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

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Honorable Ralph King Anderson, III, Chief Administrative Law Judge

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

Synovus Bank.. Appellant,

v.

South Carolina Department of Revenue,... Respondent.

SOUTH CAROLINA DEPARTMENT OF REVENUE'S INITIAL BRIEF

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TABLE OF CONTENTS

INTRODUCTION 1

COUNTER-STATEMENT OF THE ISSUES ON APPEAL 3

STATEMENT OF THE CASE 3

STATEMENT OF THE FACTS 4

1. The South Carolina Bank Tax 4
2. Synovus' Bank Tax Returns 6
3. The Department's Audit of Synovus 7
4. Financial accounting principles and expert testimony 8

ARGUMENT 11

I. The ALC correctly held the Legislature has not authorized banks like Synovus to deduct NOL carryforwards when calculating their bank tax liability 11

   a. An NOL carryforward deduction is a creature of statute, and no South Carolina statute authorizes banks to claim an NOL deduction 11

   b. The NOL carryforward deduction created by the Internal Revenue Code does not apply to the South Carolina Bank Tax 12

      i. The tax base for the bank tax is different from the corporate income tax because it includes non-taxable interest on government obligations 13

      ii. The corporate income tax is calculated based on "taxable income" as defined by the IRC, but the bank tax is not 16

      iii. The conformity and decoupling provisions in Chapter 6 (income tax) do not apply to Chapter 11 (bank tax) 20

      iv. The fact that Chapter 11 relies on certain provisions of Chapter 6 for administration and enforcement, and that the Department has at times looked to the IRC for guidance when administering the bank tax, does not mean banks are entitled to an NOL deduction 22

   c. Deduction statutes are construed narrowly, and whether Synovus can claim an NOL deduction is a question of law, not equity 25

II. The ALC correctly held it was reasonable for the Department to calculate Synovus' "entire net income" based on its net book income as computed in accordance with GAAP, where this calculation is consistent with the Department's longstanding administrative practice 27

a. Net income and book income are synonymous, commonly understood financial accounting terms.....27

b. The Department's use of net income (i.e. book income) as the tax base for the bank tax is consistent with the history of the bank tax.....28

c. The banking industry and tax professionals in South Carolina, including Synovus' expert, have always considered book income to be the tax base of the bank tax.....32

d. The Department's longstanding interpretation and application of the bank tax is entitled to deference.....33

e. GAAP does not independently create an NOL carryforward deduction where state law has not expressly granted such a deduction.....35

f. The terms "entire" and "all expenses" do not inherently authorize banks to carryforward NOLs as a deduction from entire net income in future years.....38

g. It is not unconstitutional to use book income as the tax base for the bank tax.....42

i. There is no unconstitutional delegation of the State's taxing power.....42

ii. Synovus's due process and equal protection challenges were not preserved for review.....45

iii. There is no due process violation.....45

iv. There is no equal protection violation.....47

Conclusion 49

TABLE OF AUTHORITIES

Cases:

Bodine Elec. Co. v. Alphin
389 N.E.2d 168, 173 (Ill. Ct. App 1979)....................11

Bodman v. State
403 S.C. 60, 742 S.E.2d 363 (2013)....................48

CFRE, LLC v. Greenville Cty. Assessor
395 S.C. 67, 716 S.E.2d 877 (2011)....................25

C.W Matthews Contracting Co. v. S.C. Tax Comm'n
267 S.C. 548, 230 S.E.2d 223 (1976)....................11, 25, 26, 41

Cent. Power & Light Co. v. Sharp,
919 S.W.2d 485 (Tex. App. 1996)....................44

Centex Int'l, Inc. v. S.C. Dep't of Rev.
406 S.C. 132, 750 S.E.2d 65, 2013 WL 3816542 (2013)....................26

Chronicle Publishers, Inc. v. S.C. Tax Comm'n
224 S.C. 192, 136 S.E. 2d 261 (1964)....................25, 41

Clark v. S.C. Tax Comm'm
259 S.C. 161, 191 S.E.2d 23 (1972)....................25

Davis Mech. Contractors, Inc. v. Wasson
268 S.C. 26, 231 S.E.2d 300 (1977)....................25

