interest rates for products more associated with banks like savings accounts and certificates of deposit.

Savings and loan association (S&L) example
Mountaintop Savings Bank, an entirely fictional but completely plausible savings and loan association, survived the savings and loan crisis and continues to exist to this day. It offers regular checking accounts and a variety of savings products like CDs and retirement accounts in addition to the residential mortgages that all S&Ls have to offer members. Before the crisis, it was called Mountaintop Savings and Loan, but like many S&Ls that emerged from the mid-1990s, it removed "savings and loan" from its name to let customers know of its shifted focus.

Savings & Loan Associations Incorrectly File SC Bank Returns
Sometimes a Savings and Loan Entity will file as a Bank, so you will need to convert the Bank filer to a Savings and Loan filer. The hardest part of auditing a Savings & Loan Association is determining if the entity is a Savings & Loan Association

List of Savings and Loan Companies
Use OCC website for a list of the Federal Savings Associations (click on federal savings associations).

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South Carolina Savings and Loan filers in 2000 (From DORWAY Report)

[redacted]

Savings and Loan Entities in the US

[redacted] according to the list form the Office of the Comptroller of the Currency, as of 2/28/2021, there are only 287 Savings & Loan Associations that are called federal savings association in the Website. You will have to check the website to determine if the particular entity is a Savings and Loan entity.

Savings and Loans Function Much Like a Bank

Savings and Loan Companies now are allowed to do almost everything a Bank can do. [redacted]

Differences between a Savings & Loan Return (form SC 1104) and a C Corp Return (form SC 1120)

A Savings and Loan Association files a form SC 1104 and pays tax on their modified federal taxable income. The main difference between a Savings and Loan return and a C Corp return is the tax due. Savings and Loan Associations pay tax of 6% on their SC Net Income and do not pay any license fees. [redacted] with the following exceptions:

1. Associations cannot file S Corp returns. Only corporations taxed under SC Code Title 12, Chapter 6, can elect South Carolina S corporation treatment. Therefore, Banks and Savings and Loan Associations cannot be S corporations for South Carolina income tax purposes.
2. Associations are exempt from tax during the first three years of their operation. (SCCL §12-13-40)
3. Associations cannot file Consolidated Returns. SCCL §12-6-5020(B)
3. A deduction is allowed for earnings paid to shareholders in an amount equal to the earnings actually paid and/or credited to each shareholder's account. Earnings credited to a reserve account for future payments do not qualify for this deduction. SC Reg. §117-1550.2

NOTE: This deduction allows mutual associations to deduct the earnings it distributes to its members that are the equivalent of interest.

SC Reg. 117-1550.2. Earnings Paid to Shareholders

For the purposes of SCCL §12-13-20, a deduction shall be allowed for earnings paid to shareholders in an amount equal to the earnings actually paid out and/or credited to each shareholder's account. Earnings credited to a reserve account for future payments shall not qualify for this deduction. (SC Reg. 117-1550.2 adopted by Doc. #2781, eff. 6-27-03.)

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Potential Audit Adjustments on a Savings & Loan Association:

The potential audit adjustments for a savings and loan tax would generally the same as a bank except, unlike a bank, they report on Federal Taxable income, not book income.

Here are some of the main audit adjustments you will see on a savings and loan association:

1. Failure to properly source fees received from SC customers of the Savings and Loan Association.
2. Failure to properly source interest received from SC customers of the banks.
3. Failure to include representation in the SC receipts for loans/sold securitized with a SC situs.
4. Failure to take the dividends paid deduction pursuant to SC Reg. 117-1550-2. This will be a reduction in the Modified Federal Taxable Income reported on the SC return.

Sourcing

Sourcing is the process of assigning the amount of sales or receipts within the state (in other words, determining the numerator of the sales factor). As part of the audit process, we need to request the apportionment schedules from the taxpayer **itemized by revenue stream** and also an explanation of the sourcing method used for each one.

South Carolina is not a "cost of performance state;" i.e., a state where receipts are always sourced to the state where the costs to produce the receipts are incurred. It is also not a "market state;" i.e., a state where receipts are always sourced to the state where the item or service is consumed or the location of the payer. Rather, SC policy is to apportion net income "upon a base which reasonably represents the proportion of the trade or business carried on within this State." Different sources of income have different sourcing methodologies. For example:

Sales of tangible personal property ("TPP")
Receipts from the sale of TPP must be sourced to SC if the goods, merchandise, or property were received by a purchaser in SC (SCCL section 12-6-2280(B)). In general, SC sources sales of TPP to the place where the purchaser receives the goods after all transportation is completed.

NOTE: Sales to the U.S. Government are not sourced to any state; such sales are not included in neither the numerator nor the denominator of the sales factor.

Lease, license, or rental of TPP
Receipts from rental of TPP as sourced to SC when the rental property is received by an in-state purchaser.

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Sales or rental of real property
Receipts from the sale or rental of real property *maintained for sale or rental to customers* are sourced to SC when the property is located within the state.

NOTE: For sales of real property *used in the trade or business,* SCCL §12-6-2220(4) states the gain or loss on the sale of real property is allocated to the state in which the real property is located, indicating the sale is not included in the computation of the sales factor. However, SCCL §12-6-2295(A)(4) states that the "net gain from the sale of property used in the trade or business" is part of gross receipts in the apportionment ratio. Discuss with your supervisor which approach to take. The property referenced in SCCL §12-6-2295(A)(4) is general reference to include all types of property. SCCL §12-6-2220(4) is specific to real property which must be allocated and not included in the calculation of the gross receipts.

Receipts from Intangibles

- Royalties from patents, copyrights, trade names, and trademarks are sourced to the location of where the intangibles are used (Geoffrey (SC) and SCCL §12-6-2295 (A)(3)). Note: While the statute does not specify how gains from the sale of intangible property are sourced, the Department sources receipts from the net gain on the sale of intangible property used in the trade or business to the place where the intangible is used.
- Fees and interest are sourced to the location of the customer.
- Dividends are sourced to the location of the commercial domicile of the entity receiving the dividends.
- Gains/Losses from the sale of loans are sourced to the situs of the loan.
- Gains/Losses from the sale of stock are sourced to the commercial domicile of the entity selling the stock.

Receipts from Services
Services are sourced to the location of the income-producing activity ("IPA") (SCCL § 12-6-2295(A)(5)). The statute does not define IPA nor provides further guidance on determining where an IPA is performed, which provides "flexibility" in determining the relative amount of IPA in the State. The place of performance of the IPA of a service varies by industry (see Dish (SC)) and the nature of the taxpayer's business in the state determines the method of apportionment a taxpayer must use (see DirecTV (SC)).

Place of activity sourcing
From DirecTV (SC) court case: In Lockwood Greene (SC), the taxpayer—an engineering firm with offices, projects, and clients in numerous states, including South Carolina—sought a refund of income tax based on the argument that the then-apportionment statute required receipts to be apportioned based on where its customers were located and payments were made, which is an "origin of payment" view. 293 S.C. at 448, 361 S.E.2d at 347. The tax commission argued for a "place of activity" view, which apportions income based on the place where the services are performed. Id.

The court of appeals noted that the taxpayer provided services to its clients through highly trained engineers and personnel and that clients paid the taxpayer for the expertise and time of its

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employees. Id. at 449, 361 S.E.2d at 347. The court determined that the business of engineering firms, like the taxpayer, carried on in a state was reasonably measured by services rendered by its personnel in that state, which represented a "place of activity" test. Id. The court also noted that the taxpayer's argument regarding the tax commission's inconsistent interpretation of the statute based on the commission's guidelines was unpersuasive because the taxpayer did not operate a similar business to those businesses in which the tax commission focused on whether the services were performed in South Carolina. Id. at 450, 361 S.E.2d at 348.

Sourcing of Advertising
Advertising is considered a service, in which the IPA is the delivery of ads to the intended targets located in South Carolina and elsewhere. Therefore, the receipts should be sourced based on where the intended audience is located.

In the DirecTV's (SC) decision, the judge cited in footnote 21 a Wisconsin court case that is directly on point to advertising receipts. In *Ameritech Publishing, Inc., Petitioner-Appellant, v. Wisconsin Department of Revenue, Respondent-Respondent.* (788 NW2d 383, 06/24/2010), the Commission concluded that, as in Hearst, "the "income producing activity" of advertising services associated with advertisements run in Wisconsin was performed in Wisconsin when the advertisement reached its intended, Wisconsin audience." Likewise, if the audience at which marketers choose to aim their advertising efforts is located in South Carolina, the income producing activity is performed in SC and those receipts should be sourced to SC.

For example, an internet-related company sells online advertising to third parties. A user located in SC clicks on the online advertising link. If the amount the internet-related company receives from the advertiser is based on the number of clicks, then the income received from that click should be sourced to SC.

South Carolina Population Sourcing.
If the taxpayer does not have, or will not provide, the SC receipts and the taxpayer has activity throughout the nation, auditors are advised to relate the SC population to the US population to determine the amount of apportionable income to source to SC. According to the US Census Bureau as of 7/1/2019, the SC population is 5,148,714 and the US population is 328,229,523. This results in a South Carolina Population Sourcing rate of 1.57 %.

Origin of Payment Sourcing. From DirecTV court case: In Lockwood Greene, the taxpayer—an engineering firm with offices, projects, and clients in numerous states, including South Carolina—sought a refund of income tax based on the argument that the then-apportionment statute required receipts to be apportioned based on where its customers were located and payments were made, which is an "origin of payment" view. 293 S.C. at 448, 361 S.E.2d at 347. The tax commission argued for a "place of activity" view, which apportions income based on the place where the services are performed. Id. The court of appeals noted that the taxpayer provided services to its clients through highly trained engineers and personnel and that clients paid the taxpayer for the expertise and time of its employees. Id. at 449, 361 S.E.2d at 347. The court determined that the business of engineering firms, like the taxpayer, carried on in a state was reasonably measured by services rendered by its personnel in that state, which represented a

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"place of activity" test. Id. The court also noted that the taxpayer's argument regarding the tax commission's inconsistent interpretation of the statute based on the commission's guidelines was unpersuasive because the taxpayer did not operate a similar business to those businesses in which the tax commission focused on whether the services were performed in South Carolina. Id. at 450, 361 S.E.2d at 348.

Sourcing for Specific Industries.
Certain types of businesses use a special apportionment ratio to determine the SC apportionment ratio. (SCCL § 12-6-2310).

1) *Railroad companies*. Railroad companies use a fraction in which the numerator is railway operating revenue from business done within South Carolina and the denominator is total railway operating revenue from all business done by the taxpayer, as shown by its records kept in accordance with the Uniform System of Accounts prescribed by the Interstate Commerce Commission.

2) *Motor carriers of property and passengers (trucking companies)*. For trucking companies, the numerator is vehicle miles within South Carolina and the denominator is total vehicle miles everywhere.

   NOTE: The Department of Revenue determined that a company which did not own any trucks, but which leased trucks and hired independent contractors to haul property was a motor carrier which must apportion its income pursuant to this method.

3) *Telephone service companies*. For telephone service companies, the numerator is gross receipts in South Carolina during the taxable year, and the denominator is total gross receipts everywhere. Gross receipts in South Carolina includes gross revenues derived from services rendered wholly within South Carolina, plus that portion of the company's interstate revenues attributable to South Carolina in accordance with the Federal Communications Standard Classification of Accounts

4) *Pipeline companies*. For pipeline companies, the numerator is the revenue ton miles (one ton of solid property transported one mile), revenue barrel miles (one barrel of liquid property transported one mile), or revenue cubic foot miles (one cubic foot of gaseous property transported one mile) within South Carolina and the denominator is the total revenue ton miles, revenue barrel miles, or revenue cubic foot miles everywhere.

5) *Airline companies*. Airline companies use a fraction in which the numerator is revenue tons loaded and unloaded in South Carolina during the taxable year, and the denominator is revenue tons loaded and unloaded everywhere during the taxable year. A revenue ton is a short ton (2,000 pounds) and is computed by using a standard weight of 190 pounds a passenger (including free baggage) multiplied by the number of passengers loaded and unloaded plus the tons of airmail, express, and freight loaded and unloaded within and without South Carolina

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6) *Shipping lines (aka water transportation companies).* Shipping lines apportion income to SC on the basis of the ratio of revenue tons loaded and unloaded within and without the state for the year. A revenue ton is a short ton (2,000 pounds) and must be computed using a standard weight of 190 pounds per passenger (including free baggage) multiplied by the number of passengers loaded and unloaded.

NOTE: There is no special apportionment formula used for television and radio broadcasters. Such taxpayers must use the gross receipts factor apportionment formula provided in SCCL §12-6-2290.

South Carolina Tax Credits

New Jobs Capital Investment R&D Biomass Infrastructure

Generally, each year policy publishes a manual of the various credits and other economic incentives available to taxpayers. (See Policy Manuals for Job Credits or General for all other credits on our website)

Most, if not all, of the credits foreign audit deals with are summarized in this manual. Another good source of information on credits is RIA checkpoint, which each auditor should have access to this website. Also, search the various credit forms and instructions on the Department's website for information that will be helpful.

Before conducting an audit on the taxpayer, [redacted]

NOTE: The rules and requirements for credits are constantly changing, so the auditor must be sure they are reviewing current information.

Tax credits can be applied in any order the taxpayer elects and may apply a credit against taxes and license fee in any order, unless otherwise specifically provided, and against either one or both taxes and license fees in any given year, subject to limitations in the applicable credit statute. SCCL Section 12-6-3480(3)

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New Jobs Tax Credit

This credit is reported on the SC TC-4 form. SCCL §12-6-3360 allows a taxpayer a credit up to 50% of corporate income tax for taxpayers that operate manufacturing, tourism, processing, agricultural packaging, warehousing, distribution, research and development, corporate office, qualifying service-related facilities, agribusiness operations, extraordinary retail establishment, professional sports teams, and qualifying technology intensive facilities, and banks. This credit can be carried forward up to 15 years. If this credit is claimed, refer to the New Jobs Credit Audit Program Checklist, which includes a checklist, information to request and schedules to calculate the credit.

NOTE: Each year Policy publishes the tier for each county and the amount of the credit available for each job. For the latest version of the Job or Employee Credits and Incentives document, look under the Tax Incentives for Economic Development link under the Policy Manuals section on the department's website. For prior year tiers and amounts, select from the dropdown menu on the Advisory Opinions page on the department's website. Then, select the year under the "Find an Advisory Opinion" header and scroll down until you find the link to the Job or Employee Credits and Incentives document for that year.

Capital Investment Credit

The credit is claimed on Form TC-11, "Capital Investment Credit." Any recapture is reported on Form TC-11R, "Recapture of Capital Investment Credit." Additional information on the Capital Investment Credit under the General Business Credits of the Tax Incentive for Economic Development on the department's website. If this credit is claimed, refer to the Capital Investment Credit Audit Program Checklist, which includes a checklist, information to request and schedules to calculate the credit.

SCCL §12-14-60 allows a taxpayer a credit against income taxes for qualified manufacturing and productive equipment properties placed in service during the taxable year in South Carolina.

The amount of the credit for qualifying investments is:

- 1/2% of the total aggregate basis of 3-year property
- 1% of the total aggregate basis of 5-year property
- 1 1/2% of the total aggregate basis of 7-year property
- 2% of the total aggregate basis of 10-year property
- 2 1/2% of the total aggregate basis of 15-year or greater property.

Whether property is 3, 5, 7, 10, or 15 year or greater, property is determined by the applicable recovery period for the property under IRC §168(e).

The credit claimed is limited to $5 million for a taxpayer subject to the license tax under SCCL §12-20-100 (utilities and electric cooperative). This 5,000,000 limitation is a lifetime limit and

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applies to utility companies such as [redacted] and other entities that compute the license fee pursuant to SCCL §12-20-100.

This credit does not apply to any property to which other tax credits apply, such as the headquarters credit, infrastructure credit, or the textile, abandoned building and retail revitalization credits unless the qualifying business waives the application of such credits. Any unused credit may be carried forward for 10 years. An unlimited carryforward is allowed for certain manufacturing taxpayers having significant capital investments and employment in South Carolina; however, a carryforward beyond 10 years cannot reduce the tax liability in a subsequent year by more than 25%.

Rules exist requiring:

1. Property basis reduction for the amount of the credit claimed.

2. Recapture of the credit if the property is disposed of or removed from the state before the end of the applicable recovery period. A pro rata portion of the credit previously claimed for that property must be recaptured. A taxpayer required to recapture the credit may increase the basis of the property by the amount of any basis reduction attributable to the credit claimed in prior years. The basis must be increased in the year of recapture.

For the purpose of this credit, "qualified manufacturing and productive equipment property" is any property that is:

Constructed, reconstructed, or erected in South Carolina or acquired by the taxpayer if the original use of such property begins with the taxpayer inside this state, and which is:

1. Used as an integral part of manufacturing, production, or extraction of or furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services in the economic impact zone,

2. Tangible property depreciable under IRC §168, and

3. IRC §1245 property.

Computer software that may be depreciated or amortized that is used to control or to monitor a manufacturing or production process inside South Carolina.

In SC PLR #98-2, the Department reviewed whether a company providing residential and business telephone service to South Carolina economic impact zone counties qualified for the tax credit. Based upon the facts, the Department concluded that the providing of telephone service is the business of "furnishing communications" that is eligible for the economic impact zone credit. Also, the Department determined which of the company's property constituted an integral part of furnishing communications.

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NOTE: Although there are no longer "economic impact zones" in South Carolina, this ruling still has relevance as to what qualifies as an integral part of "furnishing communications".

Research and Development Credit[21]

The credit is claimed on Form TC-18, "Research Expenses Credit." SCCL §12-6-3415 allows a taxpayer a credit against any tax due under Chapter 6 of Title 12 (income tax) or under SCCL §12-20-50 (corporate license fees based on capital stock and paid-in surplus) equal to 5% of its qualified research expenses made in South Carolina. The credit is limited to 50% of the taxpayer's tax liability remaining after all other credits have been applied. Any unused credit can be carried forward, but must be used within 10 years of the qualified research expenses. If this credit is claimed, refer to the Research and Development Credit Audit Program Checklist, which includes a checklist, information to request and schedules to calculate the credit.

For a taxpayer to qualify for the credit, the taxpayer must claim a federal income tax credit pursuant to IRC §41 for increasing research activities for the taxable year. For purposes of this credit, qualified research expenses has the same meaning as provided in IRC §41.

Biomass Resource Credit

This credit is claimed on Form TC-50, "Biomass Resource Credit". SCCL §12-6-3620 allows a company a credit against income taxes or corporate license fees, or both, for 25% of the costs incurred for the purchase and installation of equipment used to create power, heat, steam, electricity, or another form of energy for commercial use from a fuel consisting of 90% or more biomass resource. If this credit is claimed, refer to the Biomass Resource Credit Audit Program Checklist, which includes a checklist, information to request and schedules to calculate the credit.

The statute defines the following terms:

1. *"Biomass resource"* – non-commercial wood, by-products of wood processing, demolition debris containing wood, agricultural or animal waste, sewage, landfill gas, and other organic materials, not including fossil fuels.
2. *"Commercial use"* – a use intended for the purposes of generating a profit.

The credit is claimed in the year the equipment is placed in service for all expenses incurred for the purchase and installation of the equipment. All costs must be certified by the State Energy Office. The taxpayer may use up to $650,000 of credit in a tax year. Any unused credit may be carried forward 15 years.

The company must submit a request for credit to the State Energy Office by January 31st for qualifying expenses. The State Energy Office will notify the taxpayer of the amount of credit it may claim by March 1st.

[21] Information on the Research and Development Credit is under Section 19 of Part C: General Business Credits of the Tax Incentives for Economic Development

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If the equipment ceases using biomass resources as its primary fuel source before the entire credit is used, any unused credit cannot be used until it resumes using biomass resources as at least 90% of its fuel source. The carry forward period is not extended if the credit is suspended.

Construction or Improvement of Infrastructure Project Credit

SCCL §12-6-3420 allows a taxpayer a credit against South Carolina corporate income taxes imposed by SCCL §12-6-530 or bank taxes imposed by SCCL §12-11-20 for construction or improvement of an infrastructure project consisting of water or sewer lines, their related facilities or roads. This credit is calculated on SC Sch. TC-6, "Infrastructure Credit," and is also reported on Form SC1120-TC, "Corporate Tax Credits."

NOTE: If a taxpayer takes the utility license fee credit under SCCL §12-20-105, they cannot also take the normal infrastructure credit under SCCL §12-6-3420 (SCCL §12-20-105(G)).

Utility License Fee Credit[22]

NOTE: The credit allowed by SCCL §12-20-105 is commonly referred to as the "Utility License Fee Credit" and for purposes of this document, that term will be used when referring to this credit.

SCCL §12-20-105 allows a taxpayer subject to the license fee under SCCL §12-20-100 ("Utility License Fee") a credit against its liability for 100% of the amount paid in cash for qualifying infrastructure that benefits an eligible project. A taxpayer is not allowed a Utility License Fee Credit for actual expenses it incurs in the construction and operation of any building or infrastructure it owns, leases, manages, or operates.

This credit is claimed on the applicable South Carolina tax return — generally on a SC1120U, "Public Utility Tax Return," or a CL-4, "Annual Report of Electric Cooperative Corporation Property and Gross Receipts." The maximum Utility License Fee Credit that may be claimed in any tax year by a taxpayer is $400,000. The credit cannot reduce the Utility License Fee liability of the taxpayer below zero. If the applicable credit originally earned during a taxable year exceeds the taxpayer's liability, the amount of the excess may be carried forward to the next year.

Eligible Project Requirements

To qualify for the Utility License Fee Credit, the taxpayer must give cash to an "eligible project." A project can qualify as an "eligible project" in one of three ways:

- The project qualifies for one of the following tax incentives:
  - Income tax credits under Chapter 6, Title 12 (e.g., jobs tax credits);

[22] Revenue Ruling # 18-8

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- Withholding tax credits under Chapter 10, Title 12 (e.g., job development credits);
- Income tax credits under Chapter 14, Title 12 (e.g., investment tax credits); or
- Fee in lieu of property taxes under Chapter 12, Title 4; Chapter 29, Title 4; or Chapter 44, Title 12.

▪ The project is located in an office, business, commercial, or industrial park, or a combination of these, and meets both of the following requirements:

- It is used exclusively for economic development; and
- It is owned or constructed by a county, political subdivision or agency of this State when the qualifying improvements are paid for.

▪ The project is a county-owned or municipality-owned multiuse sports and recreation complex located in a county in which at least $5 million in state accommodations tax pursuant to SCCL §12-36-920 has been collected in at least one fiscal year.

Qualifying Infrastructure Requirements

The cash that the taxpayer provides for the eligible project must be used for qualifying infrastructure. SCCL §12-20-105(C)(1) defines the term "infrastructure" as improvements for water, wastewater, hydrogen fuel, sewer, gas, steam, electric energy and communications services made to a building or land that are considered necessary, suitable or useful to an eligible project. The type of infrastructure improvements that qualify include, but are not limited to:

1. Improvements to public or private water and sewer systems.

2. Improvements to public or private electric, natural gas and telecommunications systems including, but not limited to, ones owned or leased by an electric cooperative, electrical utility or electric supplier as defined by Chapter 27, Title 58.10.

