STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

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

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

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

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

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

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

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

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

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

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

AND IT IS SO ORDERED.

Ralph King Anderson, III
Chief Administrative Law Judge

June 22, 2020
Columbia, South Carolina

CERTIFICATE OF SERVICE

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

Stephanie Michelle Perez
Judicial Law Clerk

June 22, 2020
Columbia, South Carolina

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Synovus Bank, Petitioner, vs. South Carolina Department of Revenue, Respondent.	)	Docket No. 17-ALJ-17-0418-CC **AMENDED FINAL ORDER**[1]

APPEARANCES:

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

For the Respondent: Jason P. Luther, Esq.

STATEMENT OF THE CASE

This case is before the South Carolina Administrative Law Court (Court or ALC) pursuant to a Request for Contested Case filed by Synovus Bank (Petitioner) on November 16, 2017. Petitioner contests the decision of the South Carolina Department of Revenue (Respondent or Department) in which the Department determined Petitioner could not deduct net operating loss (NOL) carryforwards[2] when computing its bank tax liability for tax years 2011 through 2014.

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

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

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

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

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

MATERIAL FACTS NOT IN DISPUTE

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

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

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

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

FINDINGS OF FACTS

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

Financial Accounting Generally

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

GAAP Accounting

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

GAAP and the South Carolina Bank Tax

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

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

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

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

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

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

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

Entire Net Income

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

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

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

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

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

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

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

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

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

Book Income

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

ISSUES

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

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

CONCLUSIONS OF LAW

Standard of Review

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

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

Statutory Construction

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

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

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

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

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

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

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

The South Carolina Bank Tax

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

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

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

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

S.C. Code Ann. § 12-11-20 (2014).

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Conformity with the IRC

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

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

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

Conformity and Decoupling Provisions

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

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

> (2)(a) For purposes of this title, "Internal Revenue Code" is deemed to contain all changes necessary for the State to administer its provisions. **Unless a different meaning is required**:
>
> * * *
>
> (iv) "Income" includes the modifications required by Article 9[12] of this chapter and allocation and apportionment as provided in Article 17 of this chapter.
>
> Other terms in the Internal Revenue Code must be given the meanings necessary to effectuate this item.

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

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

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

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

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

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

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

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

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

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

> The following **corporations** are exempt from the tax imposed by **Section 12-6-530** [on corporations] and Section 12-6-540 [on exempt organizations and cooperatives]:
>
> (1) **banks as defined in Section 12-11-10**;

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

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

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

Further, section 12-6-630 provides:

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

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

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

Chapter 11 Partially Adopted Chapter 6

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

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

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

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

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

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

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

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

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

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

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

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

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

Conclusion

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

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

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

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

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

The Bank Tax is Not Based on "Taxable Income"

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

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

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

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

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

Entire Net Income

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

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

Reliance on GAAP to Define "Entire Net Income"

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

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

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

Deference

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

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

calculates or interprets "entire net income" beyond regulation 117-1500.1.[20] Moreover, at the hearing into this matter, the Department modified its interpretation of how to specifically calculate "entire net income" from stating GAAP is a wholesale proxy for "entire net income" or "book income" to asserting that it does not strictly interpret "entire net income" to be calculated pursuant to GAAP. Therefore, the evidence did not show the Department has a long-standing statutory interpretation of how to calculate "entire net income" Indeed, its current interpretation is nascent.

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

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

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

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

Does "entire net income" inherently include NOL carryforward deductions?

The parties disagree whether the term "entire net income" inherently incorporates NOLs. At the heart of this debate is the effect and meaning of the word "entire." Petitioner argues that the word "entire" implies that all income and all expenses must be included in the calculation and the only manner in which all expenses can be deducted by a bank having expenses that exceed income in a year under GAAP is through the use of a NOL carryforward. In other words, Petitioner claims the word "entire" creates the statutory authorization that allows NOL carryovers. Petitioner claims this interpretation is consistent with the legislative intent of the bank tax, the bank regulations, GAAP, and the historical application of the bank tax.[21] The Department disagrees and takes the position that (1) the primary effect of the word "entire" is meant to capture income from (usually) non-taxable securities[22] and (2) although the word "entire" also includes all expenses, it only includes expenses from the taxable year at issue.

History of Income Tax Law

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

applicable today. The corporate income tax, in contrast, has been amended several times since 1937.[25] Although the bank tax and corporate income tax were separately codified in 1937, they were both based on "entire net income." *See* S.C. Code § 65-402 (Supp. 1937) (bank tax); *see also* S.C. Code Ann. § 2676(2) (1942) (bank tax); S.C. Code § 2440 (1942) (corporate income tax). Again, "entire net income" was not defined for the purpose of the bank tax. *See* S.C. Code § 65-401 *et. seq.* (Supp. 1937). Also, no deduction for NOLs was authorized for corporations or banks.

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

> With respect only to taxpayers who have established a new business or industry in South Carolina during the calendar year 1955 and thereafter, in addition to other deductions allowed by this Chapter, there shall be allowed as a deduction from gross income a net operating loss carry over under the following rules:
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> > (A). the net operating loss as herein defined[27] for any year ending on or after December 31, 1955, may be carried forward to the next succeeding taxable year and annually thereafter for a total period of three years next succeeding the year of such operating loss, or until such net operating loss has been exhausted or absorbed by the taxable income of a succeeding year. The net operating loss deduction herein allowed shall be allowable only for the first three years of the operation of the said new business or industry in South Carolina.

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

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

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

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

§ 65-259(13)(A).

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

Implied Authorization of NOL Carryforward

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Conclusion

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

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

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

CONCLUSION

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

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

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

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

ORDER

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

AND IT IS SO ORDERED.

Ralph King Anderson, III
Chief Administrative Law Judge

June 22, 2020
Columbia, South Carolina

CERTIFICATE OF SERVICE

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

Stephanie Michelle Perez
Judicial Law Clerk

June 22, 2020
Columbia, South Carolina