E. Fed. Corp. v. Wasson
281 S.C. 450, 316 S.E.2d 373 (1984)....................43

Educ. Films Corp. of Am. V. Ward
282 U.S. 379, 51 S. Ct. 170 (1931)....................14

Garoforo, Curtiss, Lambert & MacLean, Inc. v. Dep't of Revenue, et al.
648 A.2d 1329, 1334 (Pa. 1994)....................11

Hadden v. S.C. Tax Comm'n
183 S.C. 38, 190 S.E. 249 (1937)....................25

Huber v. S.C. State Bd. of Physical Therapy Examiners
316 S.C. 24, 446 S.E.2d 433 (1994)....................46

Jackson v. Clack
2020 WL 3832992, at *1 (Ct. App. 2020)..45

Kiawah Dev. Partners, II v. S.C. Dept' of Health & Envtl. Control
411 S.C. 16, 766 S.E.2d 707..33, 34

Kiawah Prop. Owners Grp. v. Pub. Serv. Comm'n of S.C.
359 S.C. 105, 597 S.E.2d 145 (2004)..45

Macallen Co. v. Com. of Mass.
279 U.S. 620 (1929)..14

McJunkin Corp. v. W.Virginia Dep't of Tax & Revenue
457 S.E.2d 123, 124 (W.Va. 1995)..11

Media Gen. Commc'ns, Inc. v. S.C. Dep't of Rev.
388 S.C. 138, 694 S.E.2d 525 (2010)..34

NCNB Corp. v. United States
651 F.2d 942 (4th Cir. 1981), vacated, 684 F.2d 285 (4th Cir. 1982)....................................40

Neal v. Brown
383 S.C. 619, 682 S.E.2d 268 (2009)..34

Santee Mills v. Query
122 S.C. 158, 115 S.E. 202 (1922)..5

S.C. Dep't of Soc. Servs. v. Michelle G.
407 S.C. 499, 757 S.E.2d 388 (2014)..45, 46

S. Soya Corp. of Cameron v. Wasson
252 S.C. 484, 167 S.E.2d 311 (1969)..25, 41

SCANA Corp. & Subsidiaries v. S.C. Dep't of Rev.
384 S.C. 388, 683 S.E.2d 468 (2009)..25

Sierra Club v. S.C. Dep't of Health & Envtl. Control
426 S.C. 236, 826 S.E.2d 595 (2019)..33

State v. King
412 S.C. 403, 772 S.E.2d 189, 192 (Ct. App. 2015) 19

TNS Mills, Inc. v. S.C. Dep't of Revenue
331 S.C. 611, 503 S.E.2d 471 (1998) 39

Taiheiyo Cement U.S.A., Inc. v. Franchise Tax Bd.
138 Cal.Rptr.3d 536 (2012)..26

U.S. Rubber Prod.
189 S.C. 386, 1 S.E.2d 153 (1939)....................29

United States v. Olympic Radio & Television
349 U.S. 232, 75 S. Ct. 733 (1955)....................26, 48, 49

Olympic Radio & Television v. United States
108 F. Supp. 109, 110 (1952)....................48

Statutes:

26 U.S.C.A. § 172....................9, 16

26 U.S.C.A. § 275....................15

1922 S.C. Act No. 502....................4

1927 S.C. Act No. 1....................5, 10, 14, 30, 31, 40, 41, 43

1937 S.C. Act No. 349....................5, 22, 31

1955 S.C. Act No. 234....................9, 39, 41

1985 S.C. Act No. 101....................16, 17, 18, 19, 20

1995 S.C. Act No. 76....................19, 21

1996 S.C. Act No. 248....................23

2001 S.C. Act No. 89....................21

2005 S.C. Act No. 45....................21

I.R.C. § 172....................12

S.C. Code Ann. § 1-23-310 et seq....................4

S.C. Code Ann. § 12-2-25....................21

S.C. Code Ann. § 12-3-10....................15, 32

S.C. Code Ann. § 12-6-30(1)....................20

S.C. Code Ann. § 12-6-40 (2014)....................20, 21, 22

S.C. Code Ann. § 12-6-50....................20, 21

S.C. Code Ann. § 12-6-530....................19, 20

S.C. Code Ann. § 12-6-550 (2008)....18, 19, 42

S.C. Code Ann. § 12-6-550(1) (2014)....5, 20

S.C. Code Ann. § 12-6-630....18

S.C. Code Ann. § 12-6-1110....17

S.C. Code Ann. § 12-6-1120 (2014)....15

S.C. Code Ann. § 12-6-1130....17, 42

S.C. Code Ann. § 12-6-1130 (4) (2008)....17

S.C. Code Ann. § 12-6-1210....17

S.C. Code Ann. § 12-7-230....19

S.C. Code Ann. § 12-7-235....19

S.C. Code Ann. § 12-11-10 et seq....5, 20

S.C. Code Ann. § 12-11-20 (2014)....5, 29, 35, 47

S.C. Code Ann. § 12-11-40 (2014)....22, 23, 24

S.C. Code Ann. § 12-13-20 (2014)....21, 22

S.C. Code Ann. § 12-60-10 et seq....3

S.C. Code Ann. §§ 65-202 (1952)....41

S.C. Code Ann. §§ 65-255 (1952)....14, 39

S.C. Code Ann. §§ 65-281 (1952)....41

S.C. Code Ann. §§ 65-282 (1952)....41

Other Authorities:

1937 Attorney General Opinion (dated June 15, 1937)....13

1948 Attorney General Opinion (dated March 12, 1948)....13-15

Tax Commission Decision I-D-189 (dated Jan. 24, 1975)....24, 30, 47

B.A.–OAG–1 (dated March 12, 1948)....14

Final Report of S.C. Taxation Realignment Commission, p. 11 (Dec. 2010), *available at https://www.scstatehouse.gov/Archives/CitizensInterestPage/TRAC/TRAC.php* 15, 16, 32
v.
John C. von Lehe, *South Carolina Taxation and Economic Tax Incentives* 17 (3d ed. 2013)...10, 32

Re: Bank Tax, 1975 WL 23740, at *1 (S.C. Tax. Comm. January 24, 1975)...........................14, 30

S.C. Code Ann. Regs. 117-1500...14, 29, 43, 47

S.C. Code Ann. Regs. 117-1500.1...14

S.C. Code Ann. Regs. 117-1500.2...29, 48

S.C. Code Ann. Regs. 117-1500.3...29

SCDOR Information Letter #94-3...23

SCDOR P.L.R. #95-10...24

S.C. Reg. BA-R-1 (December 6, 1967)...14, 29

S.C. Revenue Ruling # 92-9...14

S.C. Revenue Ruling #16-x...14, 15, 23, 28, 29

S.C. Revenue Ruling 16-7, available at https://dor.sc.gov/resources-site/lawandpolicy/Advisory%20Opnions/RR16-7.pdf 23

U.S. Securities & Exchange Commission, *Financial Reporting Manual* § 1400...40

INTRODUCTION

Appellant Synovus Bank (Synovus) is a large regional bank with dozens of bank branch locations throughout South Carolina. For tax years 2011–2014, Synovus reported net book income of over $1.2 billion and paid approximately $4,487,374 in South Carolina bank taxes. Years later, Synovus filed amended bank tax returns for 2011–2013. Despite clear instructions on the South Carolina Bank Tax Return that "banks are not allowed a net operating loss deduction," Synovus unilaterally altered these amended bank tax returns and its original 2014 return by inserting a line item for a net operating loss (NOL) deduction. As a result, Synovus reduced its reported bank tax liability from almost $4.5 million to $0 and requested refunds of the bank taxes it had paid for 2012–2014.

The South Carolina Bank Tax is imposed on 4.5% of the "entire net income" of a taxpayer doing a banking business within South Carolina. S.C. Code Ann. § 12-11-20 (2014). The two dispositive issues in this appeal center on the meaning of the phrase "entire net income." The first is a legal one: whether South Carolina law permits Synovus to utilize net operating loss carryforwards in computing its entire net income and bank tax liability. The second issue, which the Administrative Law Court (ALC) characterized as a factual one, is whether Respondent South Carolina Department of Revenue (Department) correctly calculated Synovus' entire net income by using Synovus' book income as computed in accordance with generally accepted accounting principles (GAAP). The undisputed record evidence establishes that the Department has never permitted banks to deduct NOLs, and has always computed the bank tax based on a bank's book income. The ALC affirmed the Department's position on both of these issues. The Department urges this Court to do the same.