3. Fixed transportation facilities including highway, road, rail, water and air.

4. Shell buildings, and the purchase of land for a qualifying park, if the project is an eligible project under item (II) of the "Eligible Project Requirements" section above.

5. Incubator buildings whose ownership is retained by the county, political subdivision or agency of the State, if the project is an eligible project under item (II) of the "Eligible Project Requirements" section above.

6. Due diligence expenditures relating to environmental conditions as described in SCCL §12-20-105(C)(5) if the project is an eligible project under item (II) of the "Eligible Project Requirements" section above and the expenditures are incurred after a county or political subdivision has acquired contractual rights to the park.

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7. Site preparation costs for a project qualifying as an eligible project under item (II) of the "Eligible Project Requirements" section above, including, but not limited to:
   a) Clearing, grubbing, grading and storm water retention; and
   b) Refurbishment of buildings that are owned or controlled by a county or municipality used exclusively for economic development purposes.

8. Land acquisition and preparation costs, construction of facilities and venues, improvements and upgrades to existing facilities and venues, and any other capital costs associated with the acquisition, construction and operation of an eligible project qualifying under item (III) of the "Eligible Project Requirements" section above.

General Questions

1. Q. Who is eligible to claim the Utility License Fee Credit?
A. Only a taxpayer who pays the Utility License Fee under SCCL §12-20-100 may claim the Utility License Fee Credit. The Utility License Fee under SCCL §12-20-100 is imposed upon every express company, street railway company, navigation company, waterworks company, power company, electric cooperative, light company, gas company, telegraph company and telephone company.

2. Q. How much is the Utility License Fee Credit annually?

A. The maximum aggregate credit that may be claimed in a single taxable year by a taxpayer is $400,000 for all contributions. The Utility License Fee Credit may not reduce the Utility License Fee liability of the taxpayer below zero.

3. Q. Is there any carryforward of the Utility License Fee Credit?

A. Yes. If the applicable credit originally earned during the taxable year exceeds the taxpayer's Utility License Fee liability, the amount of the excess may be carried forward to the next taxable year. The carryforward period is only one year for the Utility License Fee Credit.

4. Q. May a taxpayer contribute cash to several eligible projects in a single taxable year?

A. Yes. A taxpayer may contribute cash to any number of eligible projects, subject to the other requirements of the statute. Similarly, a single eligible project may receive cash from more than one taxpayer who is subject to the Utility License Fee. However, the total amount that may qualify for the Utility License Fee Credit by a taxpayer for all eligible projects in a single taxable year may not exceed $400,000 for each taxpayer.

5. Q. Can a taxpayer claim the Utility License Fee Credit for amounts paid in the current tax year for an eligible project, even though construction of the qualifying infrastructure will not be completed until a future year?

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A. Yes. However, the cash contributions must be given for the eligible project in the tax year for which the taxpayer claims the Utility License Fee Credit. A promise to pay the cash amounts at a future date is insufficient to qualify for the credit.

If the qualifying infrastructure will not be completed in the tax year in which the cash is contributed, the taxpayer making the contribution must execute a waiver of the statute of limitations under SCCL §12-54-85 allowing the Department the right to assess the tax in later years. The waiver must cover a period beginning with the date that the return on which the Utility License Fee Credit is first claimed is filed and ending three years after the taxpayer notifies the Department that the qualifying infrastructure has been completed. The taxpayer may notify the Department that the infrastructure has been completed by sending a letter providing the name, address and tax identification number of the taxpayer claiming the Utility License Tax Credit, information about the qualifying eligible project and the qualifying infrastructure, and the date that the qualifying infrastructure was completed.

6. Q. Can a taxpayer claim the Utility License Fee Credit against the Corporate License Fee under SCCL §12-20-50 or income taxes under Chapter 6, Title 12?

A. No. The taxpayer may only claim the Utility License Fee Credit against the Utility License Fee under SCCL §12-20-100.

NOTE: The credit under SCCL §12-6-3420 mentioned in the "Background on Infrastructure Credits" section of this document may only be used against corporate income taxes imposed by SCCL §12-6-530 or bank taxes imposed by SCCL §12-11-20. It may not be used against the corporate license fee under SCCL §12-20-50 or the Utility License Fee under SCCL §12-20-100.

7. Q. How does a taxpayer claim the Utility License Fee Credit?

A. The taxpayer claims the credit on the proper line of the taxpayer's applicable tax return, generally either the SC1120U ("Public Utility Tax Return") or CL-4 ("Annual Report of Electric Cooperative Property and Gross Receipts"). The taxpayer should follow the instructions on the applicable return in determining what information to submit when claiming the Utility License Fee Credit.

8. Q. Can a taxpayer be pre-approved for the Utility License Fee Credit?

A. No, a taxpayer cannot be pre-approved for the Utility License Fee Credit. However, a taxpayer can request an informal, non-binding letter concerning the project and the infrastructure. The letter is based solely on the facts presented by the taxpayer and is non-binding on the Department. The cost for the letter is $35. A taxpayer can request this letter by submitting a written request along with the $35 to the Department. The request should contain all applicable information concerning the project and infrastructure and should include the required payment.

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Questions Concerning Eligible Projects

9. Q. Can an eligible project be located in any county in South Carolina?

A. Yes. An eligible project may be located in any county or group of counties in South Carolina.

10. Q. Does the project have to be in the service area of the taxpayer giving the cash to be an eligible project?

A. No. Taxpayers that are subject to the Utility License Fee may give cash to any eligible project that meets the requirements of the statute and still be eligible for the Utility License Fee Credit. The project may be in any county and inside or outside the service area of the taxpayer.

11. Q. Can a county owned jail or administrative building that houses administrative functions of the county qualify as an eligible project?

A. No. A county jail or an administrative building is not a project that is eligible for tax incentives; the project is not used exclusively for economic development; and the project is not a county or municipality-owned multiuse sports and recreation complex and therefore cannot meet the requirements of an eligible project.

12. Q. Town C would like to make some upgrades to its water system by replacing old pipes for safety reasons and expanding water capacity for the Town. The upgrades will benefit all Town C residents. Do the upgrades to the water system qualify as an eligible project?

A. No. The water system upgrades improvement project is not a project that is eligible for tax incentives; the project is not used exclusively for economic development; and the project is not a county or municipality-owned multiuse sports and recreation complex and therefore cannot meet the requirements of an eligible project.

Questions Concerning Qualifying Infrastructure

13. Q. What are examples of infrastructure that qualify for the Utility License Fee Credit?

A. The following chart provides information about qualifying infrastructure and non-qualifying infrastructure. While the chart does not address every type of infrastructure that may be necessary for a project, it does provide guidance that taxpayers can consider in determining what types of infrastructure may qualify for the Utility License Fee Credit.

Qualifying Infrastructure

1. Water, sewer, electric, gas or telecommunications lines in a county owned or constructed industrial park

2. Land to construct a county owned industrial park

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3. Due diligence expenses for environment studies associated with acquiring land for a county owned or constructed industrial park after contractual rights for the park have been acquired by a county

4. Costs associated with a shell building to be located inside a county owned or constructed industrial park

5. Roads constructed in a county owned or constructed industrial park

6. Refurbishment of a county owned building which is located inside a county owned or constructed industrial park so long as the building is used exclusively for economic development purposes

7. Costs associated with site preparation including clearing, grubbing, grading, and storm water retention for a county owned or constructed industrial park

8. Costs associated with the construction of an incubator building to be located inside a county owned or constructed commercial park so long as ownership of the building is retained by the county

9. Upgrades to existing facilities for a county or municipality-owned multiuse sports and recreation complex in a county which collects at least $5 million in state accommodations tax pursuant to SCCL §12-36-920 in a single fiscal year

Non-Qualifying Infrastructure

1. Water, sewer, electric, gas or telecommunications lines within a privately owned building

2. Repairs to a privately owned building

3. Costs associated with certifying a site

4. Wiring, flooring, air conditioning or heating systems inside a new building unless part of refurbishment of a building owned or controlled by a county or municipality and used exclusively for economic development

5. Signage, landscaping, or curbs

6. Facilities at a local technical college that might indirectly support a particular industry in the State

7. Costs associated with site preparation including clearing, grubbing, grading and storm water retention for a project which does not qualify under items (II) or (III) of the "Eligible Project Requirements" section above

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8. Impact fees for water and sewer

9. Payment for an option to acquire land even if the land may be used to develop a qualifying park

14. Q. May qualifying infrastructure still qualify for the Utility License Fee Credit if a portion of the infrastructure is located on private property?

A. Yes. However, the infrastructure must be primarily located on public property and the portion of the infrastructure located on private property must be de minimis as compared to the total of that type of qualifying infrastructure for the project.

15. Q. May a taxpayer who qualifies as a public electric company contribute cash to help lay electric lines at an eligible project if those electric lines are to be used by the taxpayer to provide electricity to the eligible project?

A. No. The statute provides that a taxpayer may not provide cash in support of any building or infrastructure it owns, leases, manages or operates, even if the infrastructure otherwise qualifies.

16. Q. If a taxpayer provides cash for a county to construct a shell building for an eligible project qualifying under SCCL §12-20-105(B)(2) (eligible projects under Item (II) of the "Eligible Project Requirements" section above), may the county sell the shell building after the shell building's construction without invalidating the Utility License Fee Credit for the taxpayer?

A. Yes. After the shell building has been completed, the county may sell the shell building at any time after the taxpayer has paid the cash for the qualifying project without disqualifying the taxpayer from claiming the Utility License Fee Credit. The county may also sell land located in a qualifying park after the cash for the qualifying project has been provided.

Transfer Pricing and 482 Study

26 U.S. Code § 482: In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he/she determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses. In the case of any transfer (or license) of intangible property (within the meaning of section 367(d) (4)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible. For purposes of this section, the Secretary shall require the valuation of transfers of intangible property (including intangible property transferred with other property or services) on an aggregate basis or the

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valuation of such a transfer on the basis of the realistic alternatives to such a transfer, if the Secretary determines that such basis is the most reliable means of valuation of such transfers.

• Substantial guidance provided in IRS regulations:

The IRS regulations and OECD guidelines provide multiple transfer pricing methods. The method chosen should depend on the taxpayer's facts and circumstances.

"Best method" rule

Two general types of transfer pricing methods:

1. Transactional methods: Relies on actual transactions, generally the tested party (taxpayer) and third parties. Example: Comparable Uncontrolled Price (CUP) method

2. Profit based methods: Does not rely on actual transactions but rather earnings realized by various companies in a particular line of business. Example: Comparable Profits Method (CPM)

Transfer Pricing Methods: Comparable Uncontrolled Price (CUP) Method

Transactional method where comparable transactions with unrelated parties are used to determine an arm's length price for controlled transactions

• Considered most direct method by OECD

• Appropriate when there is very little difference between the product purchased from related and unrelated parties or those differences would not affect the price, such as commodities.

Two types of CUP methods:

Internal CUP-Transaction between the Taxpayer and Independent enterprise

External CUP-Transaction between two Independent Enterprises.

Example:

• Cereal manufacturer (Taxpayer) purchases wheat from related parties and independent enterprises. Taxpayer pays comparable price to related parties and independent enterprises. (Internal CUP)

• Cereal manufacturer (Taxpayer) purchases wheat from related parties but wheat sales on the open market are essentially the same. Taxpayer pays open market price for wheat. (External CUP)

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Transfer Pricing Methods: Resale Price Method

Transactional method less reliable than a CUP because indirect measures, such as gross margins, are used in addition to the direct measures such as price of product.

• Calculation:

1. Start with the price the related party sells the product to a third party (the Resale Price)

2. Reduce the Resale Price by the gross margin of independent enterprises performing this function with a comparable product

• Appropriate when reliable comparisons can be made on COGS

Example:

• "Gamecock Liquor" (Taxpayer) sells to related party distributors who sell the beverage to bars and restaurants in SC for $7 bottle.

• A similar product, "Tiger Spirits" sells to a third party distributor who sells the beverage to bars and restaurants in SC for $7 bottle. The distributer generally makes a margin of $1.50 per bottle.

• The Gamecock Liquor distributor will be allotted a $1.50 per bottle margin when calculating its separate company income.

Transfer Pricing Methods: Cost Plus (C+) Method

Transactional method where an arm's length price is determined using cost plus a fixed mark-up

• Mark-up percentage based on gross profit mark-ups of comparable companies

• Appropriate for contract manufacturer or low risk assembler which does not own intangibles and incurs little risk

• Less direct than CUP

Example:

• Corded, Inc. (Taxpayer), a subsidiary of Peaches, Inc. manufactures phone charging cords and sells those cords exclusively to Peaches, Inc.

• There are many companies that manufacture cell phone charging cords.

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• If these other companies have a cost base similar to Corded, Inc., the taxpayer can use the mark-up of the comparable cell phone manufacturers to determine the mark-up it should charge to Peaches, Inc.

• This method requires controlled and uncontrolled transactions to be highly comparable.

Transfer Pricing Methods: Profit Split Method

Profit based method where profit is divided among the parties based on the relative value of each party's contribution

• Similar to a joint venture arrangement

• Two kinds of Profit Split Methods:

Contribution Profit Split Method: Profits are split among related enterprises according to the functions performed and risks assumed. Assets are also analyzed, particularly intangible assets.

Residual Profit Split Method: Identifies routine profit for an entity as the first step and then any remaining profit is split based on each party's contribution to the earnings of the non-routine profit, ownership of intangibles are significant here.

Typically used when both parties to the transaction contribute significant intangible property.

• Avoids an extreme result for one of the parties involved due to its two-sided approach

Example:

Two related enterprises have intangibles. One has marketing intangibles and branding knowledge, the other has manufacturing and production intangibles and "know how". Profits are split similar to unrelated enterprises that have entered into similar arrangements.

Transfer Pricing Methods: Comparable Profits Method (CPM)

Known in the U.S. as Comparable Profits Method (CPM) but known as Transactional Net Margin Method (TNMM) in the OECD Guidelines

•In a nutshell: Rather than determining the arm's length price at the transaction level, this method looks to the net profits of similar businesses to determine an appropriate profitability for a business

•Most common method you will see in practice

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Example:

•Specialty Electronics, Inc. (Taxpayer) operates retail stores throughout the U.S. It purchases its inventory from related member IHTG, Inc.

•Profit margins for comparable specialty electronic companies are publicly available and used to create a reasonable profit margin for the taxpayer.

Common Terms:

1. Tested Party: The entity whose profit margin is compared with that of the comparables in order to determine the arm's length price of a transaction.

2. EBIT: Earnings Before Interest and Taxes and extraordinary items. AKA: net profits, net return, operating profit

3. PLI: Profit Level Indicator. A measure of a company's profitability that is used to analyze comparable with the tested party. Typically calculated as operating profit relative to a base such as sales, assets, or costs.

4. Interquartile Range: Determined arm's length range

A 482 study should always be provided in the audit and the auditor should provide a short summary of the study to include:

1. Who are the entities involved in the study and what their business activity is.
2. Who is the tested entity(s) in the study
3. What IRC section 482 method was used to determine the transfer pricing.
4. Does the taxpayer's federal return comport with the transfer pricing

There is very good information in the 482 studies which may be helpful to the audit. If a unitary combined method is proposed, it is not necessary for the auditor to disprove the study. (SC RR #15-5)

Unitary Combinations

Alternative Apportionment Method and Revenue Ruling #15-5 - From RR #15-5.
South Carolina apportions income on a separate entity basis using either a single sales factor or single gross receipts factor pursuant to SCCL §§12-6-2280 and 12-6-2290, respectively. If the allocation and apportionment of the taxpayer's income does not fairly represent its' business activities in South Carolina, the taxpayer may petition or the department may require a reasonable alternative method under SCCL §12-6-2320(A). The party advocating an alternative apportionment method has the burden of proving the statutory formula does not fairly represent

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the taxpayer's business activity in South Carolina and the alternative method is reasonable. Refer to the CarMax (SC).

Determining whether or not a state's statutory apportionment method fairly represents a taxpayer's business activity in the state involves a factual analysis. No two fact situations are exactly alike. Some taxpayers have also suggested that an alternative apportionment method should only be used in unusual fact situations (which ordinarily will be unique and nonrecurring). This was part of the MTC's regulations for UDITPA until it was removed in 2010. However, South Carolina is not a UDITPA compact member state, never adopted this regulation, and never applied this standard. The department will focus on whether the statutory apportionment method fairly represents the taxpayer's business activity in South Carolina.

In Media General (SC), the South Carolina Supreme Court held that the combined unitary reporting method is an appropriate alternative apportionment method under SCCL §12-6-2320(A)(4). The taxpayers argued that they should be allowed to file on a combined unitary reporting basis claiming that apportionment on a separate entity basis did not fairly represent the taxpayers' business activity in South Carolina. The department agreed that South Carolina's statutory separate entity reporting method did not fairly represent the taxpayers' business activity in South Carolina. The department argued that SCCL §12-6-2320(A)(4) did not allow for combined unitary reporting as an alternative apportionment method. The South Carolina Supreme Court disagreed and held that combined unitary reported is an appropriate alternative apportionment method under SCCL §12-6-2320(A)(4). In accordance with the Media General decision, the department may require and a taxpayer may request combined unitary reporting as an alternative method, if reasonable, to effectuate equitable apportionment of the taxpayer's income when separate entity reporting does not fairly represent the taxpayer's business activity in South Carolina.

Unitary Combined Reporting – From SC RR #15-5
Taxpayers apportion their income to a state based on a unitary business with multiple entities rather than on a separate entity basis. In very general terms, a unitary business group is one in which the members of the group all contribute to income through functional integration, centralization of management and economies of scale. These contributions are evidenced by a flow of value (not necessarily a flow of goods) between the components of the business operation. Refer to the Container (US).

Combined unitary reporting essentially treats the income of a parent corporation and the other members of the unitary business group as one entity for state apportionment purposes. The unitary business group's nationwide ("water's edge") or worldwide income is combined and the state taxes a share of that combined income. The share is calculated by a formula that takes into account the combined unitary members' level of activity in the state as compared to the members' level of activity in all states. Whether nationwide or worldwide income is used depends on whether a state adopts a water's edge or worldwide unitary approach. South Carolina generally adopts a water's edge approach as described in SC RR #15-5.

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The department may examine when analyzing whether the statutory formula fairly represents the taxpayer's business activity in South Carolina when that taxpayer is a member of a unitary business group include:

(1) Amounts paid to related parties for goods and services or goods and services provided without payment;
(2) Profit margins associated with business activities;
(3) Capital investments associated with business activities;
(4) Whether goods and services are provided to both related and unrelated parties on similar terms;
(5) Whether taxpayer in similar industries provide similar goods and services to unrelated parties under similar terms; and
(6) Whether the taxpayer would be willing to enter into similar arrangements with an unrelated third party considering, among other issues, the relinquishment of control over the business activity.

An IRC §482 pricing study to support pricing between related entities is not determinative of whether South Carolina's statutory apportionment formula fairly represents the taxpayer's business activities in South Carolina.

The department has required or approved combined unitary reporting as a reasonable alternative apportionment method in situations involving the use of purchasing companies, management fee companies, and "east/west" companies within a unitary group.

Determine the members of the unitary business group focusing on a flow of value between businesses through:

- Functional Integration[23]
  a. Gradual combination and transformation of independent components of business organizations into cohesive and synergistic entities
  b. Involves streamlining the internal operations of an organization (such as maintenance, sales, purchasing, advertising, manufacturing, marketing, warehousing, legal staff, personnel training, financing, and bookkeeping)[24]

- Centralized Management
  a. Exists when directors, officers and/or other management employees jointly participate in the management decisions that affect the respective business activities and that may also operate to the benefit of the entire economic enterprise.[25]
  b. The organizational structure where a small handful of individuals make most of the decisions in a company. As a company with centralized management grows,

[23] https://www.encyclopedia.com/management/encyclopedias-almanacs-transcripts-and-maps/strategic-integration
[24] From website referenced in prior footnote and the unitary section included in the Montana Reference Manual.
[25] From information provided by the MTC

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they add new levels of mid and lower level managers, each of whom answers to a superior, with very strictly defined roles in the company[26]

c. More centralized management is usually seen in highly competitive industries, where companies specialize in similar products to their competition, where most of the direction of the company is orchestrated at the very top, while the lower levels of management and employees are very tightly organized to execute those goals
d. Examples of centralized management are common officers and directors, exchange of personnel, communication between management personnel, common planning, parental approval of major decisions of subsidiaries, and common publications and policies.[27]

- Economies of Scale[28]
    a. Spreading internal function costs across more units produced and sold helps to reduce costs
        i. includes accounting, information technology, and marketing
    b. Benefits of mergers and acquisitions

Unitary Questionnaire is a questionnaire to determine which if any affiliates of an enterprise are unitary. Currently, South Carolina does not have a unitary questionnaire. If it is determined that a unitary combination is necessary during the audit, the auditor must determine which entities are unitary using the information above on functional integration, centralized management and economies of scale.

Water's Edge Combined Reporting – From SC RR#15-5
South Carolina will generally use a water's edge approach for determining the apportionable income of a combined unitary business group. All or portion of the income and apportionment factors for any unitary business described below will be part of the water's edge combined reporting:

1. The entire income and apportionment factors of any member incorporated in the United States or formed under the laws of any state, the District of Columbia, or any territory or possession of the United States;

2. The entire income and apportionment factors of a member which is a domestic international sales corporation as described in IRC §§991-994 or any members which is an export trade corporation as described in IRC §§970-971;

3. Any member that is a "controlled foreign corporation" as defined in IRC §957, to the extent of the income of that member as defined in IRC §952 of Subpart F of the IRC (Subpart F Income). NOTE: This inclusion is only what is allowed under SCCL §12-6-40;

[26] https://content.personalfinancelab.com/finance-knowledge/management/centralized-and-decentralized-management-explained/
[27] From the Unitary section included in the Montana Reference Manual.
[28] https://www.investopedia.com/terms/e/economiesofscale.asp

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4. Any member that earns more than 20% of its income, directly or indirectly, from intangible property or service related activities that are deductible against the business income of other members of the combined unitary group to the extent of that income and the apportionment factors related to that income.

If the parties agree, a group other than the entire water's edge unitary business group may be included for combined unitary reporting purposes.

Calculating Combined Unitary Income

1. The starting point is federal taxable income computed on a proforma federal Form 1120 for each corporation in the unitary group. Each proforma federal Form 1120 must represent federal taxable income as if each corporation is not part of a consolidated federal return. The unitary group for South Carolina may include corporations that are not part of the federal consolidated return because they do not meet the federal ownership requirement for filing as part of the consolidated group. However, if the unitary group includes all entities included in the federal consolidated Form 1120, the auditor can use this as its starting point. Banks are not allowed to be part of the combined unitary return for South Carolina.

2. All the proforma federal Form 1120s must be combined.

3. All intercompany transactions between members of the combined unitary group must be eliminated.

4. Make all South Carolina modifications (additions and subtractions – refer to Schedule A/B) and allocate any income allowed under South Carolina law. The department has not adopted the IRC dealing with foreign dividends gross-up (IRC §78), Subpart F Income (IRC §951), Domestic Production Activities Deduction (IRC §199), Bonus Depreciation (IRC §§168(k), 168(m) and 168(n)) pursuant to SCCL §12-6-50. Refer to this section for a complete list. If the auditor does not have the information of the entities not filing in South Carolina, the information will need to be requested from the taxpayer. However, most of the information is available in the supporting schedules to the consolidated federal Form 1120.

5. The department generally will apportion the unitary income using the single factor sales/gross receipts formula, using the *Finnigan (CA)* method. The denominator is all sales and gross receipts of all corporations included in the combined unitary group. All sales or gross receipts in South Carolina of entities within the combined unitary group are included in the numerator. All intercompany transactions eliminated in the calculation of combined income must also be eliminated from the numerator and denominator. One apportionment factor is calculated for the entire combined unitary group. The income apportioned to South Carolina will be divided among the members of the group that have nexus with South Carolina and are not protected by PL #86-272.

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NOTE: This is not really relevant since all income is posted under one entity in DORWAY.

6. For each member of the unitary group, the taxpayer will add any non-apportionable income allocated to South Carolina to income apportioned to this State to determine total income subject to South Carolina. Any income subject to South Carolina tax as a result of allocation by members that do not have nexus or are protected by PL #86-272 will be allocated to the members subject to tax in South Carolina using the same percentages used from intrastate apportionment in #5. See NOTE above in #5.

7. A net operating loss sustained by the combined unitary group in a combined return year is allocated among the members of the group that reported losses on their proforma federal Form 1120s, after elimination of intercompany transactions and appropriate allocations. The amount allocated to each member will be determined by dividing that member's loss after elimination of intercompany transaction by the total losses after eliminations of all members of the combined unitary group in that tax year. To the extent the net operating losses are not used by the group during the years the corporation is part of the unitary combined return may be claimed by the corporation in the tax years after the corporation ceases to be a part of the group. If more than one corporation brought net operating losses from the same tax year into the combined unitary group and a portion of the losses from that year is used, the amount of used net operating losses will be prorated among the members bringing losses from that year based on the ratio of each member's losses to the total losses carried forward from that year. The auditor will need to determine if net operating losses not calculated on a unitary combined basis being carried forward would still exist if they were calculated on a unitary combined basis. In several cases, there would not be any net operating losses available to carryforward.

8. The eligibility for and calculation of a tax credit amount is determined at the separate entity level but can be used against the unitary group income. Any unused carryforward of a tax credit earned by a member of the combined unitary group remains with that entity if the entity is no longer a member of the combined unitary group or the group is no longer required to file a combined return. This is applicable whether the credit was earned by the entity before becoming a member of the combined unitary group or while a member of the combined unitary group.

Treatment of Partnerships

Any business conducted by a partnership is treated as conducted by its partners, whether held directly or indirectly through a series of partnerships, to the extent of the partner's distributive share of the partnership's income or loss.

Substantial Understatement Penalty

The department will not impose the substantial understatement penalty pursuant to SCCL §12-54-155 if the department requires a taxpayer to use an alternative apportionment method and the use of that alternative apportionment method causes the substantial understatement.

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If the taxpayer was required to use an alternative apportionment method as a result of an audit (or settlement) and the department and taxpayer agreed that the taxpayer would continue to use the alternative apportionment method until the parties agreed otherwise, then the department may impose substantial understatement penalties if there is a substantial understatement resulting from the failure to use the alternative method. Additionally, when the taxpayer has requested and received permission to use an alternative method and then fails to use the alternative method in future years, the department may impose substantial understatement penalties for failure to use the alternative apportionment method.

Utility Audits

The Public Service Commission of South Carolina (PSC) and the South Carolina Office of Regulatory Staff (ORS) regulate the Public Service Utilities.

The *South Carolina Public Service Commission* serves the public of South Carolina by providing open and effective regulation and adjudication of the state's public utilities, through consistent administration of the law and regulatory process.

The *South Carolina Office of Regulatory Staff* (ORS) was created with the enactment of Act 175 of 2004.

The ORS is responsible for many of the non-adjudicative functions associated with utility regulation that formerly fell under the authority of the Public Service Commission of South Carolina (PSC). Prior to Act 175, the PSC handled all aspects of utility regulation. The creation of ORS by Act 175 provides a revised structure for addressing the public interest that clearly separates the adjudicative function (which remains with the PSC) from the investigative, legal, prosecutorial, and educational roles necessary to utility regulation that are now within the purview of ORS. Specifically, the ORS has responsibility for the inspection, auditing, and examination of public utilities. The agency must be considered a party of record in all filings, applications, or proceedings before the PSC.

The ORS represents the public interest of South Carolina in utility regulation for the major utility industries -- electric, natural gas, telecommunications, water/wastewater, and transportation -- before the PSC, the court system, the South Carolina General Assembly, and federal regulatory bodies. The ORS also has responsibility for oversight of railroad safety and natural gas pipeline safety in South Carolina.

The ORS website provides a list of Electric & Natural Gas, Water, Wastewater, Transportation and Telecommunications Public Utilities regulated by the PSC and the ORS.

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Public Utilities.[29]

In general. Public utilities (i.e., public service corporations) are subject to the general corporation income tax in South Carolina in the same manner as other, non-utility corporations. (SCCL §12-6-530) Specifically, the corporate income tax is imposed annually on the South Carolina taxable income of every corporation doing business or having income in the state. (SCCL §12-6-530)

"Public utilities" are investor-owned electric utilities (SCCL §58-27-10; SC Regs. §103-300);

Intrastate investor-owned gas, street railways, water and sewerage companies (SCCL §58-5-10; SC Regs. §§103-400,103-500, and 103-700)

Telephone and telegraph companies. (SCCL §58-9-10; SC Regs. §103-300);

Motor carriers of household goods, hazardous waste for disposal, and passengers. (SCCL §58-23-10; SC Regs. §§103-100 and 103-200); and

Government-owned telecommunications service providers. Are subject to all state and local taxes, licenses, fees, and other assessments applicable to nongovernmental providers. (SCCL §58-9-2620) Government-owned telecommunications service providers must annually remit to the general fund of the government entity owning them an amount equivalent to any and all taxes or fees a private sector telecommunications provider would be required to pay. (SCCL §58-9-2630)

Exemptions. The following utilities are exempt from the corporate income tax:
Nonprofit corporations organized pursuant to Chapter 36 of Title 33 for the purpose of providing water supply and sewerage disposal. (SCCL §12-6-550) Regional transportation authorities. (SCCL §58-25-80)

Apportionment. Although the general income allocation rules are the same for public utilities as they are for all corporations, special apportionment rules apply to railroad companies, motor carriers of property and passengers, telephone service companies, and pipeline companies, airline companies, and shipping lines. (SCCL §12-6-2310)

Railroad companies, motor carriers of property and passengers, telephone service companies, pipeline companies, airlines and shipping lines use a special formula to source income to South Carolina pursuant to SCCL §12-6-2310.

SCCL §12-6-2310 provides the income remaining after allocation for certain companies be apportioned using the following factors:

[29] Most of the information in this section is from BNA.

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1. Railroad companies will use a fraction of the railway operating revenue, using the distance of travel of property and passengers on lines within the state to the total lines traveled by the taxpayer, plus the total amount of railroad operating revenue earned wholly in the state, over the total amount railroad operating revenue of the taxpayer.

2. Motor carriers of property and passengers will use the vehicle miles within the state to the total miles everywhere in the tax year.

3. A telephone will use a fraction of the gross receipts in the state to the total gross receipts everywhere in the tax year.

4. Pipeline companies will use a numerator that includes revenue ton miles (one ton of solid property transported one mile), revenue barrel miles (one barrel of liquid property one mile), or revenue cubic foot miles within the State to the total revenue ton miles, barrel miles, or revenue cubic foot miles of the taxpayers during the tax year.

5. Airline companies will use a fraction that includes the revenue tons loaded and unloaded in the state to the revenue tons loaded and unloaded everywhere during the tax year. A revenue ton is two thousand pounds computed using a standard of weight of one hundred ninety pounds a passenger (including free baggage) multiplied by the number of passengers loaded and unloaded plus the tons of airmail, express, and freight loaded and unloaded within the State.

6. Shipping lines use a fraction of the revenue tons loaded and unloaded within the State to the total revenue tons loaded and unloaded everywhere. A revenue ton is a short ton (two thousand pounds) that is computed using a standard weight of one hundred ninety pounds per passenger (including free baggage) multiplied by the number of passengers loaded and unloaded.

Certain Utilities do not use capital and paid in capital to determine SC license fees. In place of the corporate license tax imposed by SCCL §12-20-50 which is based on Capital and Paid in Capital, South Carolina assesses a separate license fees tax against utilities including express companies, street railway companies, navigation companies, waterworks companies, power companies, electric cooperatives, light companies, gas companies, and telephone and telegraph companies. Pursuant to SCCL §12-20-100 the license fees for these utilities is computed $1 for each thousand dollars, or fraction of a thousand dollars, of the fair market value of property owned and used within this state and $3 for each thousand dollars, or fraction of a thousand dollars, of gross receipts derived from services rendered from regulated business within the state, except electric cooperatives.

Electric Cooperatives. Do not pay income tax, as they are exempt from state and federal income tax pursuant to section IRC §501(c)(12). See SCCL §12-6-550. They are required to file a Cooperative Return and pay the License Fee pursuant to SCCL §12-20-100.
Electric Cooperatives file Form CL-4 to report and pays the SC license fee.

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Form CL-4:

Part I COMPUTATION OF LICENSE FEE - ELECTRIC COOPERATIVES

Line 1. Fair market value of property owned and used to conduct business in SC as determined by the SCDOR for Property Tax purposes for the preceding tax year. In order to verify this, ask the taxpayer to provide the cooperative's SC property Tax return for the previous year. The property tax is filed one year in advance and is based on the value of the property for the previous year. For example, the property tax return filed for the property tax year 2020 would be based on the value of the property at the taxpayer's fiscal year end for 2019. If you are auditing the taxpayer for the year end 12/31/2019, you would ask the taxpayer for a copy of the property tax return for 2019 which is based on the value of property at year end 12/31/2018. The fair market value of property owned and used in the conduct of business in South Carolina is the tax assessment value divided by 10.5%.

Line 2. License Fee: fair market value component (multiply line 1 by .001)

Line 3. Includes the total operating revenues in the Total System in 3(A) and line 3(B) reflects the total operating income in SC. Gross receipts, as used in SCCL §12-20-100, include all receipts from operations in South Carolina, and other profit and loss items located in South Carolina. Income from intangibles used to conduct business in South Carolina is also included in gross receipts.

Line 4. Includes the total other receipts in the Total System in line 3(A) and line 3(B) reflects the total other receipts in SC.

Line 5. Line 5(A) is the sum of the operating revenues and other receipts included in the total system. Line 5(B) is the sum of the operating revenues and other receipts included in South Carolina. For the total system gross receipts add line 3(A) and line 4(A). For the SC gross receipts add line 3(B) and line 4(B).

Line 6. Is the Gross Receipts component for SC (multiply line 5, column B by .003).

Line 7. Is the total License Fee due (add lines 2 and line 6).

Line 8. This is the amount of the utility license fee infrastructure credit pursuant to SCCL §12-20-105. Note: This credit is only available to utility entities who pay license fee pursuant to SCCL §12-20-100. If the company paid cash to provide infrastructure for a qualifying project, enter the amount of credit from Part II of the CL-4.

Line 8 and complete Part II. Attach a schedule to the return that includes the following:

- the name of the person completing the project
- a description of the project
- the sections of the statute the project qualifies under

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- the amounts paid in cash
- recipient and date of payment
- a description of the infrastructure provided
- the date the infrastructure was completed or is expected to be completed

If the infrastructure has not been completed as of the date the return is filed, the taxpayer should include a waiver of the statute of limitations. The maximum credit for a single tax year may not exceed $400,000. If the credit is more than the tax liability, the excess may be carried forward and deducted in the following tax year. For more information on the utility license fee infrastructure credit, see SCCL §12-20-105 and SC RR #18-8.

Line 9. Balance of License Fee (subtract line 8 from line 7, cannot be less than zero)

Line 10. This is any interest and penalty due.

Lines 11. Total License Fee, Interest, and Penalty (add line 9 and line 10).

Part II INFRASTRUCTURE CREDIT INFORMATION.
This is a summary schedule showing the unused Credit carry forward from the last year, Infrastructure credit earned this year, infrastructure taken this year. Amount of Infrastructure credit which can be carried forward.

NOTE: The infrastructure credit can only be carried forward for one year. Types of infrastructure are listed in SCCL §12-20-105(C) and eligible projects are described in SCCL §12-20-105(B). Refer to License Fee Infrastructure Credit for Utilities section.

Part III
This is the annual report which is the same as is completed for a C Corporation.

Utility Tax Return for Defined utilities other than electric cooperatives, express companies, navigation companies, water work companies, power company, light company, gas company, telegraph company, and telephone company.

Utility Tax Return – Form SC 1120 U. With regard to the Corporate income portion of the SC 1120U, everything is the same as the SC 1120 in this manual so refer to the description of the federal Form 1120 in this manual. With regard to license fee paid based on property and gross receipts, this information is reported on Schedule I and Schedule K of the SC 1120U. This is the same information that is reported on the Electric Cooperative return. Some of the largest utility entities file a SC Consolidated Return or a Unitary Combined Return and the information for the utility entities is usually included in a separate license fee schedule for the entities required to report license fee pursuant to SCCL §12-20-100. In these situations, audit has accepted the schedules in lieu of requiring the entities to file a separate SC 1120U.

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Utility Entities Foreign Section Likely to Audit

NOTE: With regard to the Utility companies who pay the License fee, imposed pursuant to SCCL §12-20-100, the foreign audit section will most likely only deal with power companies, gas companies and telephone companies.

Cell Phone Service Companies are not Telephone Companies. A cell phone service company is not a telephone company. See *Alltel Communications, Inc. v. South Carolina Dept. of Revenue, 399 S.C. 313, 731 S.E.2d 869 (201)* before the SC Supreme Court which determined cell phone service companies were not telephone companies and did not have to pay the heightened license fees imposed by SCCL §12-20-100.

There is an issue in determining who is actually a utility company that pays the license fee imposed by SCCL §12-20-100. Part of the issue of auditing a potential utility entity is to determine if the entity is, in fact, a utility and whether they pay the license fee computed pursuant to SCCL §12-20-100.

Discussion on Computation of the License Fee on the Utility Return[30]

> **NOTE:** Historically, these enumerated companies were utilities and certain other companies that were regulated, generally by the South Carolina Public Service Commission. This fact has led to some confusion. Form SC1120U, "Public Utility Tax Return," provides for the license fee calculation based upon property and gross receipts. Form SC 1120, "C Corporation Income Tax Return," provides for the license fee calculation based upon capital stock and paid in capital. Over the years, this statute has been amended and some businesses have been deregulated. Since some of these companies became deregulated, there is confusion as to whether these enumerated companies should file Form SC1120U or Form SC1120. In addition, new companies of the enumerated types have come into existence which have never been regulated. The license fee section of the income tax forms and instructions have not been revised for unregulated companies which should pay the license fee based upon property. This fact appears to have led some taxpayers and some Department employees to the belief that a license fee measured by property and gross receipts only applied to regulated companies, in spite of the fact that the statute is not limited to regulated companies.

Part I. One dollar for each thousand dollars, or fraction of a thousand dollars, of fair market value of property owned and used within South Carolina in the conduct of business as determined by the Department for property tax purposes for the preceding taxable year; and

Part II. Three dollars for each thousand dollars, or fraction of a thousand dollars, of gross receipts derived from services rendered from regulated business within South Carolina during the preceding taxable year.

[30] Old Corporate Income Tax Manual 2005

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Part I of the license fee is based upon the property owned and used in South Carolina in the conduct of business in the prior tax year, regardless of whether the business is regulated or unregulated. The property does not have to be owned by the taxpayer for the previous year in order to be subject to the license fee, but it must be owned and used within South Carolina by one of the specifically listed companies (*i.e.,* a waterworks company, gas company, etc.) and must have been valued for property tax purposes by the Department in the previous year.

Part II of the license fee is based upon gross receipts from services rendered from regulated business in South Carolina during the prior tax year (*i.e.,* operating revenue and other receipts). Gross receipts is a broad term defined by regulation to include "…all receipts from operations within the State, and also other profit and loss items with a local situs. Intangible income from intangibles used in the conduct of the business within this State is included in gross receipts." Gross receipts has been interpreted to mean the whole receipts as opposed to the net receipts and the entire gross receipts and not just receipts from customer charges.

Distribution electric cooperatives are subject to Parts I and II of the license fee. Other electric cooperatives, however, are only subject to Part I of the license fee based on property.

License Fee for a local exchange Carrier. The Department provided guidance in this license fee computation when reviewing the calculation of the license fee liability of a local exchange telephone carrier. The principles are applicable to any type of company subject to this license fee provision. The Department determined that:

1. The term "receipts derived from services rendered from regulated business within this State" includes access charges related to long distance telephone calls that cross State lines.

2. The gross receipts portion of the license fee is limited to those businesses of the company that are regulated in some manner. Aside from its telephone operations, the taxpayer is engaged in various other business activities. These activities include selling, leasing, and maintaining customer premise telephone equipment; premise wiring and maintenance; billing and collecting on behalf of interexchange carriers; CATV channel service; installation and maintenance of cablevision customer premise wiring; selling yellow pages ads; leasing of telephone equipment; and providing operator services for other carriers. In the taxpayer's case, such regulation would be by the Public Service Commission since that is the regulating agency for telephone companies in South Carolina. The only other business regulated in some manner is the taxpayer's billing and collecting service; other receipts from the nonregulated businesses should be excluded.

3. The property portion of the license fee applies to all property owned by the corporation, not just the property that is used in its telephone operations. The measure of the tax is the value of property owned and used by telephone companies in the conduct of business. There are no words in the statute limiting such business to telephone operations. The term "telephone company" is used but that is only for purposes of identifying the taxpayer.

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4. If the license fee is measured based on South Carolina property and gross receipts, then the phrase "gross receipts derived from services rendered from regulated business" does not include gross receipts arising from transactions between the separate members of the return group. The minimum license fee of $25 applies to each corporation in the consolidated group.

NOTE: In the calculation of the property and gross receipts license fee, the gross receipts portion is limited to the gross receipts derived from a regulated business but the property portion is for property used in the conduct of regulated or unregulated business. See *Duke Power Company v. South Carolina Tax Commission, 292 S.C. 64, 354 S.E.2d 902 (1987), Anonymous Taxpayer v. South Carolina Department of Revenue, 95-ALJ-17-0634-CC (May 13, 1996),* and CD #91-41 (August 12, 1991)(obsolete). SCCL §§12-20-100(A)(1) and12-20-100(A)(2)(a).

Worldwide Combinations

A worldwide combination can only be used if requested by the taxpayer and agreed to by both the taxpayer and SCDOR. If it is agreed to use a worldwide combination, the taxpayer needs to provide a calculation of worldwide amounts, including support of their calculations. The auditor should ask the taxpayer to provide the calculation on a by-foreign corporation basis if the taxpayer is using the federal Forms 5471.

Schedule M-3
If you have the supporting statements to page 1 of the consolidated federal Schedule M-3, you can use those schedules to verify if the amounts are reasonable for each entity.

NOTE: The amounts reported on lines 5a and 5b on Part I of the Schedule M-3 are the book amounts after taxes are deducted. For 2017 and older, the amounts equal line 21 of Schedule C of each federal Form 5471. For 2018 and forward, the amounts equal line 22 of Schedule C of each federal Form 5471. Depending on the location of the foreign corporation, there could be substantial income taxes paid. The auditor will need to review this and ask the taxpayer for additional information if the federal Forms 5471 have not been provided.

Calculation
There are two main ways to calculate worldwide income: (1) using the Annual Report, 10-K or 20-F (See SEC website) or (2) using the federal Forms 5471. If there is an ultimate foreign parent, it is best to use the Annual Report or 20-F. If there is an ultimate domestic parent, you can use either option.

(1)Using the Annual Report, 10-K or 20-F
The taxpayer should provide their calculation of the foreign or worldwide income. The amounts for everywhere gross receipts and net income before taxes are from the income statement. These

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amounts will be after eliminations. Be sure to pick up all of the items included in gross receipts (e.g. interest, rents, royalties, other income, etc.).

Income calculation

To just calculate the foreign income using the Annual Report, there may be a breakdown in the Income Tax note indicating the net income before income taxes in the U.S. The rest of the income is the book amount of foreign net income before income taxes.

You should do book to tax adjustments to report the income on a tax basis. Depending on the industry, this can reduce the taxable income. The domestic book to tax adjustments can be found on the federal Schedule M-3. The taxpayer will have to provide the foreign book to tax adjustments. If they are reasonable with the domestic book to tax adjustments, it is reasonable to accept the foreign book to tax adjustments.

If it is an ultimate foreign parent, be sure the amounts are in U.S. dollars. The 20-F generally is in U.S. dollars. If the Annual Report is not in U.S. dollars, sometimes the exchange rate used is reported in the Annual Report. If not, the auditor will need to look up the exchange rate. Be sure to use the average exchange rate for income and sales.

(2)Using Federal Forms 5471

The taxpayer should provide their calculation, including a by-foreign corporation breakdown. The federal Form 5471 is only required to be completed by domestic corporations that own a foreign corporation. Therefore, if there is a foreign parent, the federal Forms 5471 will not include the foreign parent or any of the subsidiaries not owned by a U.S. entity.

Refer to the Foreign Income Calculations 5471 template for schedules on calculating income and gross receipts for foreign corporations. Enter the information on the Data Entry tab for the applicable year. For income and gross receipts, you will have to enter additional information. Be sure to review the comments and notes for tips and tricks on entering the information on the schedule.

(A)Gross Receipts Calculation

Gross receipts can be verified using Schedule C. The auditor will need to ask for the intercompany eliminations. If the schedule M is completed for each Form 5471, the auditor may be able to get intercompany elimination schedule from the Schedule M. Unless the foreign corporation has activity in South Carolina, there will be no eliminations to the numerator. If you are having difficulties with the intercompany eliminations, you can use the Annual Report for sales and the federal Forms 5471 for income.

NOTE: Compare the worldwide everywhere gross receipts to the Annual Report. The Annual Report should include all the worldwide gross receipts net of intercompany eliminations. If the worldwide everywhere gross receipts calculation is materially higher than the Annual Report, the auditor will need to ask the taxpayer for an explanation of the variance. If there are any significant partnerships, the auditor will need to review the notes to the Annual Report to see if the partnerships are included in the calculations.