The Department's longstanding administrative interpretation of the bank tax is consistent with other South Carolina authorities and is entitled to deference. The General Assembly has enacted specific statutes that allow corporations to deduct NOL carryforwards for income tax purposes. It has never adopted a similar statute for the bank tax. Synovus concedes there is no statute authorizing

banks to deduct NOLs. Banking and tax professionals in South Carolina openly acknowledge that banks are not permitted to claim NOL deductions. The record contains no evidence of any bank, other than Synovus, ever attempting to claim an NOL deduction on its South Carolina bank tax return.

Similarly, the Department and other authorities have always classified the bank tax as a franchise tax that is calculated differently than the corporate income tax. Corporations are taxed on their adjusted federal taxable income, but banks have always been taxed on their book income. The experts for both parties agree that the long-held understanding and practice of South Carolina tax accountants is that the bank tax is based on book income. Book income can be computed under a number of different accounting methods, but GAAP is the primary accounting method employed by banks, including Synovus. Regardless of the accounting method, under basic financial accounting principles a company may not take a loss incurred in one year and carry it forward to reduce its book income in future years.

The gist of Synovus' appeal is that for over 80 years the Department (and its predecessor, the Tax Commission), the Attorney General, the Legislature, the banking industry, and even Synovus' own expert have just gotten it wrong. Synovus asks the Court to overlook the differences between the bank tax and corporate income tax, give no deference to the Department's longstanding administrative practice, and grant a deduction it admits must be legislatively created and does not exist in the current bank tax statutes. Synovus also asks this Court to declare unreasonable the method the Department and other banks have used for decades to calculate the bank tax— and the very method Synovus used to calculate its bank tax liability on its original tax returns for the tax years in dispute. The ALC correctly held that South Carolina law does not permit banks to claim an NOL deduction, and correctly held it was reasonable for the Department to use book income to compute the tax base for the bank tax. This Court should affirm.

COUNTER-STATEMENT OF THE ISSUES ON APPEAL

I. Did the ALC correctly hold the Legislature has not authorized banks like Synovus to deduct NOL carryforwards when calculating their bank tax liability?

II. Did the ALC correctly hold it was reasonable for the Department to calculate Synovus' "entire net income" based on its net book income as computed in accordance with GAAP, where this calculation is consistent with the Department's longstanding administrative practice?

STATEMENT OF THE CASE

On November 16, 2017, Synovus commenced this proceeding in accordance with the Revenue Procedures Act, S.C. Code Ann. § 12-60-10 et seq., by filing a request for a contested case hearing challenging the Department's October 17, 2017 final agency Determination. *See* Request for a Contested Case Hr'g (filed Nov. 16, 2017) **(R. __)**. The Determination disallowed the net operating loss (NOL) deductions that Synovus had claimed and carried forward on its amended bank tax returns for tax years 2011 through 2014. *See* Tr. Ex. 21 – Department Determination **(R. __)**. The Determination assessed Synovus $1,370,716 in bank tax and $184,520.86 in interest (as calculated through November 20, 2017).

Synovus and the Department filed Cross-Motions for Summary Judgment. *See* Synovus Mot. for Summ. J. (filed July 25, 2018) **(R. __)**; SCDOR Mot. for Summ. J. (filed July 25, 2018) **(R. __)**; Synovus Resp. to DOR Mot. for Summ. J. (filed Aug. 8, 2018) **(R. __)**; DOR Resp. to Synovus Mot. for Summ. J. (filed Aug. 8. 2018) **(R. __)**; Synovus Reply (filed Aug. 15, 2018) **(R. __)**; DOR Reply (filed Aug. 15, 2018) **(R. __)**. By Order dated October 22, 2018, the ALC granted partial summary judgment in favor of the Department but denied Synovus' motion for summary judgment. *See* Order Granting Partial Summ. J. **(R. __)**. The ALC affirmed the Department's position that there is no statutory basis under South Carolina law for Synovus to claim an NOL carryforward deduction when computing its bank tax. *Id.* at 15–17. However, the ALC found it was a question of fact whether it was reasonable for the Department to use "book income" as the basis for determining the "entire net

income" of a bank when calculating its bank tax. Accordingly, the ALC did not grant summary judgment on this sub-issue but identified a limited number of issues to be determined during the contested case hearing. *Id.* at 19.