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(B)Income Calculation
Either Schedule C (book) or Schedule H (tax) can be used to calculate the net income of the foreign corporations. Be sure the same method is used for all foreign corporations.

Schedule C for periods 2017 and older
There are 3 options using Schedule C: (a) net income before taxes - line 18, (b) net income after taxes with addback on Schedule A/B for taxes using only Schedule C - line 21 with an addback of line 20 on Schedule A/B or (c) net income after taxes with addback on Schedule A/B for taxes using Schedules C and E - line 21 with an addback of line 8 of Schedule E on Schedule A/B. If using option (b), be sure to watch the signs for line 20. The taxpayer may enter taxes based on income as positive amount and then subtract it to reach line 21 or may enter line 20 as a negative and sum the amount with lines 18 and 19 to reach line 21.

NOTE: Line 20 is taxes based on income.

Also, review the statements for other income and other deductions to determine if there are any state adjustments that need to be made (e.g. foreign exchange, dividends, taxes based on income, etc.).

If the foreign corporation is part of a tiered structure, the income may be overstated if you are picking up the income for each corporation in that tiered structure. Generally, these amounts will be removed on Schedule H.

Schedule C for periods 2018 and forward
There are 3 options using Schedule C: (a) net income before taxes - line 19, (b) net income after taxes with addback on Schedule A/B for taxes using only Schedule C - line 22 with an addback of line 21 a &b on Schedule A/B or (c) net income after taxes with addback on Schedule A/B for taxes using Schedules C and E - line 22 with an addback of Line 8, Section 1 of Schedule E for 2018 and Line 6, Section 1 of Schedule E for 2020 on Schedule A/B. If using option (b), be sure to watch the signs for line 21. The taxpayer may enter taxes based on income as positive amount and then subtract it to reach line 22 or may enter line 21 as a negative and sum the amount with lines 19 and 20 to reach line 22. Note: Line 21 is taxes based on income. If using option (c), you will need to pick Schedule E more than once for each applicable category. The categories are the same as on federal Form 1118.

Also, review the statements for other income and other deductions to determine if there are any state adjustments that need to be made (e.g. foreign exchange, dividends, taxes based on income, etc.).

If the foreign corporation is part of a tiered structure, the income may be overstated if you are picking up the income for each corporation in that tiered structure. Generally, these amounts will be removed on Schedule H.

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Schedule H for periods 2017 and older
Line 1 of Schedule H is equal to line 21, Schedule C, in functional currency. All lines 1 through 5c are in functional currency on Schedule H.

Start your calculation with line 5c of Schedule H and reverse taxes based on income (line 20 in functional currency on Schedule C and line 2g on Schedule H, both Net Additions and Net Subtractions) and any other state adjustment (review the statements to other adjustments). Then, divide the subtotal by the exchange rate on Schedule H. If the exchange rate is blank, it could be in U.S. dollars (check if functional currency column is completed on Schedule C or currency indicated on page 1) or you may find it on Schedule J. This is your net income of the foreign corporation on a tax basis. If the taxpayer is using Schedule C, the auditor will still want to verify the calculation using Schedule H since it is a better number. In some cases, it may be significantly higher.

Schedule H for periods 2018 and forward
Line 1 of Schedule H is equal to line 22, Schedule C, in functional currency. All lines 1 through 5c are in functional currency on Schedule H. Also, the income will be broken into the same categories as federal Form 1118. Therefore, you may have to pick up the information for Schedule H more than once for each applicable category.

Start your calculation with line 5c of Schedule H and reverse taxes based on income (line 21 a & b in functional currency on Schedule C and line 2g on Schedule H, both Net Additions and Net Subtractions) and any other state adjustment (review the statements to other adjustments). Then, divide the subtotal by the exchange rate on Schedule H. If the exchange rate is blank, it could be in U.S. dollars (check if functional currency column is completed on Schedule C or currency indicated on page 1) or you may find it on Schedule J. This is your net income of the foreign corporation on a tax basis. If the taxpayer is using Schedule C, the auditor will still want to verify the calculation using Schedule H since it is a better number. In some cases, it may be significantly higher.

Other Foreign Entities
If the foreign corporations owns any disregarded entities, generally the amounts of the disregarded entities flow up to the foreign corporation and have been accounted for in the federal Form 5471.

If the foreign corporation owns any partnerships, the auditor needs to follow the same process for determining if they should be included in the worldwide calculation and making the appropriate adjustments to gross receipts if the partnership is included in the calculation

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South Carolina Revenue Rulings, Procedures, and Commission Decisions

1980s 1990s 2000s 2010s 2020s

The auditor needs to read the entire ruling, procedure or decision before referencing it.

NOTE: Only the commonly used advisory opinions will have a direct link to the document. All others will lead you to the main page.

Tax Commission Decision no. 87-108. This Commission Decision indicates the following: We further find that in computing any deduction due to net operating loss carry forwards, the appropriate adjustments shall be made in prior years so as to reflect the correct net operating losses to be carried forward. In other words, the Department audits SC NOLs back to the start of SC NOLs carried forward to open audit years.

Tax Commission Decision 91-5. This decision held that gain on the sale of a partnership interest was allocated. The business of the partnership was not unitary with a business otherwise being conducted by the partners, and it was a limited partnership interest. It cannot be predicted as to what the Department's position may be in a future case where the partnership interest is owned by a corporation and the business of the partnership is not unitary with the business of the corporation (except to the extent the corporation may be deemed to be conducting the partnership's business). It is sometimes argued that the gain or loss should be allocated as the sale of an intangible not connected with the taxpayer's trade or business. On the other hand, it is argued that the gain or loss should be apportioned because the pass through nature of partnership makes it the equivalent of the sale of business assets by the person in business, or it should be at least partially apportioned because the gain or loss on the sale of the partnership interest should be matched with the apportioned pass through income and losses of the partnership which affected the partner's basis in his partnership interest. The authors do, however, believe that the Department will take the position that gain or loss from the sale of a partnership interest should be apportioned where the business of the partnership is unitary with the business of the corporation.

SC Information Letter 94-35. Multistate Income. Banks will comply the apportionment rules in the SCCL Income Chapter similar to non-bank financial businesses.

SC Commission Decision 94-44. Required Taxpayer to impute interest on cash sweeping transactions pursuant to IRC §7872.

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SC Revenue Ruling 97-15. Provides a summary of Public Law 86-272 and defines SC protected and non-protected activities. Only the solicitation to sell tangible personal property is afforded immunity under Public Law 86-272. The leasing, renting, licensing or other disposition of tangible personal property or transactions involving real property or intangibles, such as franchises, patents, copyrights, trademarks, service marks and the like are not protected activities under Public Law 86-272. The selling or providing of services is also not protected. The sale or delivery and the solicitation for the sale or delivery of any type of service that is not either (1) ancillary to solicitation or (2) otherwise set forth as a protected activity in this Ruling is also not protected under Public Law 86-272.

SC Revenue Procedure 98-1. This deals with Qualified Subchapter S subsidiary election for federal purposes and only applies to person subject to tax under Title 12, Chapter 6 of the South Carolina Code of Laws. An S corporation having a valid QSSS election for federal income tax purposes is deemed to have a valid QSSS election for South Carolina income tax purposes. This federal election is automatic for South Carolina purposes. If the federal election is not made, the election may not be made solely for South Carolina purposes.

Since South Carolina has adopted the Subchapter S provisions contained in Internal Revenue Code '1361 et. seq., South Carolina will treat the assets, liabilities, income, and deductions of the QSSS as they are treated for federal purposes. For South Carolina income tax purposes, including the determination of nexus for income tax purposes, the parent and subsidiary will be treated as one entity.

This election does not apply to license fees pursuant to SCCL Title 12, Chapter 20. The parent and each subsidiary will have to pay the license fee on a separate entity basis.

NOTE: The requirement that each QSSS subsidiary is required to file a separate license fee return was modified by SC Revenue Ruling 05-11.

The parent S corporation files a single SC Form 1120S, "S Corporation Income Tax Return," in the name of the parent; a separate SC1120S is not filed for each entity. The parent computes the combined items of income, deduction, credit, and capital stock base using the apportionment ratio(s) of the entire entity (*i.e.,* the separate attributes of each entity are disregarded.) Simply stated, the items of income, deduction, credit, and capital stock of the QSubs are treated as if the QSubs are divisions of the S Corporation, not subsidiaries.

SC Private Letter Ruling 98-2. The Department reviewed whether a company providing residential and business telephone service to South Carolina economic impact zone counties qualified for the tax credit. Based upon the facts, the Department concluded that the providing of telephone service is the business of "furnishing communications" that is eligible for the economic impact zone credit. Also, the Department determined which of the company's property constituted an integral part of furnishing communications.

NOTE: Although there are no longer "economic impact zones" in South Carolina, this ruling still has relevance as to what qualifies as an integral part of "furnishing communications".

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SC Revenue Ruling 98-14. This revenue ruling deals with the deductions on commissions paid to Foreign Sales Corporations (FSCs) and Domestic International Sales Corporations (DISCs. SC will allow the commission payments as deductions for SC purposes if the FSCs and DISCs have economic substance. This regulation is obsolete because federal law changes have limited the benefit of establishing a regular DISC or a FSC.

However, more exporters of US products in recent years have been using an IC-DISC or interest charge domestic international sales corporation because this is considered the last tax incentive available to U.S. exporters and has generated significant federal tax benefits to IC-DISC shareholders. US Corporations pay commissions to IC-DISCs who are able to deduct the commissions paid. The allowable IC-DISC commission is generally determined by reference to qualifying export sales on a transaction-by-transaction basis, although some grouping of transactions is permitted. There are very complicated federal rules for establishing the IC- DISC. South Carolina will allow the commission payments by the Domestic Corporations to the IC-DISCs. SC conforms to IRC § 991 and allows the commission payments by the Domestic Corporation and does not tax the IC-DISCs. See SCCL §§12-6-40, 12-6-50, and 12-6-2840. For SC reporting purposes, the taxpayer is double dipping by taking the commission deductions and not taxing the exempt federal dividends. Auditors might consider a related expense addback when the SC exempt dividends from the IC-DISC are distributed back to the US Corporation or possibly alternative apportionment.

SC Revenue Ruling 99-4. This ruling states a purchasing company making a qualified stock purchase (at least 80% of the voting power and value of the stock of a corporation during a 12-month acquisition period) of a target corporation can elect to make a joint election under IRC §338, to treat the stock purchase as an asset acquisition. The internal elective recognition gain/loss of the target corporation, along with the non-recognition gain/loss on stock sold by the seller allows the target corporation that was a member of the selling consolidated group before the transaction to be treated as a member of the consolidated group with the stock sale transaction treated as if the target corporation has sold all of its assets at the close of the acquisition date at fair market value in a single, fully taxable transaction, distributed the proceeds of the sale to the seller (the corporation that owns the target, e.g. another member, parent, or Q Sub) in tax free deemed liquidation under IRC §332 and treated as a new corporation which purchased all the assets as of the beginning of the day after the acquisition date (i.e., repurchased its own assets in a hypothetical sale).

As a result, the purchasing corporation receives a stepped up (or stepped down) basis in the assets acquired from the target corporation and a gain or loss on the deemed sale of assets is recognized by the target on its old consolidated return if the target is a member of the selling consolidated group, or the old target's separate return if the target was a member of an affiliated group filing separate returns or an S corporation. An IRC §338(h) (10) election can be made until the 15th day of the 9th month after the month in which the acquisition date occurs. The election must be made jointly by both the seller and the purchaser. SCCL §12-6-2220 specifically lists items of income that must be directly allocated.

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This statute is generally applicable to nonbusiness items of net income. SCCL §12-6-2240 provides that all income remaining after allocation is apportioned. Accordingly, the proper sourcing and the amounts used in the apportionment factors depend on the facts and circumstances. Based on the above statute, the target subsidiary's gain from the deemed sale of assets used in the business is generally apportionable business income. However, the target subsidiary's gains and losses from the sale of real property less all related expenses are allocable income and are allocated to the state in which the real property is located except to the extent that gain represents the return of amounts deducted as depreciation. The amount of gain which represents the return of amounts deducted as depreciation is allocated to South Carolina to the extent of depreciation previously deducted in computing South Carolina taxable income. Gain in excess of recaptured depreciation is allocated to the state where the real property is located whether or not the real property was used in or connected with the taxpayer's trade or business. The target subsidiary's gain from the deemed sale of assets not used in the business is allocable income.

SC Revenue Ruling 05-11. This a summary document that provides answers to various corporate license fee such as:

1. Measure of the license fee base under SCCL §§ 12-20-50 and 12-20-50.
2. What entities are subject to the license fee?
3. How much is the license fee?
4. When the license fee is due?
5. Apportioned License Fee
6. The license fee for a Qualified Subchapter S corporation.
7. License Fee Due on initial Returns
8. License fee due on final returns.
9. When license fees are prorated?

SC Revenue Ruling 09-10. This is a list of state and foreign taxes that are added back pursuant to SCCL §12-6-1130(2):

The deduction for taxes permitted by Internal Revenue Code §164 is computed in the same manner as §164 except there is no deduction for state and local income taxes, or state and local franchise taxes measured by net income, or any income taxes, or any taxes measured by or with respect to net income. In addition, if a taxpayer elects, pursuant to §164, to deduct state and local sales taxes instead of state and local income taxes, the taxpayer may not deduct state and local sales and use taxes….

South Carolina does not have any local income-based income taxes imposed by local governments, but if it did, the deduction would be disallowed.

SC Revenue Ruling 15-5. This revenue ruling discusses the use of the alternative apportionment methods, including combined unitary reporting, allowed under SCCL §12-6-2320(A) in light of the court case *Media General (SC)*. It also explains how to calculate a combined unitary reporting.

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SC Revenue Ruling 16-7. This document provides an overview of South Carolina net operating losses (NOLs), the application of Internal Revenue Code (IRC) §382 limitations on South Carolina NOL carryforwards, and the application of IRC §382 limitations and other NOL use limitations on South Carolina consolidated.

Auditors should ask the taxpayer if there were any acquisitions during the audit years that required a computation of the federal 382 limitation. If any of these entities have SC NOL carryforwards, these SC NOLs are limited by the apportioned SC 382 Limitation.

Example:
Taxpayer A acquired Taxpayer B effective 1/1/2014 and Taxpayer B merged into Taxpayer A on 1/1/2014. Prior to the merger, taxpayer B had a SCNOL Carryforward of 10,000,000. The federal 382 limitation is 2,000,000 (this is an amount the taxpayer will provide). For the final year (12/31/2014), before the merger, taxpayer B had a SC Apportionment ratio of 1.5%. Therefore, the SC apportioned 382 limitation is 30,000 (2,000,000 * 1.5%).

For the 12/31/2015 year, Taxpayer A filed its SC return and reported SC Net income (before SC NOLS) of 2,000,000. After application of the SC 382 limitation of 30,000, the taxpayer reports SC Net Income of 1,970,000. The adjusted SC NOL carryforward for Taxpayer A is 9,970,000 (10,000,000 minus 30,000). Taxpayer will continue to limit the application of pre-merger SC NOLs to 30,000 per year until the SC NOLs (if not expired) have been fully absorbed. Taxpayer A does not have any limitations on application of SC NOLs generated after the merger.

SC Revenue Ruling 16-11. Revenue Ruling which provides nexus creating activity for income tax purposes. The document covers the following categories:

A. General Activities
B. Registration with State Agencies/Departments
C. Ownership/Leasing of In-State Property
D. Ownership Interest of In-State Pass-Through Entities
E. Licensing Intangibles
F. Employee Activities – Sales Related
G. Employee Activities – Non-Sales Related
H. Activities of Unrelated Parties
I. Distribution and Delivery
J. Financial Activities/Transactions
K. Transactions with South Carolina Printers
L. Cloud Computing or Software as a Service (SaaS) Transactions
M. Internet-Based Activities

SC Revenue Ruling 18-8. This is a summary of the complicated rules a utility company must comply with regarding the utility license fee infrastructure credits available pursuant to SCCL § 12-20-105. In order to claim the license fee infrastructure credits, the utility must be required to compute its license fee pursuant to SCCL §12-20-100. If auditors are dealing with a utility

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company that is claiming the license fee utility infrastructure credit, this license fee Revenue Ruling must be reviewed.

SC Revenue Ruling 18-14. In accordance with SCCL §12-36-70 and the principles of Wayfair (US), a remote seller whose gross revenue from sales of tangible personal property, products transferred electronically, and services delivered into South Carolina exceeds $100,000 in the previous calendar year or the current calendar year has economic nexus (*i.e.*, substantial nexus) with South Carolina and is responsible for obtaining a retail license and remitting South Carolina sales and use tax. This RR does not address corporate income tax nexus. However, SC has been an Economic Presence Nexus state since Geoffrey (SC) was decided in 1993.

SC Revenue Procedure 20-1. This is the SC Appeals Procedure for protested audits. After the audit is submitted, the taxpayer must respond within 90 days with either payment or protest. Once the protest is received, the Auditor Supervisor must acknowledge the protest via the Department's Protest Acknowledgment letter and options letter. The taxpayer has 30 days to respond to the letter and has four options:

Option 1 - Request a conference with the Audit Supervisor and Auditor(s)
Option 2 - Request file to be forwarded to the Appeals Section
Option 3 - Withdraw protest
Option 4 – If the taxpayer does not respond within 30 days, the audit is forward to the Appeals Group

Within 1 year of the date of the protest, if the audit is not settled, a Final Department Determination must be issued by the Litigation section. The Department must notify the taxpayer of the right to request a contested case hearing before the Administrative Law Court if the Department does not timely issue a department determination.

After the final determination is issued, the taxpayer has 30 days to pay the audit or appeal to the Administrative Law Court requesting a contested case hearing in accordance with the Rules of Procedure of the Administrative Law Court.

SC Revenue Procedure 20-2. This is the Department's Voluntary Disclosure program and it is for taxpayers who may have nexus with South Carolina but are not registered with the Department to collect or remit South Carolina taxes. In order to be considered for the Voluntary Disclosure Program, the taxpayer or the taxpayer's representative must initiate contact with the Department and meet the conditions specified in this advisory opinion. The request may be made by a taxpayer or the taxpayer's representative on a named or unnamed basis.

The Voluntary Disclosure Program is not available to a taxpayer that:

1. Has been contacted by the Department to schedule an audit or notified that an examination is pending prior to the time its name is disclosed to the Department in connection with participation in the voluntary filing program.
2. Is involved in an audit or litigation with the Department.

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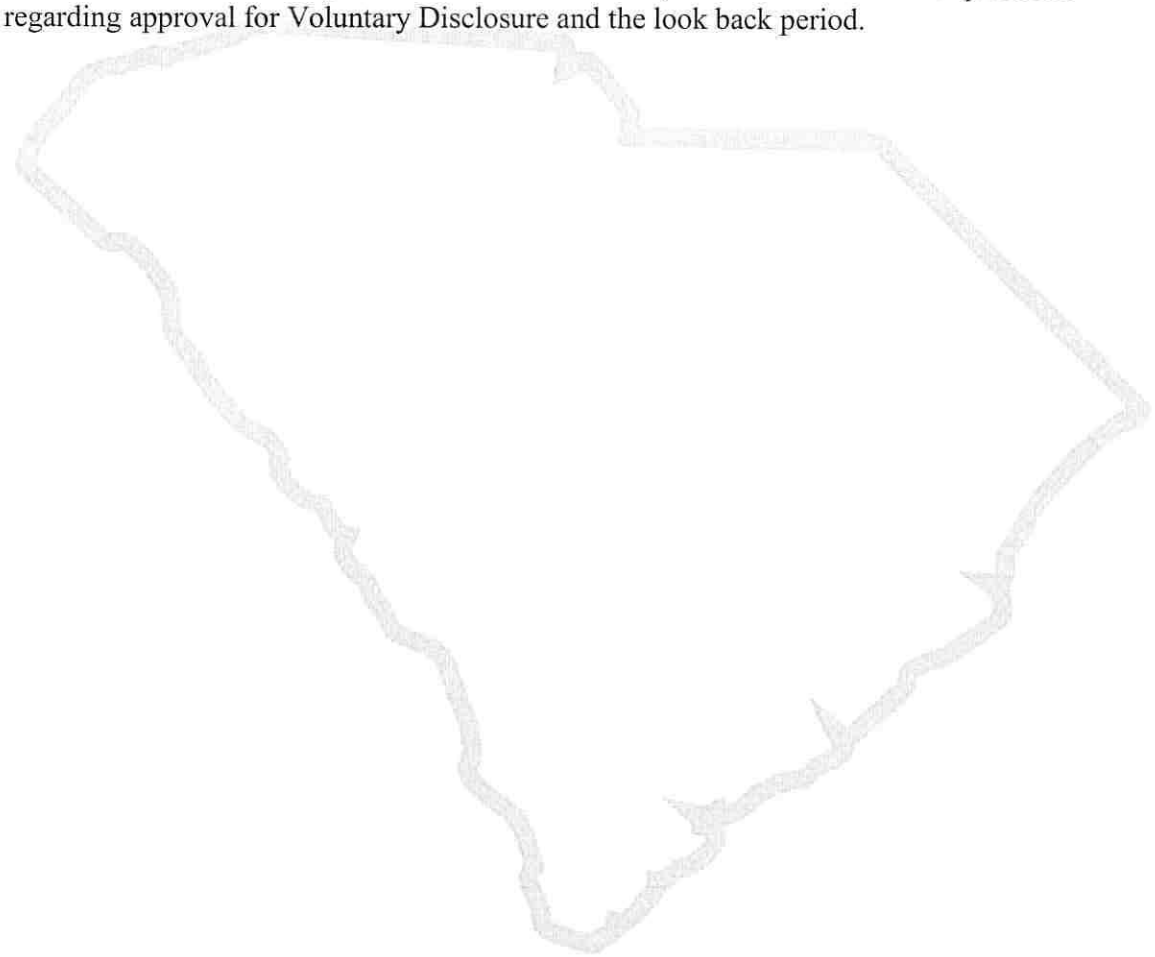
3. Requests an advisory opinion regarding matters relating to the existence of nexus.
4. Is requesting voluntary disclosure participation for non-business individual income taxes.
5. Does not respond timely and completely to a nexus questionnaire (if requested by the Department).
6. Does not provide adequate facts for the Department's Nexus/Discovery Section to determine the existence of nexus.
7. Failed to file a return as the result of fraud or gross negligence

Refer to the RP or The Department's Nexus/Discovery section for answers to questions regarding approval for Voluntary Disclosure and the look back period.



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Court Cases

South Carolina Court Cases Federal Court Cases Other State Court Cases

This section summarizes the court cases list below in three sections: South Carolina Court Cases, Federal Court Cases and Other State Court Cases. To reference a case, use the bold section after the case header. Any links to the actual cases with take you to the External Resources and you will have click on the appropriate external link.

NOTE: The auditor needs to read the entire court case before referencing it.

South Carolina Court Cases

A B C D E F G H I J K L M N O P Q R S T U V W X Y Z

The auditor needs to read the entire court case before referencing it.