The ALC conducted a contested case hearing on October 17, 2019, the Honorable Ralph K. Anderson, III presiding. The parties presented testimony from three experts, and entered 49 exhibits into evidence. *See* Trial Tr. (Tr.) 8:7–9:9 **(R. __)**. Thereafter, the ALC held a status conference on January 30, 2020, during which it requested supplemental briefing on a number of issues. Both parties filed supplemental briefs. *See* Synovus Supplemental Brief (filed Feb. 20, 2020) **(R. __)**; SCDOR Supplemental Brief (filed Feb. 21, 2020) **(R. __)**.

On April 17, 2020, the ALC entered a Final Order and Decision affirming the Department's Determination and denying Synovus' deduction of NOL carryforward credits for tax years 2011–2014. *See* Final Order at 40 **(R. __)**. Synovus filed a Motion to Reconsider on May 8, 2020, *see* Synovus Mot. to Reconsider **(R. __)**, and the Department responded on May 19, 2020, *see* SCDOR Resp. to Mot. to Reconsider **(R. __)**. On May 20, 2020, the ALC entered an order rescinding the Final Order and Decision pending a decision on the Motion to Reconsider. *See* Order dated May 20, 2020 **(R. __)**. On June 22, 2020, the ALC denied Synovus' Motion to Reconsider, *see* Order dated June 22, 2020 **(R. __)**, and entered an Amended Final Order, *see* Am. Final Order dated June 22, 2020 **(R. __)**. The Amended Final Order reflected changes made to the initial order based on the reconsideration, but again affirmed the Department's Determination and denied Synovus' deductions of NOL carryforwards for tax years 2011 through 2014. *Id.* at 40 **(R. __)**. Synovus filed its Notice of Appeal on July 17, 2020.

STATEMENT OF THE FACTS

1. The South Carolina Bank Tax

The basic facts of this appeal are not in dispute. Banks have been taxed in South Carolina since the state's first income tax in 1922. *See* 1922 S.C. Acts 896, § 2 (1922 Act). Under the 1922 Act,

banks and other corporations were taxed on their "net income," and the tax was calculated as a percentage of their federal income tax. *Santee Mills v. Query*, 122 S.C. 158, 115 S.E. 202, 205 (1922).

The 1922 tax was repealed and replaced by the Income Tax Act of 1926 (1926 Act). *See* 1927 S.C. Acts 1, § 1. The 1926 Act imposed a 4% tax on the "entire net income . . . as herein defined" of corporations, including for-profit banks. *Id.* at § 3. The tax was not computed by reference to federal law or the Internal Revenue Code (IRC). Instead, "net income" was computed on the taxpayer's gross income in accordance with "the method of accounting [the taxpayer] regularly employed in keeping [its] books," less any exemptions or deductions specifically allowed by the Act. *Id.* at §§ 7–9. Net income did not include interest on government obligations, nor did it include a deduction for NOLs.

In 1937, the General Assembly enacted a separate tax on banks, which is now codified in Chapter 11 of Title 12. *See* 1937 S.C. Acts 565–66, *codified at* S.C. Code Ann. § 12-11-10 et seq. The 4.5% tax was imposed annually on "the entire net income of the taxpayer doing a banking business within this State." *Id.* at § 2, *codified at* S.C. Code Ann. § 12-11-20 (2014). The bank tax was "in lieu of all other taxes" (including the corporate income tax) except taxes on real property. *Id.* at § 3, *codified at* S.C. Code Ann. § 12-6-550(1) (2014) (exempting banks and building and loan associations from the corporate income tax). The 1937 Act did not authorize an NOL carryforward deduction nor did it provide any other exemptions or deductions from net income.