CarMax Case. ***CarMax Auto Superstores West Coast, Inc. v. South Carolina Dep't of Revenue*, 411 S.C. 79, 767 S.E.2d 195 (2014)**. The decision in CarMax found that the party seeking to alter the statutory apportionment formula must prove that its alternative approach is reasonable, even if that party is the South Carolina Department of Revenue. In CarMax, the South Carolina Court of Appeals reversed the administrative law court's finding and held that the Department of Revenue had an affirmative burden to show that an alternative apportionment methodology was reasonable as applied to the taxpayer.

The court of appeals looked to an earlier decision in Media General (SC). There, the South Carolina Supreme Court upheld the taxpayer's proffered alternative apportionment method because the Department had not established that another method would be more appropriate. Based on that holding, the court of appeals ruled that when the Department proposes an alternative apportionment method, it is the Department that "must establish that its alternative method is not only appropriate, but more appropriate than any competing methods."

Acknowledging that the alternative apportionment statute did not specify a standard of proof, the court of appeals looked to the nature of the provision, namely its permitting limited deviation from the legislature's prescribed apportionment method, to support the court's conclusion that the party seeking to "override" the legislature's judgment should bear the burden of proving the propriety of the proffered alternative.

The case was remanded back to the ALC for further proceedings on whether the Department can meet its burden.

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Centex Case. ***Centex International Inc. v. South Carolina Dept. of Revenue*, 406 S.C. 132, 750 S.E. 2d 65 (2013).** The South Carolina Supreme Court held that under the infrastructure credit statute (SCCL §12-6-3420), which provides that a corporation could claim a credit for construction or improvement of an infrastructure project against corporate income taxes for expenses paid or accrued by the taxpayer, the legislature intended that a corporation had to be the entity that incurred the expenses to generate the tax credit and thus, a partnership was precluded from earning the infrastructure credit.

Colonial Life Case. ***Colonial Life & Acc. Ins. Co. v. S.C. Tax Comm'n*, 248 S.C. 334, 338-339; 149 S.E.2d 777, 780 (1966).** This case supports the "matching principle". "It would lead to the unreasonable conclusion that the General Assembly intended the tax statutes in question, which exempt from the license tax base Colonial's income from policyholders in other states, to allow deduction for income and license tax purposes not only of those taxes that are fairly referable to the production of taxable South Carolina income, but also of those that are referable to the production of the tax-free out-of-state income". This Court case has been used to support mainly matching adjustments for payments to offshore affiliates when the interest expense deductions and cost of goods sold are substantially overstated in comparison to what the combined entity on a worldwide basis earns.

Dish/DirecTV Cases. ***Dish DBS Corporation, f/k/a EchoStar, DBS Corp., and Affiliates, Appellant, v. South Carolina Department of Revenue, Respondent.*, 2016-001642; 2018-UP-404, 10/31/2018** and ***DIRECTV, Inc. & Subsidiaries, Appellant, v. South Carolina Department of Revenue, Respondent.*, 2015-001509; 5513, 08/30/2017**. SC court decisions issued in the Dish/DirecTV cases determined the income producing activity for satellite TV subscribers is access to the signal form set top boxes that allow SC subscribers to receive satellite TV programming. One hundred percent of the subscription receipts from the SC subscribers were sourced to SC. These cases were monumental in that they laid out how service providers source receipts to SC:

1. SC is not a cost of performance or a market state.
2. Service businesses determine their SC gross receipts based on the location of the income producing activity. (SCCL §12-6-2295 (A)(5)).
3. The location of the income producing activity is different for different businesses.
4. The income producing activity for banks and financial entities (generally) is the location of the customer.
5. The income producing activity for management companies and engineering companies (generally) is the location of the where the services were performed.

Duke Energy I Case. ***Duke Energy Corporation, Petitioner, v. South Carolina Department of Revenue, Respondent*, 782 SE2d 590 (2016)**. The principal recovered from the sale of short-term securities is not includible in the sales factor.

Duke Energy generates and sells electricity. Because Duke Energy does business in both North Carolina and South Carolina, it must apportion its income to determine its income tax liability in South Carolina (SCCL §12-6-2210(B) (2014)) "If a taxpayer is transacting or conducting

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business partly within and partly without this State, the South Carolina income tax is imposed upon a base which reasonably represents the proportion of the trade or business carried on within this State").

Duke Energy has a treasury department responsible for purchasing and selling securities. In 2002, Duke Energy filed amended corporate tax returns with the SCDOR for the income tax years of 1978 to 2001, seeking a total refund of $126,240,645 plus interest. In the amended returns, Duke Energy sought to include the principal recovered from the sale of short-term securities from 1978 to 1999 in the sales factor of the multi-factor apportionment formula. In its original returns, Duke Energy included only the interest or gain from those transactions. Duke Energy claimed it was required by SCCL §12-6-2280 (1995) to include all monies recovered from any sales in the "total sales" computation of the apportionment calculation, including the principal recovered from the sale of short-term securities.

The SCDOR disagreed and denied the refund request. Duke Energy appealed the decision to the SCDOR's Office of Appeals. The Office of Appeals denied Duke Energy's refund request, finding, inter alia, that including recovered principal in the apportionment formula: was contrary to the SCDOR's long-standing administrative policy, would lead to an absurd result, and would misrepresent the amount of business Duke Energy does in South Carolina.

Duke Energy filed a contested case in the Administrative Law Court ("ALC"). The Court of Appeals affirmed, albeit applying a different analysis.

The artificial inflation of the denominator of the sales factor allows a taxpayer to significantly reduce its tax liability in South Carolina in a manner clearly inconsistent with the legislative intent and logical interpretation of the term "reasonably attributable." See Emerson (SC) ("the statutory policy [as to the apportionment formulas] is designed to apportion to South Carolina a fraction of the taxpayer's total income reasonably attributable to its business activity in this State.").

The Court found that the potentially drastic impacts cash management decisions have on determining a company's business activity demonstrates the absurdity that results from Duke Energy's position. Duke Energy's view would require two taxpayers, equal in all respects except for their level of investment activity, to report drastically different results in the taxable income reported through application of the multi-factor apportionment formula due solely to the difference in frequency at which the taxpayers roll over their investments. Plainly, counting the same principal that is invested and sold repeatedly as "total sales" can radically misrepresent any taxpayer's business activity.

Duke Energy II Case. ***Duke Energy Corporation, Petitioner, v. South Carolina Department of Revenue, Respondent*, 19-ALJ-17-0153-CC, 10/27/2020**. Duke and the Department disagree whether subsection (G) of SCCL §12-14-60 limits the capital investment tax credit to $5 million per taxable year or whether the $5 million limitation represents a lifetime limitation. Both parties filed cross motions for summary judgment on this legal issue.

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The Judge concluded the application of the limitation described in SCCL §12-14-60(G) is ambiguous. It is both reasonable, and plausible, for the $5 million limitation to be either an annual limitation or a lifetime limitation. Because it is ambiguous, the ambiguity must be resolved against the taxpayer and in favor of the Department because of our policy to strictly construe a tax credit against the taxpayer, as it is a matter of legislative grace.

Emerson Case. ***Emerson Electric Co., and Affiliates, Appellant, v. South Carolina Department of Revenue, Respondent*, 719 SE2d 650, 12/12/2011**. This a case often cited when we do a matching adjustment, also called a related expense addback adjustment. This case dealt with allocable income that was not reported to SC. The South Carolina Supreme Court upheld the Administrative Law Court's (ALC's) decision to disallow an out-of-state company's interest expense deductions related to properly excluded dividend income. The taxpayer, a company based in Missouri, did not claim deductions for expenses related to dividends received from its subsidiary corporations, for tax years 1999-2002. It later filed amended returns, claiming the deductions and seeking a refund. The ALC determined that under SCCL §12-6-2220(2) certain expense deductions had to be allocated to Missouri, the taxpayer's principal place of business, and therefore could not use those deductions for South Carolina income tax purposes. The court found that the taxpayer had properly excluded from its taxable income, dividends received from its wholly owned subsidiaries, but under the "matching principle" if the income was not taxable in state, then the expenses incurred in generating that income could not be used as a deduction in state. The taxpayer also argued that the statute discriminated against non-resident taxpayers in violation of the federal Commerce Clause, because it resulted in disparate treatment of the taxpayer based solely on residence. Citing *Shaffer v. Carter*, U.S. S.Ct., 252 US 37 (1920), which held a statute may limit the deductions of non-residents to those related to the production of instate income, the court found the South Carolina statute was consistent in its allocation and matching of income and expenses. Any disparity in the tax consequences was a result of Missouri law, over which the court had no control.

Exxon Case. ***Exxon Corporation, Appellant, v. South Carolina Tax Commission, Respondent*, 273 SC 594 258 SE2d 93, 09/05/1979**. This is a significant SC Court Case. Exxon was South Carolina's first unitary business doctrine case. Exxon (Humble Oil and Refining Company during the tax years in question) marketed and sold its products in South Carolina. It argued that it should be able to exclude its exploration and production activities from its apportionment factors and net income used to determine the amount of its income taxable in South Carolina. The Court rejected Exxon's claim. Refer to the Department's old Corporate Manual and search Exxon to bring up a detail Summary of the case.

Geoffrey Case. ***Geoffrey, Inc. v. South Carolina Tax Commission*, 437 SE2d 13 313, SC 15 (07/06/1993)**. A South Carolina Supreme Court case asserting that 1) the royalty payments made for the licensing of the trademarks and symbols need to be sourced to South Carolina and 2) nexus for income tax purposes does not require physical presence.

Kodak Case. ***Eastman Kodak Company v. SC Tax Com*. 418 S.E.2d 542 (SC 1992)**. The issues were whether the safe harbor leases were connected with Kodak's trade or business and whether

the safe harbor lease transactions were part of Kodak's unitary business, and therefore deductible from Kodak's apportionable income. The Court found that the safe harbor leases were part of Kodak's unitary business because the safe harbor leases could not be segregated from Kodak's general business operations for the following reasons:

1. The funding for the safe harbor leases came from the general corporate treasury;
2. No separate staff supervised the transactions; and
3. The magnitude of the transactions and resulting tax benefits suggest a significant contribution to Kodak's general business

There is a summary of the court case in the Old Corporate manual.

Lockwood Greene Case. ***Lockwood Greene Engineers v. South Carolina Tax Commission* 361 S.E.2d 346 (1987)**. A court case in which the courts held the purpose of the apportionment statutes is to provide for the imposition of South Carolina income tax upon a base which reasonably represents the proportion of the trade or business carried on within South Carolina. Allocating income of a multistate engineering firm was determined according to where the services where performed rather than according to where the customers were located.

Lowenstein Case. ***M. Lowenstein Corporation v. SC Tax Comm.*, 298 S.C. 93, 378 S.E.2d 272 (SC Ct. App. 1989).** Lowenstein is in the business of manufacturing textiles. Clark-Schwebel is a subsidiary of Lowenstein and is in the business of manufacturing fiberglass fabrics. They both have their principal places of business in New York, and they both do business in South Carolina.

The case involved two issues:

1. Whether South Carolina can tax the gain Lowenstein made from the repurchase of bonds it issued; and
2. Whether South Carolina can tax Clark-Schwebel on the interest income it earned from loans it made to Lowenstein.

Although these corporations are related, South Carolina is a separate entity state, so there was no claim that the apportionment factors of Lowenstein and Clark-Schwebel should be combined. The issue was the second unitary issue, whether the income was nonbusiness income which should be allocated to the state of the corporation's principal place of business or whether it was business income which should be included in the income that South Carolina apportions.

The Court characterized the question as whether or not the property producing the income in dispute is "connected with the business of the taxpayer." If the property is connected with the business of the taxpayer it is properly apportioned to South Carolina and all other states in which the corporation conducts business, but if the property is not connected with the business of the taxpayer, it must be allocated to New York.

There is a complete summary of this case in the old corporate manual.

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Media General Case. ***Media General Communications, Inc. v. South Carolina Dep't of Revenue*, 388 S.C. 138, 694 S.E.2d 525 (2010.** In *Media General*, the South Carolina Supreme Court held that the combined unitary reporting method is an appropriate alternative apportionment method under SCCL §12-6-2320(A)(4).

In accordance with the *Media General* decision, the Department may require and a taxpayer may request combined unitary reporting as an alternative method, if reasonable, to effectuate equitable apportionment of the taxpayer's income when separate entity reporting does not fairly represent the taxpayer's business activity in South Carolina.

NCR I and NCR II Cases[31]. ***NCR Corporation, Appellant v. South Carolina Tax Commission, Respondent*, 304 SC 1 402 SE2d 666, 02/04/1991** and ***NCR Corporation, Appellant v. South Carolina Tax Commission, Respondent*, 312 SC 52 439 SE2d 254, 12/13/1993**. Taxpayers may attempt to prove a state's apportionment formula is unconstitutional because it does not properly reflect the way their income was earned. They argue that the factors used in the formula do not "actually reflect a reasonable sense of how income is generated." This issue has been litigated in a number of state "factor representation" cases. These cases generally involve a multinational corporation that is receiving dividends and other income, such as royalties and interest, from foreign subsidiaries. In South Carolina's factor representation case, NCR claimed that South Carolina should include its foreign subsidiaries factors in NCR's apportionment formula because they generated the income that was used to pay royalties and interest to NCR.

The South Carolina Supreme Court remanded the case to the trial court with specific instructions to: (1) recompute NCR's taxable income by factoring into the apportionment formula the proportionate contribution by foreign subsidiaries in generating NCR's income; (2) determine NCR's tax liability accordingly; and (3) compare this new calculation to the tax liability actually imposed. If there was a "gross disparity" between these two amounts, NCR would be entitled to a refund. The basis of this holding was that NCR's Due Process rights would be violated if the apportionment formula as applied resulted in a tax liability that was grossly disproportionate to the income generated in South Carolina.

The South Carolina Supreme Court reasoned that to a degree, the income received by NCR from its foreign subsidiaries was earned in the United States (and to an extent in South Carolina) as it was partly here where loan monies were created and patents developed and researched. Hence, domestic payroll, property, and sales which are related to producing this royalty and interest income (like domestic research and development companies) have already been included in the formula denominator. However, if the wholly owned foreign subsidiary did not exist, no royalty or interest income could be generated for NCR.

In NCR II, the audit was adjusted to included representation for the apportionment factors for the foreign entities paying the interest and dividends. The *NCR II* trial judge found an average difference of 27.9% for the three tax years in question. He concluded this margin of error indicated no gross disparity in NCR's apportioned income calculated under the apportionment

[31] Excerpts of Old Corporate Manual

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formula and held there was no due process violation. The South Carolina Supreme Court agreed that 27.9% is not a gross disparity and held that the apportionment formula as applied by the Department did not result in a due process violation.

When *NCR I* and *NCR II* were decided, SCCL §12-6-2320 had not been enacted. SCCL §12-6-2320 allows the Department to require alternate allocation and apportionment provisions if the normal provisions do not fairly represent the extent of the taxpayer's business activity in South Carolina. If a new case were presented, the Department may argue, in the alternative, that if South Carolina statutes do not meet the external consistency test required by the Constitution, that the taxpayer should be required to use the benchmark of apportionment formulas – worldwide combined reporting (subject to the right of a company incorporated in a foreign country to use SCCL §12-6-2290 and elect to apportion only United States source income as determined for federal purposes on Form 1120F).

NOTE: It is interesting to note that the writer indicates that a worldwide combination would cure the distortion. While SC RR #15-5 generally does not allow a worldwide combination, it could be possible, in agreement with the taxpayer, to allow worldwide apportion since SCCL §12-6-2290 does not exclude this apportionment method. While these cases dealt with the distortion in the taxpayer's favor, the opposite occurs frequently where the taxpayer pays royalties, interest and purchases substantially marked up inventory from foreign entities those results in the federal and SC Income being grossly understated. Refer to the Old Corporate Manual for the complete summary of NCR I and NCR II.

Rent-A-Center Texas LP Case. ***Rent-A-Center Texas, L.P., Petitioner, vs. South Carolina Department of Revenue, Respondent.*** **09-ALJ-17-0206-CC, 1/6/2012.** In this case, Rent-A-Center East (RAC East), a SC filer, was paying a management fee to its affiliate Rent-A-Center Texas, L.P (RAC Texas), which did not file income taxes in SC. All of the services provided by RAC Texas were performed by employees located in Texas. The SCDOR tried to assert Nexus on RAC Texas and source some of the management fee income it received from RAC East to SC. The SCDOR's argument was that because some aspects of RAC East's management occur in SC, RAC Texas was receiving income for activities in the state. The Administrative Law Court determined that management services are sourced to the location of where the services are performed (Texas) and, therefore, there was no income to source to SC.

Synovus Case. ***Synovus Bank, Petitioner, v. South Carolina Department of Revenue, Respondent*****, 17-ALJ-17-0418-CC, 06/22/2020.**

The recent Synovus Bank ALC decision dealt with a couple of very important bank issues:

1. What is Book Income?
2. Is the Bank Tax an Income Tax or a Franchise Tax?
3. Can a Bank apply SCNOLs to reduce Bank Tax for the current year?

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The court sided with the Department and stated the following:

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

2. Because of this history, the Court finds that in promulgating regulation 117-1500 in 2003, the Department was filling in the details by codifying a long-standing interpretation of the bank tax. See *Hampton*, 403 S.C. at 407–08, 743 S.E.2d at 264. Therefore, pursuant to the applicable and regulations, this Court finds the bank tax is a franchise tax. See *Goodman v. City of Columbia*, 318 S.C. 488, 490, 458 S.E.2d 531, 532 (1995) ("Regulations authorized by the legislature have the force of law.").

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

Travelscape, LLC Case. ***Travelscape, LLC, Appellant, v. South Carolina Department of Revenue, Respondent*, 705 SE2d 28, 01/18/2011**. This court case is often cited when a taxpayer is not filing in SC and an affiliate provides SC activity which allows the non-filer to maintain a SC Market. This was a sales tax case.

In *Tyler Pipe* (US), the State of Washington imposed a sales tax on a corporation that manufactured products outside of Washington for in-state sale. 483 U.S. at 249, 107 S.Ct. at 2821. The Supreme Court found the corporation had a physical presence in Washington even though it manufactured all of its products outside the State, maintained no offices in the State, owned no property within the State, and had no employees residing in the State. 483 U.S. at 249, 107 S.Ct. at 2821. The Supreme Court reached this conclusion in light of the services provided by non-employee in-state sales representatives. Id. The sales representatives provided services that were essential to the corporation's ability to make sales in Washington, including calling customers, soliciting orders, maintaining contacts, and providing information. Id. at 250, 107

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S.Ct. at 2821. Based on these facts, the Supreme Court found the corporation had a physical presence in the state for tax purposes. Id.

In a similar case, the Supreme Court found a Georgia corporation was subject to a use tax imposed by the State of Florida in spite of the fact the corporation had no offices or employees in Florida. Scripto (US) There, the corporation used independent contractors to sell its products in Florida. Id. at 211, 80 S.Ct. at 621-22. Although these "salesmen" were not technically employees of the corporation, the Supreme Court found their activities within Florida on behalf of the corporation were sufficient to satisfy the physical presence requirement. Id. The Court further found that the corporation's disclaimer of an agency relationship with the independent contractors was insignificant for constitutional purposes. Id. at 211, 80 S.Ct. at 622.

Like the corporations in Tyler Pipe (US) and Scripto (US), the services provided by the hotels are significantly associated with *Travelscape*'s ability to establish and maintain a market in South Carolina for its sales. Without the hotels actually providing the sleeping accommodations to the customer, Travelscape would be entirely unable to conduct business within the state. For Commerce Clause nexus purposes, it simply does not matter that Travelscape specifically disclaims any agency relationship with the hotels in the contracts it enters into (Scripto (US)). Accordingly, we find Travelscape has a physical presence within South Carolina.

Federal Court Cases

A B C D E F G H I J K L M N O P Q R S T U V W X Y Z

The auditor needs to read the entire court case before referencing it.

A. Magnano Co. Case. ***A. Magnano Co. v. Hamilton*, 292 U.S. 40 (1934).** A statute of the State of Washington lays a tax of fifteen cents per pound on all butter substitutes, including oleomargarine, sold within the State.

Held:

1. In respect of the equal protection clause it is obvious that the differences between butter and oleomargarine are sufficient to justify their separate classification for purposes of taxation.
2. The requirement that a tax shall be for a public purpose has regard to the use to be made of the revenue derived from the tax. Its purpose may be public, although the motive behind it may have been to benefit one industry (dairying) by burdening another (oleomargarine).
3. The statute in question imposes no burden on interstate commerce.
4. The effect on an individual of an interference with federal taxing power, caused by destruction of a potential source of federal taxes through excessive state taxation, is too speculative, indirect, and remote to afford the individual any equitable standing in a suit to enjoin the state tax on the ground of such interference.

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5. In general, the due process clause of the Fourteenth Amendment, applied to the States, like the due process clause of the Fifth Amendment, applied to Congress, is not a limitation upon the taxing power.
6. The due process clause applies if the Act be so arbitrary as to compel the conclusion that it does not involve an exertion of the taxing power, but constitute, in substance and effect, the direct exertion of a different and forbidden power, as, for example, the confiscation of property.
7. Collateral purposes or motives of a legislature in levying a tax of a kind within the reach of its lawful power are matters beyond the scope of judicial inquiry.
8. A tax otherwise within the lawful power of a state cannot be adjudged contrary to due process merely because its enforcement may or will result in restricting or even destroying particular occupations or businesses.

Bellas Hess Case. ***National Bellas Hess v. Department of Revenue*, 386 U.S. 753 (1967).** Appellant is a mail order house with its principal place of business in Missouri. It owns no tangible property in Illinois, has no sales outlets, representatives, telephone listing, or solicitors in that State, and does not advertise there by radio, television, billboards, or newspapers. It mails catalogues twice a year to customers throughout the United States, including Illinois, supplemented by occasional "flyers." Orders for merchandise are mailed to appellant's Missouri plant, and goods are sent to customers by mail or common carrier.

Appellant obtained a judgment from the Illinois Supreme Court requiring appellant to collect and pay to the State the use tax imposed by Illinois upon consumers who purchase appellant's goods for use within the State. *Held:* The Commerce Clause prohibits a State from imposing the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or by mail. Pp. 386 U. S. 756-760. 34 Ill. 2d 164, 214 N.E.2d 755, reversed.

International Harvester Case. ***International Harvester Co. v. Wis. Dep't of Taxation* (US), 322 U.S. 435, 441-42 (1944).** It has long been held that income arising from business or property within a state is subject to state taxation (*International Harvester Co. v. Wis. Dep't of Taxation*, 322 U.S. 435, 441-42 (1944)). Indeed, the Supreme Court has held that the taxpayer need not be a resident of the state for the income in question to be taxable by the state authorities.

Mobil Oil Case. ***Mobil Oil v. Commissioner Vermont*, 445 U.S. 425 (1980).** This case did not turn on whether the dividends were part of the "unitary business" the Court gave us the famous "linchpin of apportionability" language and a definition of what constitutes a unitary relationship (sort of):

Functional integration,
Centralization of management, and
Economies of scale.

The Court also stated that the form in which income is recognized—e.g., ordinary earnings, dividends, capital gains, etc., is irrelevant for constitutional purposes.

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Significantly, some of the dividends came from Mobil's minority ownership interest in Aramco, a Saudi- Arabian corporation.

Quill Case. ***Quill Corp. v. North Dakota,* 504 U.S. 298 (1992).** In *Quill*, the State (North Dakota) was trying to collect the tax on an out-of-state mail-order retailer. Specifically, *Quill* was a Delaware corporation, with office or warehouses in Illinois, California, and Georgia. It sold office equipment and supplies through catalogs, flyers, and phone calls. None of its employees even worked or lived in North Dakota. At issue, North Dakota, similar to its sales tax, imposed a use tax on property purchased for storage, use, or consumption in the state.

As relevant here, it basically imposed the collection obligation on every retailer that made regular or systematic solicitations in the state, which was defined to include three or more advertisements in a 12-month period. For its part, *Quill* argued that North Dakota had no power to make it collect the tax. In *Quill*, there were two competing legal theories: the Due Process Clause and the Commerce Clause. As the Court explained, "[t]he Due Process Clause 'requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax, and that the 'income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State.'" (citations omitted) From a historic perspective—and supported by a case called *Bellas Hess (US)* —some form of physical presence was required to satisfy the due process requirements.

The *Quill* Court, even though prior precedent emphasized physical presence, stated that "to the extent that our decisions have indicated that the Due Process Clause requires physical presence in a State for the imposition of duty to collect a use tax, we overrule those holdings as superseded by developments in the law of due process." So, the Court made clear in *Quill* that perhaps physical presence wasn't needed for due process concerns—so long as the retailer purposefully directed its activities at residents of the state and the magnitude of those contacts and activities was large enough. Think of it this way: Due Process is concerned with whether the person's activities with a State are substantial enough to justify the State's exercise of jurisdiction or power over him. It is, at bottom, a fairness concern. But, next was the Commerce Clause analysis. The Commerce Clause, of course, allows Congress to regulate commerce among the several States, i.e., interstate commerce. There is, though, a judicially recognized "negative sweep" to the commerce clause, often referred to as the "Dormant Commerce Clause" or the "negative Commerce Clause." In effect, under the dormant Commerce Clause, states cannot take actions that unduly interfere with or burden interstate commerce. The Commerce Clause concerns are distinct from that of the due process concerns; the Commerce Clause and its negative sweep are concerned with the structure of the market and the effect of state action and regulation on the national economy. In *Quill*, the Court embraced a bright-line physical presence requirement, like it did in *Bellas Hess* (US). The Court noted that, "a bright-line rule in the area of sales and use taxes also encourages settled expectations and, in doing so, fosters investment by businesses and individuals." So, as of 1992, the Supreme Court—through its decisions in *Quill* and *Bellas Hess (US)* —had a bright-line rule requiring physical presence, due to the Commerce Clause, for imposing sales or use tax collection obligations on retailers. That's why, depending on the retailer you bought your online purchase from, you may (or may not) have had

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sales tax collected—it depended on whether that retailer had a physical presence in your state. (You may have had a separate individual use tax obligation, though.)

NOTE: There is no bright line that physical presence be presence for asserting corporate income tax Nexus. In fact, SC has been an "economic presences" state for asserting corporate nexus since *Geoffrey (SC)* was decided in 1993. Furthermore, the *Quill* Case was overturned by the *Wayfair* (US) 2018.

Scripto Case. ***Scripto, Inc. v. Carson,* 362 U.S. 207 (1960).** This is an often quoted case for asserting nexus based on the instate activity of third parties which allows the entity in the taxing state to maintain a market in the taxing state. Although dealing with sales tax, the case is often quoted for asserting state income tax nexus. Appellant, a Georgia corporation, has no office or place of business in Florida and no property or regular full-time employees there; but it does have in Florida ten brokers, wholesalers or jobbers who solicit sales of appellant's products on a commission basis and forward orders to Georgia, where they are accepted and whence the goods are shipped to Florida residents.

Held: a Florida statute which levies a tax on the use of such products in Florida and makes appellant responsible for its collection from Florida purchasers is not repugnant either to the Commerce Clause of the Constitution or to the Due Process Clause of the Fourteenth Amendment. *General Trading Co. v. State Tax Comm'n, 322 U. S. 335*, followed. *Miller Bros. Co. v. Maryland, 347 U. S. 340, distinguished. Pp. 362 U. S. 207-213.*
105 So. 2d 775 affirmed.

Shaffer Case. ***Shaffer v. Carter,* 252 (U.S.) 37 (1920).** When, upon application for a preliminary injunction, the district court not only refuses the injunction but dismisses the bill, appeal to this Court should be under Jud. Code, § 238, from the final decree, and not under § 266.

Equity may be resorted to for relief against an unconstitutional tax lien, clouding the title to real property, if there be no complete remedy at law.

Quaere whether the Oklahoma laws afford an adequate legal remedy in a case where the constitutionality of the state income tax law is in question.

The Oklahoma taxing laws afford no legal remedy for removing a cloud caused by an invalid lien for an income tax.

Having acquired jurisdiction, equity affords complete relief. *Id.*

Governmental jurisdiction in matters of taxation depends upon the power to enforce the mandate of the state by action taken within its borders either *in personam* or *in rem.*

A state may tax income derived from local property and business owned and managed from without by a citizen and resident of another state; such power is consistent with Const., Art. IV, §

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2, guaranteeing privileges and immunities and the equal protection Clause of the Fourteenth Amendment.

The constitutionality of such a tax depends on its practical operation and effect, and not on mere definitions or theoretical distinctions respecting its nature and quality.

The fact that the Oklahoma income tax law permits residents to deduct from their gross income losses sustained without as well as those sustained within the state, while nonresidents may deduct only those occurring within it, does not make the law obnoxious to the privileges and immunities clause, *supra,* or the equal protection clause of the Fourteenth Amendment.

Net income derived from interstate commerce is taxable under a state law providing for a general income tax.

The Oklahoma gross production tax, imposed on oil and gas producing companies, was intended as a substitute for the *ad valorem* property tax, and payment of it does not relieve the producer from taxation under the state income tax law.

The Constitution, including the Fourteenth Amendment, does not forbid double taxation by the states.

Without deciding whether it would be consistent with due process to enforce a tax on the income derived by a nonresident from part of his property within a state by imposing a lien on all his property, real and personal, there situate, *held* that, in this case, the state was justified in treating the various properties and business of a producer of oil and natural gas, who went on with their operation after the income tax law was enacted, as an entity, producing the income and subject to the lien.

Tyler Pipe Case. ***Tyler Pipe Industries, Inc. v. Washington Department of Revenue,*** **483 U.S. 232, 107 S. Ct. 2810, 97 L. Ed. 2d. 199.** Summary from the *Travelscape (SC)* case discussed above:
In *Tyler Pipe*, the State of Washington imposed a sales tax on a corporation that manufactured products outside of Washington for in-state sale. *483 U.S. at 249, 107 S.Ct. at 2821.* The Supreme Court found the corporation had a physical presence in Washington even though it manufactured all of its products outside the State, maintained no offices in the State, owned no property within the State, and had no employees residing in the State. *483 U.S. at 249, 107 S.Ct. at 2821.* The Supreme Court reached this conclusion in light of the services provided by non-employee in-state sales representatives. Id. The sales representatives provided services that were essential to the corporation's ability to make sales in Washington, including calling customers, soliciting orders, maintaining contacts, and providing information. *Id. at 250, 107 S.Ct. at 2821.* Based on these facts, the Supreme Court found the corporation had a physical presence in the state for tax purposes. Id.

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South Dakota vs. Wayfair, Inc. Case. **South Dakota v. Wayfair, Inc., 585 U.S., 138 S.CT. 2080 (2018)**. On June 21, 2018, The United States Supreme Court ruled 5-4 in *South Dakota v. Wayfair* that states can mandate that businesses without a physical presence in a state with more than 200 transactions or $100,000 in-state sales collect and remit sales taxes on transactions in the state.

NOTE: With regards to corporate income, SC has been an economic presence state since 1992 when *Geoffrey* was decided.

Wrigley Case. ***Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214 (1992).** During 1973-1978, respondent chewing gum manufacturer, which is based in Chicago, sold its products in Wisconsin through a sales force consisting of a regional manager and various "field" representatives, all of whom engaged in various activities in addition to requesting orders from customers. Wisconsin orders were sent to Chicago for acceptance, and were filled by shipment through common carrier from outside the State. In 1980, petitioner Wisconsin Department of Revenue concluded that respondent's in-state business activities during the years in question had been sufficient to support imposition of a franchise tax. Respondent objected to the assessment of that tax, maintaining that it was immune under US 15 §381(a), which prohibits a State from taxing the income of a corporation whose only business activities within the State consist of "solicitation of orders" for tangible goods, provided that the orders are sent outside the State for approval and the goods are delivered from out of state. Ultimately, the State Supreme Court disallowed the imposition of the tax.

Held: Respondent's activities in Wisconsin fell outside the protection of US 15 §381(a). pp. 220-235.

(a) In addition to any speech or conduct that explicitly or implicitly proposes a sale, "solicitation of orders" as used in US 15 §381(a) covers those activities that are entirely ancillary to requests for purchases-those that serve no independent business function apart from their connection to the soliciting of orders. The statutory phrase should not be interpreted narrowly to cover only actual requests for purchases or the actions that are absolutely essential to making those requests, but includes the entire process associated with inviting an order. Thus, providing a car and a stock of free samples to salesmen is part of the "solicitation of orders," because the only reason to do it is to facilitate requests for purchases. On the other hand, the statutory phrase should not be interpreted broadly to include all activities that are routinely, or even closely, associated with solicitation or customarily performed by salesmen. Those activities that the company would have reason to engage in any way but chooses to allocate to its in-state sales force are not covered. For example, employing salesmen to repair or service the company's products is not part of the "solicitation of orders," since there is good reason to get that done whether or not the company has a sales force. Pp. 223-231.

(b) There is a de minimis exception to the activities that forfeit US 15 §381 immunity. Whether a particular activity is sufficiently de minimis to avoid loss of US 15 §381 immunity depends upon whether that activity establishes a nontrivial additional connection with the taxing State. Pp. 231-232.

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(c) Respondent's Wisconsin business activities were not limited to those specified in US §381. Although the regional manager's recruitment, training, and evaluation of employees and intervention in credit disputes, as well as the company's use of hotels and homes for sales-related meetings, must be viewed as ancillary to requesting purchases, the sales representatives' practices of replacing retailers' stale gum without cost, of occasionally using "agency stock checks" to sell gum to retailers who had agreed to install new display racks, and of storing gum for these purposes at home or in rented space cannot be so viewed, since those activities constituted independent business functions quite separate from the requesting of orders and respondent had a business purpose for engaging in them whether or not it employed a sales force. Moreover, the nonimmune activities, when considered together, are not de minimis. While their relative magnitude was not large compared to respondent's other Wisconsin operations, they constituted a nontrivial additional connection with the State. Pp. 232-235.

Other States Court Cases

A B C D E F G H I J K L M N O P Q R S T U V W X Y Z

The auditor needs to read the entire court case before referencing it.

Container Case. **CA: *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159 (1983)**. California imposes a corporate franchise tax geared to income. It employs the "unitary business" principle and formula apportionment in applying that tax to corporations doing business both inside and outside the State. The formula used -- commonly called the "three-factor" formula -- is based, in equal parts, on the proportion of a unitary business' total payroll, property, and sales that are located in the State. Appellant paperboard packaging manufacturer is a Delaware corporation headquartered in Illinois and doing business in California and elsewhere. It also has a number of overseas subsidiaries incorporated in the countries in which they operate. For the tax years in question in this case, in calculating the share of its net income that was apportionable to California under the three-factor formula, appellant omitted all of its subsidiaries' payroll, property, and sales. Appellee Franchise Tax Board issued notices of additional assessments, the gravamen of which was that appellant should have treated its overseas subsidiaries as part of its unitary business, rather than as a passive investment. After paying the additional assessments under protest, appellant brought an action for a refund in California Superior Court, which upheld the additional assessments. The California Court of Appeal affirmed.

Held:
1. California's application of the unitary business principle to appellant and its foreign subsidiaries was proper.

(a) The taxpayer has the burden of showing by "clear and convincing evidence" that the state tax results in extraterritorial values being taxed. This Court will, if reasonably possible, defer to the judgment of state courts in deciding whether a particular set of activities constitutes a "unitary

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business." The Court's task is to determine whether the state court applied the correct standards to the case, and, if it did, whether its judgment was within the realm of a permissible judgment.

(b) Here, there is no merit in the appellant's argument that the Court of Appeal, an important part, analyzed the case under the incorrect legal standard. Rather, the factors relied upon by the court in holding that appellant and its foreign subsidiaries constituted a unitary business -- which factors included appellant's assistance to its subsidiaries in obtaining equipment and in filling personnel needs that could not be met locally, the substantial role played by appellant in loaning funds to the subsidiaries and guaranteeing loans provided by others, the considerable interplay between appellant and its subsidiaries in the area of corporate expansion, the substantial technical assistance provided by appellant to the subsidiaries, and the supervisory role played by appellant's officers in providing general guidance to the subsidiaries -- taken in combination, clearly demonstrate that the court reached a conclusion "within the realm of permissible judgment."

2. California's use of the three-factor formula to apportion the income of the unitary business consisting of appellant and its foreign subsidiaries was fair. Appellant had the burden of proving that the income apportioned to California was out of all appropriate proportions to the business transacted in the State. This burden was not met by offering various statistics that appeared to demonstrate not only that wage rates are generally lower in the foreign countries in which appellant's subsidiaries operate, but also that those lower wage rates are not offset by lower levels of productivity. It may well be that, in addition to the foreign payroll going into the production of any given corrugated container by a foreign subsidiary, there is a California payroll, as well as other California factors, contributing to the same production. The mere fact that this possibility is not reflected in appellant's accounting does not disturb the underlying premises of the formula apportionment method.

3. California had no obligation under the Foreign Commerce Clause to employ the "arm's length" analysis used by the Federal Government and most foreign nations in evaluating the tax consequences of intercorporate relationships. Japan Line, Ltd. v. County of Los Angeles, 441 U. S. 434, distinguished.

(a) The double taxation occasioned by the California scheme is not impermissible. Due in part to the difference between a tax on income and a tax on tangible property, California would have trouble avoiding double taxation of corporations subject to its franchise tax even if it adopted the "arm's length" approach. Moreover, the California tax does not result in "inevitable" double taxation. It would be perverse, simply for the sake of avoiding double taxation, to require California to give up one allocation method that sometimes results in double taxation in favor of another allocation method that sometimes has the same result.

(b) The California tax does not violate the "one voice" standard established in Japan Line, supra, under which a state tax at variance with federal policy will be struck down if it either implicates foreign policy issues which must be left to the Federal Government or violates a clear federal directive. Three factors weigh strongly against the conclusion that the tax might lead to significant foreign retaliation. The tax does not create an automatic "asymmetry" in international

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taxation, it is imposed on a domestic corporation and not on a foreign entity, and even if foreign nations had a legitimate interest in reducing the tax burden of domestic corporations, appellant is amenable to be taxed in California one way or another, and the tax it pays is more the function of California's tax rate than of its allocation method. Moreover, the California tax is not preempted by federal law or fatally inconsistent with federal policy. There is no claim that the federal tax statutes themselves provide the necessary preemptive force. The requirement of some tax treaties that the Federal Government adopt some form of arm's length analysis in taxing the domestic income of multinational enterprises is generally waived as to taxes imposed by each of the contracting nations on its own domestic corporations. Tax treaties do not cover the taxing activities of States. And Congress has never enacted legislation designed to regulate state taxation of income.

Edison California Stores Case. ***Edison California Stores v. McColgan,* (CA) 30 Cal.2d 472 (Ca. 1947).** The California Supreme Court holds that the state's adoption of formulary apportionment and the unitary business principle should not be confined to separate entities:

That is, where the unitary business was operated through multiple corporate entities, the legislature intended to extend the use of formulary apportionment to all entities comprising the unitary business. This was the case that established the concept of combined reporting.

U.S. Supreme Court affirms without opinion.

Finnigan Case. **CA: In the Matter of the Appeal of *FINNIGAN CORPORATION*, 88-SBE-022-A, 01/24/1990**. In *Finnigan Corporation, Cal. St. Bd. of Equalization*, nexus established by one member of a group creates nexus for all other members of the group. This approach applies only if the taxpayer is filing on a unitary combined basis in South Carolina. All members of the combined unitary group are viewed more like a single taxpayer. The unitary group income is apportioned to the state for the group as a whole. The income of all unitary members is multiplied by a single sales factor. The numerator includes total sales to South Carolina of all members of the unitary group including those members protected by PL 86-272 and/or do not have nexus in the state.

InterAudi Bank Case. **NY: *Interaudi Bank,* 2011 WL 1537402 (NY St Div of Tax Appeals DTA No. 821659, April 14, 2011)**. This is a New York Case cited for requiring a matching adjustment (related expense addback) on expenses deducted that apply to foreign dividends and other foreign income not reported to SC[32].

A New York chartered bank subject to the State Bank Tax transferred approximately $100 million of its investment assets to a subsidiary that qualified as a passive investment company under Delaware law. That subsidiary had one part-time employee who was paid $2,000 annually. While she was the president of the subsidiary, she also was an employee of a company that was an affiliate of the entity hired to be the custodian of the assets of the subsidiary and she held approximately 100 positions as an officer with other clients of that same company. Nevertheless,

[32] From BNA

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the administrative law judge found that the passive investment company "was not an empty shell. It was exceedingly well capitalized. It was not formed to create fake losses so as to generate tax deductions . . . . It was intended to generate a profit from its very inception and did in fact generate such profit. It did not pretend to serve some function . . . which was actually being performed by its parent." In *Interaudi Bank* there were no intercorporate transactions other than the initial capital contribution of the investment assets so no presumption of distortion was created. However, the State Tribunal affirmed the administrative law judge's determination that the transfer of the investment assets to the subsidiary was an "arrangement, agreement or understanding" that resulted in a mismatch of income and related expense causing the State Bank Tax liability of the bank to be distorted.

The administrative law judge stated: "If petitioner used funds which it had borrowed from its depositors, then it had . . . created an arrangement whereby the expense of obtaining such funds (the interest paid to depositors) was allocated to New York State while the income earned on such funds was allocated outside of New York State. This is the very definition of distortion. If, on the other hand, petitioner used funds for which petitioner incurred no expense (e.g. paid-in capital or undistributed profits), then it is hard to see where there is any mismatching of income and expenses which would cause distortion." The administrative law judge found that, at the time the investment assets were transferred to the subsidiary, the source of those assets was deposits held by the bank or other borrowings all of which resulted in interest expense incurred by the bank while the subsidiary earned over $5 million in investment income but incurred no interest expense. This finding was based on the administrative law judge's finding that the stockholders' equity in the bank was only about $38.7 million at the time almost $100 million in assets were transferred to the subsidiary.

The administrative law judge held: "It can only be concluded that petitioner created a distortion in its income by claiming an interest deduction in its combined report attributable to assets held by a subsidiary corporation which was not included in the combined report. As a result either its deductions were overstated or its income was understated. By including BA Investments' income in the combined report, this distortion is eliminated."

Joyce Case. **CA: In the Matter of the Appeal of *JOYCE, INC.*, 66-SBE-070, 11/23/1966.** Nexus established by one member of a group does not create nexus for any other member of the group. Only the in-state activities shall be considered in determining nexus. Activities conducted by any other person or business is not considered in determining nexus unless they are acting in a representative capacity on behalf of that company. This method is considered a separate company method of combined reporting. The income of all unitary members is multiplied by the sales for each unitary member that has nexus within the state and is not protected by PL 86-272. Each member has its own sales factor. The denominator of the sales factor for each member includes the total sales of all unitary members, including those protected by PL 86-272 and that do not have nexus in the state. The numerator includes only the sales in the state for that member. For each member, the resulting apportionment factor is multiplied by the combined income of all unitary members. SC does not adopt *Joyce* for unitary combine filers.

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External Resources

This section contains all the links to resources outside of this document. These links are only included here. Any references to any external resource will bring you to this page and you will have to click on the appropriate external resource link to access any resources outside of this document.

1. South Carolina Department of Revenue's Website: dor.sc.gov
    a. South Carolina Forms
    b. South Carolina Policy & Publications:
        i. Advisory Opinions (RR, RP, CD, PLR, etc.): You can search by year for 2003 and forward or you can search by category. The License Fee is under Miscellaneous Taxes category under title "Annual Reports and Licenses".
            1. Important Advisory Opinions
                a. SC RR #15-5: Use of Alternative Apportionment
                b. SC RR #16-11: Nexus
                c. SC RP #20-1: Appeals Process
        ii. Policy Manuals: Tax Incentives for Economic Development
            1. Chapter 2, Part A – General Tax Provisions and Administration of Credits.
            2. Chapter 2, Part B – Job or Employee Credits and Incentives
        iii. South Carolina Codes & Regulations
            1. South Carolina Code of Laws: Title 12
            2. Tax Regulations: You will have click on the specific regulations.

2. Toolbox on SharePoint:
    a. Guide to Toolbox
    b. Articles
    c. Audit Checklists:
        i. Audit Program Checklist: This checklist is used for each audit.
        ii. Credit Checklists: This folder contains a specific checklist for each credit, including calculations in excel and information to request.
    d. Court Cases:
        i. SC Cases: The cases listed below are cases used frequently.
            1. CarMax
            2. DIRECTV
            3. Dish
            4. Emerson
            5. Geoffrey
            6. Lockwood Greene
            7. Media General
        ii. U.S. Cases

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iii. Other State Cases

e. DORWAY

f. Other Manuals

i. California Franchise Tax Board: This is another manual but it is **not** included in the Other Manuals folder on Toolbox.

1. Manual of Audit Procedures (MAP)
2. Multistate Audit Technique Manual (MATM)

g. Other Resources:

i. Draft RR - Bank Tax: This Revenue Ruling was not issued by Policy but has great information on the procedures followed by SCDOR.

ii. Oil & Gas

h. Sample Write-ups

i. Templates:

i. Excel Write-up Schedules

ii. IDRs

iii. Related Expense Addback

j. Training

3. SEC website company search (EDGAR): https://www.sec.gov/edgar/search/

4. U.S. Patent and Trademark Office (USPTO) website: Search to find the order of trademarks and patents.
   a. Trademark search (TESS): https://www.uspto.gov/trademarks/search
   b. Patent search: https://patft.uspto.gov/netahtml/PTO/search-bool.html

5. IRS website: https://www.irs.gov/
   a. Practice Units: These are developed through internal collaboration and service as training material on tax issues. These are continuously added as information changes or there are new insights. This information can provide additional information on specific IRC topics.