Banks annually report their income to the Department using the Bank Tax Return Form1101B. *See* Form1101B – Tr. Ex. 45 **(R. __)**. Form1101B computes the tax on a bank's total *net income*. To determine net income, Form1101B includes a Schedule A and B, which directs banks to make certain adjustments to their federal taxable income in order to report their net income as it was recorded on their books. These adjustments include adding back expenses that can be deducted for federal taxable income purposes but which are not included in book income, such as the federal net

operating loss deduction. The form plainly states: "Federal net operating loss deduction. (Banks are not allowed a net operating loss deduction.)." *Id.* (emphasis added) **(R. __).**

2. **Synovus' Bank Tax Returns**

Synovus was formed following a 2010 merger between the National Bank of South Carolina and Columbus Bank and Trust Company. *See* Stip. Facts, ¶ 10–12 **(R. __)**. In 2009 and 2010, Synovus and its predecessor entities reported combined losses of $391,050,990. *Id.* at ¶ 14–15) **(R. __)**.

Synovus filed bank tax returns for tax years 2011–2013. *Id.* at ¶ 13 **(R. __)**. On its original returns, Synovus did not claim any NOL deductions for the 2009 and 2010 losses. *Id.* at ¶ 16 **(R. __)**. Instead, Synovus calculated its entire net income on its original returns as directed by the instructions on Form SC1101B, including the appropriate net adjustments from Schedule A and B. *Id.* Synovus reported its entire net income and South Carolina bank tax liability for 2011–2013 as follows:

Synovus Bank Tax Returns (Original)			
Tax Year	**2011**	**2012**	**2013**
Company-wide Book Income per Federal Schedule M-2	$24,172,236	$712,351,287	$173,783,226
Entire Net Income	$24,171,754	$712,326,730	$173,402,129
South Carolina Bank Tax	$116,000	$3,478,544	$892,830

See Synovus 2011 Return - Tr. Ex. 7 at 2–3 **(R. __)**; Synovus 2012 Return – Tr. Ex. 11 at 2–3 **(R. __)**; Synovus 2013 Return – Tr. Ex. 14 at 2–3 **(R. __)**.

Synovus subsequently filed amended bank tax returns for 2011–2013 in which it claimed— for the first time— an NOL deduction for its losses from 2009 and 2010. *See* Stip. Facts, ¶¶ 17–18, 20–22 **(R. __)**. As a result, Synovus reported "zero" entire net income and no South Carolina bank tax liability on its amended returns for 2011–2013 and requested a refund for 2012–2013. *See* Synovus 3rd Amended 2011 Return - Tr. Ex. 10 at 2–5 **(R. __)**; Synovus 2nd Amended 2012 Return – Tr. Ex. 13 at 2–5 **(R. __)**; Synovus 2nd Amended 2013 Return – Tr. Ex. 16 at 2–6 **(R. __)**; Stip. Facts, ¶¶ 17–18, 20–23 **(R. __)**. On its original return for 2014, Synovus also claimed an NOL carryforward

deduction and requested a refund of $968,585. *See* Stip. Facts, ¶ 22 (**R.** __); Synovus 2014 Return – Tr. Ex. 17 at 186–87, 196 (**R.** __).

The returns for 2012 illustrate the mechanics of how Synovus' attempt to claim an NOL deduction impacts its bank tax liability. On its original 2012 return, Synovus reported entire net income of $712,326,730. *See* Synovus 2012 Return – Tr. Ex. 11 at 2 (**R.** __). On its amended 2012 return, Synovus altered Schedule A and B by typing onto the form a line that read "SC Bank Net Operating Loss Carryover Deduction" and included an amount— $712,326,730— equal to the entire net income Synovus had reported on its original return. *See* Synovus 2nd Amended 2012 Return - Tr. Ex. 13 at 3 (**R.** __). This created a net adjustment on the amended Schedule A and B in the amount of $91,914,767. *Id.* (**R.** __). When added to Synovus' federal taxable income of -91,914,767, this reduced Synovus' entire net income for 2012 to zero. *Id.* at 2 (**R.** __). Synovus also created an attachment that it included with its amended returns, which showed the amount of NOLs that Synovus intended to carryforward as deductions for future tax years:

Synovus Bank Tax Returns (Amended)			
Tax Year	2011	2012	2013
Company-wide Book Income per Federal Schedule M-2	$24,172,236	$712,351,287	$173,783,226
Entire Net Income	$0	$0	$0
South Carolina Bank Tax	NONE	NONE	NONE
NOL Carryforward Remaining for Future	$366,879,236	$311,172,233	$291,331,561

See Tr. Ex. 10 at 2–5 (**R.** __); Tr. Ex. 13 at 2–5 (**R.** __); Tr. Ex. 16 at 2–6 (**R.** __); Stip. Facts, ¶¶ 17–18, 20–23 (**R.** __).