6. Checkpoint website: https://checkpoint.riag.com/ (This site is a great resource for researching topics, court cases, code sections, etc.)

7. FDIC website bank search: https://www7.fdic.gov/idasp/advSearchLanding.asp

8. Office of the Comptroller of the Currency (OCC) website: https://www.occ.treas.gov/ (There is institution search on the homepage.

9. NAICS website: https://www.naics.com/

10. South Carolina Secretary of State website business name search: https://businessfilings.sc.gov/BusinessFiling/Entity/Search

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11. South Carolina Department of Insurance website database search: https://online.doi.sc.gov/Eng/Public/Static/DBSearch.aspx

12. South Carolina Public Service Commission website: https://psc.sc.gov/

13. South Carolina Office of Regulatory Staff (ORS) website: https://ors.sc.gov/

14. Multistate Tax Commission website: https://www.mtc.gov/

15. U.S. National Library of Medicine's database of clinical studies conducted around the world: https://www.clinicaltrials.gov/

Computer Audit Specialists (fka Computer Assisted Audit)

Computer Audit Specialists (CAS) is a part of Audit Support. Currently there are two full-time employees, Carol Solomons (Carol.Solomons@dor.sc.gov) in Columbia and Stefanie Lee (Stefanie.Lee@dor.sc.gov) in Greenville.

What does the CAS section do? (Specifically for Foreign audit)

- **File conversions** – for example, converting PDF files to Excel or Word files. Primarily done for field audit, but also for other sections, such as property, nexus, etc.
- **File cleanup** – converting raw taxpayer data into a good format for audit review

What software is specific to CAS?

- **ACL**: database management, very large databases
- **Adobe Pro DC**: more flexibility with PDF files
- **Able2Extract**: converts PDF files to Excel (or Word)

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Certified to be a true and exact copy of the original document on file with the South Carolina Administrative Law Court.

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

U.S. Bank National Association, Petitioner, vs. South Carolina Department of Revenue, Respondent.	Docket No. 20-ALJ-17-0168-CC **JOINT EXHIBIT LIST**

In the interest of judicial economy, U.S. Bank National Association (Petitioner) and Respondent South Carolina Department of Revenue (Respondent) hereby submit this Joint Exhibit List to the Court. Given the voluminous exhibits, including excel spreadsheets, the parties will provide all exhibits to the Court and court reporter via electronic means. The parties do not object to the authenticity or admissibility of Exhibits 1 - 32, as specifically set forth below.

Exhibit #	Description
1.	Department Determination
2.	Field Audit Report
3.	Petitioner's 2011 Bank Tax Return (with 2011 Federal Return attached)
4.	Petitioner's 2012 Bank Tax Return
5.	Petitioner's Amended 2012 Bank Tax Return (with 2012 Federal Return attached)
6.	Petitioner's 2013 Bank Tax Return
7.	Petitioner's Amended 2013 Bank Tax Return (with 2013 Federal Return attached)
8.	Petitioner's 2014 Bank Tax Return
9.	Petitioner's Amended 2014 Bank Tax Return (with 2014 Federal Return attached)
10.	Petitioner's 2015 Bank Tax Return (with 2015 Federal Return attached)
11.	Petitioner's 2016 Bank Tax Return (with 2016 Federal Return attached)
12.	Proposed Assessment
13.	Consent to Extend Time to Assess Tax
14.	Public Draft SC Revenue Ruling Re: Bank Tax
15.	Portion of Record from *Lockwood Greene Engineers, Inc.*
16.	CV of Professor John A. Swain
17.	CV of Dr. Greg George
18.	Brian J. Cody, Ph.D. *Curriculum Vitae*

19.	Petitioner's 2011 Apportionment Workpapers – Market Sourcing Revised
20.	Petitioner's 2012 Apportionment Workpapers – Market Sourcing Revised
21.	Petitioner's 2013 Apportionment Workpapers – Market Sourcing Revised
22.	Petitioner's 2014 Apportionment Workpapers – Market Sourcing Revised
23.	Petitioner's 2015 Apportionment Workpapers – Market Sourcing Revised
24.	Petitioner's 2016 Apportionment Workpapers – Market Sourcing Revised
25.	Petitioner's 2016 Apportionment Workpapers – Market Sourcing
26.	Petitioner's 2015 Apportionment Workpapers – Market Sourcing
27.	Petitioner's 2012 Apportionment Workpapers – Market Sourcing
28.	Petitioner's 2011 Apportionment Workpapers – Market Sourcing
29.	Petitioner's 2013 Apportionment Workpapers – Market Sourcing
30.	Petitioner's 2014 Apportionment Workpapers – Market Sourcing
31.	Petitioner's 2014 – 2016 Apportionment Workpapers – As Filed
32.	Email from taxpayer dated July 10, 2018

{Signatures on following page}

Respectfully submitted,

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Columbia, South Carolina
July 17, 2022

STATE OF SOUTH CAROLINA

DEPARTMENT OF REVENUE

OFFICE OF THE GENERAL COUNSEL

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June 18, 2020

VIA US MAIL

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Re: US Bank National Association
File Number: 200807653
DOR File Number: 190199

Dear Counsel,

Enclosed is the South Carolina Department of Revenue's Determination in the above-referenced matter. If you disagree with the Determination, you may request a contested case hearing before an Administrative Law Judge. If you choose to pursue such remedy, you must do so within thirty (30) days of the date of this letter. If you fail to respond within this time limitation, you will lose your right to appeal the Department Determination and your protest will be ended. Should you desire a contested case hearing, you must complete the enclosed request form and mail it, along with a $500.00 filing fee, to the Administrative Law Court at the address stated on the form's instruction sheet.

The Administrative Law Court rules require that you also send me a copy of your request. My address is as follows: PO Box 12265, Columbia, SC 29211-9979.

Sincerely,

OFFICE OF GENERAL COUNSEL FOR LITIGATION

Marcus D Antley III

Marcus D. Antley, III, Esquire
Counsel for Litigation

MDA/hch
Enclosures

DEPARTMENT DETERMINATION

Taxpayer:

US Bank National Association
800 Nicollet Mall
Minneapolis, MN 55402

Periods at Issue:

South Carolina Bank Tax ("Bank Tax") for the Periods ending December 31, 2011 through December 31, 2016 ("Audit Period")[1]

Matters in Dispute:

1. Should US Bank National Association ("Taxpayer") include income from loan interest, credit card interest and fees, and merchant fees in its gross receipts from within South Carolina?

2. Should the Taxpayer include income from the sale of Visa stock in its apportionable income?

3. Is the Taxpayer subject to substantial understatement penalties?

Amount at Issue:

Tax	$3,775,638.00
Penalty	$943,909.25
Interest*	$1,053,532.18
TOTAL	**$ 5,773,079.43**

*The interest amount has been updated from the Proposed Assessment and is computed through July 18, 2020, and will continue to accrue until this matter is resolved.

Determinations:

1. The Taxpayer must include income from loan interest, credit card interest and fees, and merchant fees in its gross receipts from within South Carolina.

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[1] Pursuant to S.C. Code Ann. § 12-54-85(C)(3) (2014), the Department extended the audit to include periods ending in December 31, 2011, December 31, 2012, and December 31, 2013, which were outside the thirty-six month limitation, because the understatement of tax exceeded twenty percent (20%).

MDA

2. The Taxpayer must include income from the sale of Visa stock in its apportionable income.

3. The Taxpayer is subject to substantial understatement penalties.

Relevant Facts:

1. The Taxpayer is a national bank and wholly-owned subsidiary of U.S. Bancorp. The Taxpayer provides a wide range of banking and trust services for retail and commercial clients. The Taxpayer is headquartered in Minnesota and engaged in a banking business in South Carolina and other states. In addition to other sources, the Taxpayer receives income from: (1) interest from residential mortgages, commercial loans and consumer loans; (2) credit card interest and fees; and (3) merchant fees from processing credit/debit card transactions.

2. U.S. Bancorp and other banks created National BankAmericard, Inc. (NBI) in 1970 which became Visa USA, Inc. in 1975. In 2007, Visa USA Inc. became Visa, Inc. and issued U.S. Bancorp 5.1% of the Class B common stock of Visa, Inc. (Visa stock), which it transferred to the Taxpayer. U.S. Bancorp's payment services business issues and acquires credit and debit card transactions through the Visa, Inc. card association or its affiliates. US Bancorp, Annual Report (Form 10-K) (February 23, 2017) at 135. The Taxpayer has "derivative contracts that are created through its operations, including...swap agreements executed in conjunction with the sale of a portion of its Class B common shares of Visa Inc. (the "Visa swaps")." *Id.* at 128. In 2014, 2015, and 2016, the Taxpayer redeemed a portion of the Visa stock.

3. The Taxpayer filed bank tax returns (SC 1101 B) for tax years 2011-2016. The Taxpayer excluded from its gross receipts from within South Carolina: (1) interest from residential mortgages, commercial loans and consumer loans; (2) credit card interest and fees; and (3) merchant fees. The Taxpayer excluded income from the sale of Visa stock from its apportionable income.

4. On September 28, 2018, the Department issued a Proposed Notice of Adjustment ("PNOA"), increasing the Taxpayer's apportionable net income by the Visa stock sale and South Carolina receipts (loan interest, credit card interest and fees, and merchant fees) and adjusting its South Carolina apportionment ratio accordingly. As a result of the increased apportionable net income and the adjusted apportionment ratio, the PNOA asserted an understatement of South Carolina Bank Tax for the Audit Period.

5. On December 18, 2018, the Taxpayer timely filed a written protest of the PNOA.

6. The Taxpayer and the Appeals Division of the Department held an appeals conference on January 31, 2019 in an attempt to settle this matter. Because they were unable to reach an agreement on the additional tax to be paid, the Appeals Division transferred the case to the Office of General Counsel for Litigation on July 1, 2019 for issuance of this Department Determination.

7. The Department calculated the understatement of South Carolina Bank Tax for the Audit Period as follows:

Tax Year	Tax Owed	Tax Paid	Underpayment
2011	$532,308.00	$45,632.00	$486,676.00
2012	$914,091.00	$193,738.00	$720,353.00
2013	$855,034.00	$242,150.00	$612,884.00
2014	$869,920.00	$204,128.00	$665,792.00
2015	$835,271.00	$211,245.00	$624,026.00
2016	$871,507.00	$205,600.00	$665,907.00
Total	**$4,878,131.00**	**$1,102,493.00**	**$3,775,638.00**

Analysis:

South Carolina imposes a Bank Tax of 4.5 % on the entire net income of every bank engaged in business in the State. S.C. Code Ann. § 12-11-20 (2014). Although the Bank Tax is distinct from the income tax imposed in Chapter 6 of Title 12, certain provisions related to income tax are adopted for Bank Tax purposes. *See* S.C. Code Ann. § 12-11-40 (2014). Specifically, § 12-11-40 provides that "[f]or the purpose of . . . allocation and apportionment . . .[and] penalties,...all of the provisions of Chapter 6 of this title[2] that may be appropriate or applicable are adopted and made a part of this chapter for the enforcement and administration of this chapter . . . ." Therefore, the income tax rules for allocation, apportionment, and penalties apply to Bank Tax. Additionally, the Department's longstanding administrative policy is that banks will comply with sourcing principles similar to those used by multistate non-bank financial businesses, such as finance companies. *See* SC Information Letter #94-35.

Consistent with constitutional limitations, South Carolina only taxes income that is apportionable to this state. "If a taxpayer is transacting or conducting business partly within and partly without this State, the South Carolina income tax is imposed upon a base which *reasonably represents* the proportion of the trade or business carried on within this State." S.C. Code Ann. § 12-6-2210(B) (2014) (emphasis added). Unless an item of income is directly allocated, it must be included in the apportionment income and the apportionment factors. *See* S.C. Code Ann. § 12-6-2220 (2014). If a taxpayer is not dealing principally in tangible personal property, which is the case for the Taxpayer here, the "base" for apportionment is set by S.C. Code Ann. § 12-6-2290 (2014):

> [T]he taxpayer shall apportion its remaining net income using a fraction in which the numerator is gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year. For purposes of this section, items included in gross receipts are as provided in Section 12-6-2295.

[2] Chapter 6 of Title 12 is titled "South Carolina Income Tax Act."

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Section 12-6-2290 requires service providers, like the Taxpayer, to use the single gross receipts apportionment formula. S.C. Code Ann. § 12-6-2295 (2014) provides a non-exclusive list of the items to be sourced, or included, in the gross receipts apportionment ratio:

> (A)The terms . . . "gross receipts" as used in Section 12-6-2290 include, but are not limited to, the following items if they have not been separately allocated:
>
> * * *
>
> (3) receipts from the use of intangible property in this State including, but not limited to, royalties from patents, copyrights, trademarks, and trade names;
>
> (4) net gain from the sale of property used in the trade or business. For purposes of this subsection, property used in the trade or business means property subject to the allowance for depreciation, real property used in the trade or business, and intangible property used in the trade or business which is:
>
> (a) not property of a kind that properly would be includible in inventory of the business if on hand at the close of the taxable year; or
> (b) held by the business primarily for sale to customers in the ordinary course of the trade or business;
>
> (5) receipts from services if the entire income-producing activity is within this State. If the income-producing activity is performed partly within and partly without this State, sales are attributable to this State to the extent the income-producing activity is performed within this State.

Therefore, a taxpayer that uses intangibles in South Carolina must include revenue from those intangibles in its gross receipts from South Carolina. Further, a taxpayer that derives its revenue from activities inside and outside of South Carolina must include revenue from services performed in South Carolina in its gross receipts from South Carolina. Moreover, a taxpayer must apportion a net gain from the sale of property used in the business.

I. The Taxpayer must include income from loan interest, credit card interest and fees, and merchant fees in its gross receipts from within South Carolina.

In *DIRECTV, Inc. & Subsidiaries v. South Carolina Dept. of Revenue,* 421 S.C. 59, 804 S.E.2d 633 (Ct. App. 2017), our Court of Appeals examined the phrase "income-producing activity" in § 12-6-2295(A)(5). DIRECTV, a corporation headquartered in California, provided access to television entertainment via satellite to residential and commercial customers across the United States in exchange for a fee. Other than local collection facilities, equipment rental and sale, and one or two employees, nearly all of DIRECTV's assets, employees, and property involved in providing its services to subscribers were located outside of South Carolina. Nevertheless, the

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Court of Appeals concluded that DIRECTV's customers are paying for the delivery of a satellite signal into their homes and businesses. Thus, the activity that produces DIRECTV's income is delivery of the satellite signal, not other activities that DIRECTV may have conducted outside of South Carolina. *DIRECTV* 421 S.C. at 75, 804 S.E.2d at 642. Furthermore, the Court agreed the South Carolina customers' subscription payments, which allowed for delivery of a signal to them represented 100% of DIRECTV's South Carolina subscription receipts. Therefore, the numerator—the receipts sourced to South Carolina—was best represented by including 100% of DIRECTV's South Carolina subscription receipts.

In response to DIRECTV's argument that its income-producing activity should include the groundwork in developing the package of services, the Court found those activities were preparatory and performed in anticipation of customers signing up for DIRECTV's services and of future profits. *See Mercury Motor Express, Inc. v. S.C. Tax Comm'n*, 244 S.C. 134, 135 S.E.2d 756 (1964) (excluding "incidental" activities from determination of a taxpayer's income-producing activity). Therefore, "these activities cannot be [income producing activities] because they do not produce income, but rather, are 'income-anticipatory' activities. . . . While the other activities occurring prior to the delivery of signal are important for DIRECTV in that it can help lead to income, section 12-6-2295(A)(5) requires activities that actually produce income." *DIRECTV* at 78. Similarly, all the income-producing activities from gross receipts from loan interest income, credit card interest and fees, and merchant fees from South Carolina customers and merchants are directly related to activity that occurs within the State.

A. Loan interest must be sourced to the location of the borrower.

Here, the Department properly sourced the gross receipts of loan interest income to the location of the borrower. Debts owed to a taxpayer are intangibles, rather than a service. Instead of sourcing intangibles based on the income-producing activities, South Carolina sources intangibles to where they are used. Section 12-6-2295(A)(3); *See also Geoffrey, Inc. v. S.C. Tax Comm'n*, 313 S.C. 15, 437 S.E.2d 13 (1993) (royalty income from trademark licenses used in South Carolina was subject to South Carolina income tax). Debts generate income from interest—money paid for the use or forbearance of money. Like the royalty income from trademarks, the interest income from loans to debtors in South Carolina must be sourced to South Carolina. This is consistent with the Department's longstanding administrative practice of sourcing income from loans to where the borrower is located. Accordingly, payments on loans are receipts from within the South Carolina when paid by a borrower located in South Carolina.

Even if the loans were a service, the borrower paying to use or hold money is analogous to the DIRECTV subscriber paying to receive digital television signal. Instead of subscription fees, the Taxpayer's customers pay interest. The income producing activity is loaning money to the customer and that occurs where that customer who receives the loan is located. According to the Taxpayer, the income-producing activities are preparatory activities like soliciting the customer and checking the customer's creditworthiness and ancillary administrative activities if a loan is approved. The Court of Appeals rejected such a cost of performance argument in *DIRECTV*. The customer is not paying to be solicited, to have its creditworthiness checked, or for the Taxpayer's other administrative work. The customer is paying the Taxpayer to use or hold money. The debtor

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holding or using the borrowed money creates the income. For loans to South Carolina borrowers, that income-producing activity occurs in South Carolina.[3]

B. Credit card interest and fees must be sourced to the location of the customer.

Additionally, the Taxpayer offers credit cards to its customer in exchange for interest and fees. Like with its loans, the Taxpayer claims the income-producing activities are preparatory activities like soliciting the customer and checking the customer's creditworthiness and ancillary administrative activities after the customer receives a credit card. However, the solicitation of customers, evaluation of the credit card applications, and administrative tasks supporting the credit card do not produce income. The Taxpayer admits in its protest that credit cards exist for the purpose of obtaining money, property, labor, or services on credit. When a customer pays interest and fees related to a credit card, the customer is paying for the ability to spend money now on credit and pay later. This loan is the activity that produces income for the Taxpayer. For credit card holders in South Carolina, that income-producing activity occurs in South Carolina.

C. Merchant fees must be sourced to the location of the merchant.

Another service income source in dispute is fees from the Taxpayer's processing merchant transactions. Merchants are charged a fee each time a credit/debit card is "swiped" for a customer to purchase a product or services. The Taxpayer argues the preparatory and ancillary administrative support activities produce its income. However, the customer is paying for the service of processing a transaction—i.e. consummating transactions without requiring use of cash—in South Carolina. The Taxpayer's income is produced by a cardholder accessing a continuously provided network in South Carolina. It is the cardholder's access to the network by a cardholder—the income producing activity—which produces the revenue generated when merchants accept Cards to complete transactions. Therefore, these fees are sourced to South Carolina if the merchant is located in South Carolina.[4] The source of the income is the in-state merchant, and the purchase of goods or services, which generates the swipe fees, is from within the South Carolina.

All of the out-of-state activities identified by the Taxpayer lack any intrinsic value and all income-producing activities occur at the location of the service recipient or borrower in South Carolina.

II. The Taxpayer must include income from the sale of Visa stock in its apportionable income.

Certain items of income are directly allocated and excluded from income apportioned to South Carolina. *See* S.C. Code Ann. § 12-6-2220 (2014). The gains from the sale of stock—an

[3] Certainly, the Taxpayer performs many of the same or similar administrative tasks on loan applications that are ultimately denied.

[4] For online sales, the merchant is considered located where the customer is located.

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intangible—are either allocated pursuant to § 12-6-2220(5) ("Gains and losses from sales of intangible personal property not connected with the business of the taxpayer and not held for sale to customers in the regular course of business, less all related expenses, are allocated to the state of the corporation's principal place of business...") or apportioned pursuant to § 12-6-2295(A)(4). The test of allocation or apportionment of gains on stock sales is not whether *the sale* of the stock is connected to the business. Instead, the test is whether the stock is connected to the business. *M. Lowenstein Corp. v. S.C. Tax Comm'n*, 298 S.C. 93, 100, 378 S.E.2d 272, 276 (Ct. App. 1989). "[T]he answer to the question of whether income is allocated or apportioned depends, not upon whether the income in dispute is connected with the business of the taxpayer, but rather upon whether the property producing the income is connected with the business." Id. at 101 and 276 ("The director of taxes for Lowenstein testified that the bonds were issued 'because the company needed the funds to put into their operations.' Lowenstein offered no other reason for the bond issue. Thus, the bonds in question were connected with Lowenstein's business.").

From its inception as NBI to the current Visa, Inc., the Taxpayer's membership in NBI/Visa USA, Inc. and eventual ownership of the Visa stock has been connected to the Taxpayer's business. The Taxpayer's parent company created NBI and owned Visa stock. The Taxpayer issues Visa cards and processes Visa card transactions. The use of swap agreements with the Visa stock alone makes the stock connected to the business, and the Taxpayer even admits in its Form 10-K that the swap agreements were created through its operations. *Texaco, Inc. v. Wasson* 269 S.C. 255, 237 S.E.2d 75 (1977) addresses an oil company drilling for oil but finding salt and sulfur and held those salt and sulfur royalties were connected to the business because they were discovered while conducting the oil exploration business. The VISA stock arose as a result of the Taxpayer conducting its banking business, and the VISA stock formed a portion of its banking business. This relationship makes the stock connected to the Taxpayer's business, and gains from the stock's sale are apportionable.

III. The Taxpayer is Subject to Substantial Understatement Penalties.

A. The substantial understatement penalties must be imposed.

S.C. Code Ann. § 12-54-43 (2014) provides that "[e]xcept as otherwise provided, the civil penalties imposed by this penalty section apply to every revenue or tax law of the State that provides for the filing with the department of a return or statement of the tax or the amount taxable." S.C. Code Ann. § 12-54-155 (2014) addresses the penalties for a substantial underpayment of tax due to a substantial understatement of tax. Specifically, section 12-54-155(A)(1) imposes a substantial understatement penalty of twenty-five percent of an understatement of tax if the understatement for the taxable period exceeds the greater of ten percent of the tax required to be shown on the return for the taxable period or five thousand dollars.

When filing its bank tax returns, the Taxpayer should have but did not include income from loan interest, credit card interest and fees, and merchant fees from its gross receipts from within South Carolina and improperly failed to include gains from the sale of Visa stock from its apportionable income. This resulted in a substantial understatement of tax for every year of the Audit Period. Each understatement was more than ten percent of the tax required to be shown on the return for

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the taxable period. Therefore, twenty-five percent of the underpayment amount must be added to the tax.

B. The substantial understatement penalties should not be reduced.

Section 12-54-155(B)(2)(b) allows for a reduction of the understatement if the taxpayer had substantial authority for its tax treatment of the item, and section 12-54-155(D)(1) prohibits the penalty if the taxpayer had reasonable cause and acted in good faith with respect to the portion of the understatement. As provided in section 12-54-155, "substantial authority," and "reasonable cause" and "good faith" are interpreted in accordance with Treasury Regulation Sections 1.6662-4 and 1.6664-4, respectively. Under those federal regulations, substantial authority is present "only if the weight of authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary treatment." Determining whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances. "Generally, the most important factor is the extent of the taxpayer's effort to assess the taxpayer's proper tax liability" when considering the "experience, knowledge, and education of the taxpayer." *See* 26 C.F.R. § 1.6664-4(b)(1).

In its protest, the Taxpayer—a sophisticated bank—opposes the substantial understatement penalty by merely stating that it had reasonable cause and good faith based on the plain language of the statute and case law. However, other than this conclusory assertion, the Taxpayer has failed to explain how the weight of authorities support the Taxpayer's position—especially light of the contrary holdings and analysis in *DIRECTV* and *Lowenstein*. Moreover, the Taxpayer has failed to put forth a persuasive case that that the imposition of understatement penalties is prohibited or should be reduced pursuant to Section 12-54-155. Accordingly, the imposition of penalties for substantial understatements of tax is appropriate.

Conclusion:

South Carolina law sources to this State the gross receipts that the Taxpayer generates from loans, credit card interest/fees, and facilitating transactions from South Carolina customers and merchants. Further, the VISA stock is connected to the Taxpayer's business, so gains from the stock's sale are apportionable. Additionally, the Taxpayer merits the penalties for substantial understatements of tax.

Department Determination drafted by Department Representative:

Marcus D. Antley, III, Esquire
Counsel for Litigation
South Carolina Department of Revenue

June 18, 2020

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SOUTH CAROLINA DEPARTMENT OF REVENUE
REPORT OF FIELD AUDIT: Bank Tax

TAXPAYER:	**US Bank National Association**	**FEI # :**	31-0841368
ADDRESS:	800 Nicollet Mall BC-MN-HI9U	**FILE # :**	20080765-3
	Minneapolis, MN. 55402	**PERIOD:**	12/31/2011-12/31/2016
		DATE:	9/10/2018
		AUDITOR:	Sharpe
			Sprowl

INTEREST COMPUTED TO:

Bank Tax:

PERIOD ENDED:	INCOME TAX	INTEREST	PENALTY	TOTALS
12/31/2011	$494,714			$494,714
12/31/2012	$729,038			$729,038
12/31/2013	$622,528			$622,528
12/31/2014	$676,862			$676,862
12/31/2015	$635,435			$635,435
12/31/2016	$675,384			$675,384
TOTALS	**$3,833,961**	$0	$0	**$3,833,961**

S.C. Code Ann. § 12-54-25
Interest due on late taxes; applicable interest rate.

(A) If any tax is not paid when due, interest is due on the unpaid portion from the time the tax was due until paid in its entirety. For administrative convenience, the department may waive up to thirty days' interest.

(B) For purposes of this section, a tax is due on the last day provided for its payment, without regard for any extension of time for payment and without regard for or to any assessment under Section 12-60-910. Stamp taxes and any other tax for which no payment date is provided are due on the day the liability arises.
(C) Omitted

(D) Except as preempted or superseded by federal law or inter-governmental compact such as the International Fuel Tax Agreement, the rate of interest on underpayments and overpayments is established by the department in the same manner and at the same time as the underpayment rate provided in Internal Revenue Code Sections 6621(a)(2) and 6622.

S.C. Code Ann § 12-54-155(A)(1)
Substantial underpayment of tax or substantial valuation misstatement.
If there is an underpayment attributable to either a substantial understatement of tax for a taxable period or a substantial valuation misstatement, there must be added to the tax an amount equal to twenty-five percent of the amount of the underpayment.

S.C. Code Ann § 12-54-155(B)
Substantial underpayment of tax or substantial valuation misstatement.

(1)(a) For purposes of this section, there is a substantial understatement of tax for a taxable period if the amount of the understatement for the taxable period exceeds the greater of ten percent of the tax required to be shown on the return for the taxable period or five thousand dollars.

(b) In the case of a corporation other than an "S" Corporation or a personal holding company, as defined in Internal Revenue Code Section 542, item (1) must be applied by substituting "ten thousand dollars" for "five thousand dollars".

(2)(a) For purposes of item (1), "understatement" means the excess of the amount of the tax required to be shown on the return for the taxable period over the amount of the tax imposed which is shown on the return.

(b) The amount of the understatement under subitem (a) must be reduced by that portion of the understatement which is attributable to the tax treatment of an item: (i) by the taxpayer if there is or was substantial authority for that treatment, or (ii) with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return and there is a reasonable basis for the tax treatment of the item by the taxpayer. For purposes of subsection (B)(2)(b)(ii) a corporation must not be treated as having a reasonable basis for its tax treatment of an item attributable to a multiple-party financing transaction if the treatment does not clearly reflect the income of the corporation. For purposes of this paragraph, the words "substantial authority" and "adequately disclosed" must be interpreted in accordance with Treasury Regulation Section 1.6662-4 as of the date on which the Internal Revenue Code is applied to state tax laws pursuant to Section 12-6-40.

SOUTH CAORLINA DEPARTMENT OF REVENUE
COMPUATION OF BANK NET INCOME AND BANK TAX

Taxpayer:	**US Bank National Association**	**Schedule:**	A	
File#:	20080765-3	**Auditor:**	Sharpe	Sprowl
Period:	12/31/2011-12/31/2016	**Date:**	9/10/2018	

Period Ended:	**12/31/2011**	**2nd Amended 12/31/2012**	**2nd Amended 12/31/2013**	**Amended 12/31/2014**	**12/31/2015**	**12/31/2016**	
Apportionable Income Per Return:	**3,233,127,405**	**4,237,487,198**	**4,687,383,536**	**4,165,442,932**	**4,078,474,055**	**4,119,826,806**	
Net Book Income Difference (2)	(48,151,323)	115,524,965	41,398,098	(58,013,130)	-	-	
Dividends, Part II of M-3, line 6 (c) (Permanent Difference) (3)	13,580,473	33,326,802	33,314,028	37,169,251	37,994,425	42,294,521	
Add- investment income directly allocated (4)	109,274,945	-	-	328,228,121	255,073,432	135,884,648	
Apportionable Income As Adjusted:	**3,307,831,500**	**4,386,338,965**	**4,762,095,662**	**4,472,827,174**	**4,371,541,912**	**4,298,005,975**	
SC Ratio (1)	0.3618%	0.4675%	0.4035%	0.4377%	0.4304%	0.4555%	
SC Proportion	**11,967,734**	**20,506,135**	**19,215,056**	**19,577,565**	**18,815,116**	**19,577,417**	
SC NOL Taken in error (5)	39,953						
SC Net Income	12,007,687	20,506,135	19,215,056	19,577,565	18,815,116	19,577,417	
SC NOL							
SC Taxable Net Income	**12,007,687**	**20,506,135**	**19,215,056**	**19,577,565**	**18,815,116**	**19,577,417**	
TAX RATE	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	
TAX DUE	**540,346**	**922,776**	**864,678**	**880,990**	**846,680**	**880,984**	
TAX CREDITS	-	-	-	-	-	-	
BALANCE OF TAX	**540,346**	**922,776**	**864,678**	**880,990**	**846,680**	**880,984**	
TAX PREVIOUSLY PAID	(45,632)	(193,738)	(242,150)	(204,128)	(211,245)	(205,600)	
UNDERPAYMENT (OVERPAYMENT)	**494,714**	**729,038**	**622,528**	**676,862**	**635,435**	**675,384**	**$ 3,833,961**

(1) SC Ratio as adjusted	**12/31/2011**	**12/31/2012**	**12/31/2013**	**12/31/2014**	**12/31/2015**	**12/31/2016**
	****	****	****	****	****	****
South Carolina Receipts	**70,007,931**	**103,144,037**	**90,911,440**	**100,361,255**	**98,903,359**	**111,685,323**
Everywhere Receipts (Per Returns)	19,351,862,318	22,064,765,500	22,531,007,542	22,930,584,972	22,978,405,296	24,518,861,458
Plus Allocated Income on the return as filed determined to be Apportionable	(A)	-	-	(A)	(A)	(A)
Adjusted Everywhere Receipts	**19,351,862,318**	**22,064,765,500**	**22,531,007,542**	**22,930,584,972**	**22,978,405,296**	**24,518,861,458**
SC Gross Receipts Ratio	**0.3618%**	**0.4675%**	**0.4035%**	**0.4377%**	**0.4304%**	**0.4555%**

**** The SC and Everywhere Receipts are based on amended apportionment factors provided by taxpayer.
Auditors consider the adjusted SC receipts to be based on "the location of income producing activity".
Taxpayer considers the adjusted SC receipts to be based on "market sourcing".

(A) This return reflected allocable income, but there is no evidence that the allocable income was deducted from the everywhere receipts. Therefore, it is not necessary to adjust the everywhere receipts for allocated income determined to be apportionable.

SOUTH CAORLINA DEPARTMENT OF REVENUE
COMPUATION OF BANK NET INCOME AND BANK TAX

Taxpayer:	**US Bank National Association**	**Schedule:**	**A**	
File#:	20080765-3	**Auditor:**	**Sharpe**	**Sprowl**
Period:	12/31/2011-12/31/2016	**Date:**	9/10/2018	

SECTION 12-54-85. Time limitation for assessment of taxes or fees; exceptions.

(A) Except as otherwise provided in this section, taxes must be determined and assessed within thirty six months from the date the return or document was filed or due to be filed, whichever is later.

(B) Except as otherwise provided in this section:

(1) if a tax, except for a penalty described in item (2), is not required to be remitted with a return or document, the amount of taxes must be determined and assessed within thirty six months after the later of the date the tax was due or the first date on which any part of the tax was paid; and

(2) a penalty that is not associated with the assessment of a tax must be determined and assessed within thirty six months after the date of the violation giving rise to the penalty.

(C) Taxes may be determined and assessed after the thirty six month limitation if:

(1) there is fraudulent intent to evade the taxes;

(2) the taxpayer failed to file a return or document as required by law;

(3) there is a twenty percent understatement of the total of all taxes required to be shown on the return or document. The taxes in this case may be assessed at any time within seventy two months from the date the return or document was filed or due to be filed, whichever is later. For the purpose of this item, the total of all taxes required to be shown on the return is the total of all taxes required to be shown on the return before any reduction for estimated payments, withholding payments, other prepayments, or discount allowed for timely filing of the return and payment of the tax due, but that amount must be reduced by another credit that may be claimed on the return;

Interest, Fees and Swipe Fees are sourced to the location of the customer

Banks must use the gross receipts method of apportionment. The Department's longstanding administrative policy is that banks will comply with sourcing principles similar to those used by multistate non-bank financial businesses, such as finance companies. SC Information Letter #94- 35 and Code Section 12-11-40. Based on the Department's longstanding administrative practices, the Department sources income from loans to where the borrower is located. Accordingly, payments on loans are receipts from within the South Carolina when paid by a borrower located in South Carolina. See, Lockwood Greene Engineers, Inc. vs. South Carolina Tax Commission, 293 S.C. 447, 361 S.E.2d 346 (SC Ct. App. 1987), Brief of Plaintiff-Appellant, Lockwood Greene Engineers, Inc. vs. South Carolina Tax Commission, supra. Stipulation of Facts, Transcript of Record p. 27, Lockwood Greene Engineers, Inc. vs. South Carolina Tax Commission, supra. For banks that issue credit cards, interest paid by credit card users is sourced to the location of the credit card customer. Similarly, yearly credit card fees and late fees charged to customers are sourced to the location of those customers since the production of that income is most significantly associated with the customer.

Merchants are charged a fee each time a credit card is "swiped" for a customer to purchase a product or services. These fees are sourced to South Carolina if the merchant is located in South Carolina since the source of the income is the in-state merchant and the purchase of goods or services which generates the swipe fees is from within the state.

(2) Net Book Income is the normal starting point for reconciled income (line 1, Page 3 of SC 1120). For some unknown reason, the reconciled net income reported on the SC return did not match net book income for some years. If the taxpayer provides a valid reason, with supporting information, for the items comprising the difference between reconciled net income reported on the bank return and Net book income shown in the M-3 of the banks US 1120 proforma, consideration will be given to adjusting the audit.

	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016
Net Book Income shown on M-3	**5,449,645,681**	**6,164,359,158**	**6,478,951,882**	**6,199,813,632**	**5,989,276,877**	**6,111,858,233**
Less Income Loss from equity method	(2,155,394,654)	(1,811,346,995)	(1,750,170,248)	(1,764,155,709)	(1,655,729,389)	(1,856,146,779)
Adjusted Net Book Income	**3,294,251,027**	**4,353,012,163**	**4,728,781,634**	**4,435,657,923**	**4,333,547,488**	**4,255,711,454**
Less Reconciled Net Book Income Reported on SC Return	(3,342,402,350)	(4,237,487,198)	(4,687,383,536)	(4,493,671,053)	(4,333,547,487)	(4,255,711,454)
Adjustment to Book Net Income	**(48,151,323)**	**115,524,965**	**41,398,098**	**(58,013,130)**	**1**	**-**

(3) Dividends are considered part of the Bank's Net Income. Code Section 12-11-20 provides that the bank tax is imposed on the entire net income of the bank from any source whatsoever. Taxpayer advises these Dividends are from Reits.

Taxpayers' Explanation:

US Bank NA directly allocated income from the sale of Visa stock which is nonbusiness income. The amounts which were directly allocated are as follows:

- 2014 - $328,228,121
- 2015 - $255,073,432
- 2016 - $135,884,648

Section 12-6-2220(5) of the South Carolina Code states that "[g]ains and losses from sales of intangible personal property not connected with the business of the taxpayer and not held for sale to customers in the regular course of business, less all related expenses, are allocated to the state of the corporation's principal place of business as defined in Section 12-6-30(9)." Section 12-6-30(9) defines "principal place of business" to mean the domicile of a corporation.

US Bank NA had previously been a member bank in the Visa association. It is important to note that membership is not a requirement in order to issue credit cards. When Visa, Inc. completed its initial public offering each member bank received shares of Visa. Despite receiving these shares it is important to note that members are not involved in the day-to-day operations of Visa and do not set policy for Visa. Also, members are not required to own stock in Visa. US Bank NA's relationship with Visa was not impacted by either the issuance or sale of the Visa stock. As a national banking association US Bank NA is generally not allowed to invest in equity holdings and therefore typically does not hold shares of stock. The holding of stock and investing in the stock of a corporation is not within the business activities of US Bank NA.

The ownership of the Visa stock was not related to US Bank NA's regular trade or business nor did the sale of the Visa stock result in the direct financial betterment of US Bank NA's regular trade or business. The sale of the Visa stock did not financially improve the operations of US Bank NA's business lines. US Bank NA's relationship with Visa was the same after the issuance of the stock as it was before the issuance of the stock. The sale of the Visa stock was not integral to US Bank NA's business as a whole.

The sale of the Visa stock was not connected to the business of US Bank NA so the gain from the sale of the Visa stock should be allocated to US Bank NA's state of domicile which is Minnesota.

Auditor's Explanation:

US Bank, NA's Gain from the Sale of Visa Stock for the years 12/31/2014-12/31/2016 should be apportioned as Business Income and not Allocated as Non-Business Income.

We disagree with the taxpayer. Since the inception of "Visa" as a nonstock corporation the taxpayer has been a significant owner of "Visa" either as member of the nonstock corporation or as an owner of stock when "Visa" in 2007 become a public stock owned corporation. Furthermore, the taxpayer and/or its affiliates as card issuers are licensed to utilize "VISA" trademarks in South Carolina and elsewhere. In addition, the taxpayer and/or its affiliates is one of "Visa's" largest customers. The taxpayer and its affiliates earn significant card income from the issuance of Visa branded Cards and the processing of Visa card transactions.

Conclusion: The gain from the sale of Visa, Inc. stock is business related and should be apportioned in the audit pursuant to SCCL, section 12-6-2220 (5). Below are excerpts of the taxpayer's 12-31-2016 10-K which discusses relationships the taxpayer has with Visa. The taxpayer's income with the taxpayer would be significantly reduced without the taxpayer's association with VISA, whether through ownership of Visa Stock or through Card Services, which mutually benefit both the taxpayer and Visa.

Excerpts of the Taxpayer's 12-31-2016 10-K

The Company and certain of its subsidiaries, along with other Visa U.S.A. Inc. member banks, have a contingent guarantee obligation to indemnify Visa Inc. for potential losses arising from antitrust lawsuits challenging the practices of Visa U.S.A. Inc. and MasterCard International. The indemnification by the Company and other Visa U.S.A. Inc. member banks has no maximum amount. Refer to Note 22 in the Notes to Consolidated Financial Statements for further details regarding guarantees, other commitments, and contingent liabilities, including maximum potential future payments and current carrying amounts.

Net revenue decreased $154 million (4.8 percent) in 2016, compared with 2015. Net interest income, on a taxable-equivalent basis, decreased $285 million (12.1 percent) in 2016, compared with 2015, principally due to the impact of higher margin benefits on deposits credited to the business lines and the issuance of long-term debt, partially offset by growth in the investment portfolio. Noninterest income increased $131 million (15.1 percent) in 2016, compared with 2015, mainly due to the Visa Europe sale and the impact of the 2015 student loan market valuation adjustment, partially offset by lower equity investment income and the impact of a gain on the sale of a deposit portfolio in 2015.

NOTE 22 Guarantees and Contingent Liabilities

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

Using proceeds from its IPO and through reductions to the conversion ratio applicable to the Class B shares held by Visa U.S.A. member banks, Visa Inc. has funded an escrow account for the benefit of member financial institutions to fund their indemnification obligations associated with the Visa Litigation. The receivable related to the escrow account is classified in other liabilities as a direct offset to the related Visa Litigation contingent liability. On October 19, 2012, Visa signed a settlement agreement to resolve class action claims associated with the multi-district interchange litigation, the largest of the remaining Visa Litigation matters. The United States District Court for the Eastern District of New York approved the settlement, but that approval was appealed by certain class members. On June 30, 2016, the United States Court of Appeals for the Second Circuit reversed the approval of the settlement and remanded the case to the district court for further proceedings consistent with the appellate ruling. On November 23, 2016, plaintiff merchants filed a petition with the United States Supreme Court asking it to review the Second Circuit's decision to reject the settlement.

At December 31, 2016, the carrying amount of the Company's liability related to the Visa Litigation matters, net of its share of the escrow fundings, was $19 million. During 2016, the Company sold 1.5 million of its Class B shares. These sales, and any previous sales of its Class B shares, do not impact the Company's liability for the Visa Litigation matters or the receivable related to the escrow account. Upon final settlement of the Visa Litigation, the remaining 4.9 million Class B shares held by the Company will be eligible for conversion to Class A shares of Visa Inc., which are publicly traded. The Class B shares are excluded from the Company's financial instruments disclosures included in Note 21.

The Company also has other derivative contracts that are created through its operations, including commitments to purchase and originate mortgage loans and swap agreements executed in conjunction with the sale of a portion of its Class B common shares of Visa Inc. (the "Visa swaps"). The mortgage loan commitments are valued by pricing models that include market observable and unobservable inputs, which result in the commitments being classified within Level 3 of the fair value hierarchy. The unobservable inputs include assumptions about the percentage of commitments that actually become a closed loan and the MSR value that is inherent in the underlying loan value, both of which are developed by the Company's mortgage banking division. The closed loan percentages for the mortgage loan commitments are monitored on an on-going basis, as these percentages are also used for the Company's economic hedging activities. The inherent MSR value for the commitments are generated by the same models used for the Company's MSRs and thus are subject to the same processes and controls as described for the MSRs above. The Visa swaps require payments by either the Company or the purchaser of the Visa Inc. Class B common shares when there are changes in the conversion rate of the Visa Inc. Class B common shares to Visa Inc. Class A common shares, as well as quarterly payments to the purchaser based on specified terms of the agreements. Management reviews and updates the Visa swaps fair value in conjunction with its review of Visa related litigation contingencies, and the associated escrow funding. The fair value of the Visa swaps are calculated by the Company's corporate development department using a discounted cash flow methodology which includes unobservable inputs about the timing and settlement amounts related to the resolution of certain Visa related litigation. The expected litigation resolution impacts the Visa Inc. Class B common share to Visa Inc. Class A common share conversion rate, as well as the ultimate termination date for the Visa swaps. Accordingly, the Visa swaps are classified within Level 3. Refer to Note 22 for further information on the Visa restructuring and related card association litigation.

(5) The net operating loss deduction is part of the Internal Revenue Code which is adopted for South Carolina income tax purposes (Code Sections 12-6-40 and 12-6-50) but not for purposes of the bank tax. South Carolina law must specifically provide that an income tax section of the Internal Revenue Code applies to the bank tax.

**** CONFIDENTIAL INFORMATION FILED UNDER SEAL ****

** U.S. Bank National Association v. South Carolina Department of Revenue **

** Appellant Case No. 2024-001577 **

Joint Exhibit # 3 – 2011 U.S. Bank SC Bank Tax Return

**** CONFIDENTIAL INFORMATION FILED UNDER SEAL ****

** U.S. Bank National Association v. South Carolina Department of Revenue **

** Appellant Case No. 2024-001577 **

Joint Exhibit # 4 – 2012 U.S. Bank SC Bank Tax Return

**** CONFIDENTIAL INFORMATION FILED UNDER SEAL ****

** U.S. Bank National Association v. South Carolina Department of Revenue **

** Appellant Case No. 2024-001577 **

Joint Exhibit # 5 – 2012 Amended U.S. Bank SC Bank Tax Return

**** CONFIDENTIAL INFORMATION FILED UNDER SEAL ****

** U.S. Bank National Association v. South Carolina Department of Revenue **

** Appellant Case No. 2024-001577 **

Joint Exhibit # 6 – 2013 U.S. Bank SC Bank Tax Return

R. 1243-1247

**** CONFIDENTIAL INFORMATION FILED UNDER SEAL ****

** U.S. Bank National Association v. South Carolina Department of Revenue **

** Appellant Case No. 2024-001577 **

Joint Exhibit # 7 – 2013 Amended U.S. Bank SC Bank Tax Return

R. 1248-1289

**** CONFIDENTIAL INFORMATION FILED UNDER SEAL ****

** U.S. Bank National Association v. South Carolina Department of Revenue **

** Appellant Case No. 2024-001577 **

Joint Exhibit # 8 – 2014 U.S. Bank SC Bank Tax Return

R. 1290-1294

**** CONFIDENTIAL INFORMATION FILED UNDER SEAL ****

** U.S. Bank National Association v. South Carolina Department of Revenue **

** Appellant Case No. 2024-001577 **

Joint Exhibit # 9 – 2014 Amended U.S. Bank SC Bank Tax Return

R. 1295-1336

**** CONFIDENTIAL INFORMATION FILED UNDER SEAL ****

** U.S. Bank National Association v. South Carolina Department of Revenue **

** Appellant Case No. 2024-001577 **

Joint Exhibit # 10 – 2015 U.S. Bank SC Bank Tax Return

R. 1337-1432