3. The Department's Audit of Synovus

The refund requests for 2013–2014 were paid, but the 2012 refund request was "held for verification." *See* Stip. Facts, ¶¶ 24–25 (**R.** __). As a result of the verification process, the Department commenced an audit of Synovus, discovered the improper NOL deductions, and disallowed the

claimed NOL deductions for 2011–2014. *Id.* at ¶¶ 23–26 **(R. __)**; Synovus Audit File – Tr. Ex. 19 at 2–12 **(R. __)**. In its Proposed Notice of Adjustment, the Department explained:

> Banks cannot carryforward net operating losses. . . . [because the] base for bank taxes is the Company's book income. . . The concept of net operating loss carryforwards is related to an *income tax* calculation: it is a loss calculated using an adjusted federal taxable income. It is former year's *income tax loss* being carried forward to (ideally) offset current and later years *net taxable income* as reconciled. Bank taxes are based on *book income(loss),* not on adjusted federal taxable income.

Id. at 9 **(R. __)** (emphasis in original).

4. **Financial accounting principles and expert testimony.**

Three experts testified at the contested case hearing. John von Lehe is a South Carolina tax attorney and Certified Public Accountant who testified for Synovus regarding the history of South Carolina's bank tax as a franchise tax and the application of GAAP to the bank tax. *See* Tr. 30:17-22 **(R. __)**. Doug Branch is a Certified Public Accountant and professional expert with PricewaterhouseCoopers (PWC). *See* Tr. 70:23-71:6 **(R. __)**. He testified for Synovus regarding how GAAP accounts for deferred tax assets like NOLs. *See* Tr. 70:2–7 **(R. __)**. Robert J. Beckwith is a Certified Public Accountant who retired as a lead bank tax shareholder at Elliott Davis, one of the top accounting firms in the United States. *See* Tr. 118:3–120:20 **(R. __)**; *see also* DOR Expert Witness Disclosure – Ex. 33 **(R. __)**. Mr. Beckwith testified for the Department regarding the calculation of "entire net income" for purposes of the South Carolina bank tax, including the application of GAAP to the bank tax. *Id.*.[1]

All three experts provided consistent testimony regarding the basic financial accounting principles that frame this dispute. Financial accounting (or book accounting) is the method by which

[1] Mr. Beckwith was the only expert who has ever represented any bank in preparing and filing bank tax returns in South Carolina. *See* Tr. 45:15–17, 99:3–5, 118:20–122:16 **(R. __)**; *see also* CV of Robert Beckwith – Ex. 34 **(R. __)**. During his ten years at Elliott Davis, he spent about 70% of his time on bank tax matters and represented approximately 20–25 banks in filing numerous South Carolina bank tax returns. *See* Tr. 118:20–122:16 **(R. __)**.

banks and other corporations prepare their audited financial statements. *See* Tr. 47:21–24, 124:17–25 **(R. __)**. The financial statements include the income statement and balance sheet. *Id.* The income statement lists the bank's revenues and expenses during the accounting period. The income statement covers a one-year period. *See* Tr. 127:10–12 **(R. __)**. The balance sheet shows the bank's assets, liabilities, and the shareholders' equity. *See* Tr. 126:14–127:1 **(R. __)**. Unlike the income statement, the balance sheet does not cover a full accounting period but is an itemized snapshot of the bank's assets, liabilities, and shareholder's equity at a specific point in time. *See* Tr. 127:13–15 **(R. __)**.

"Net income" or "book income" are synonymous financial accounting terms and refer to the difference between a company's income and expenses during an accounting period. *See* Tr. 131:16–132:5 **(R. __)**. When annual expenses and losses exceed revenues and gains, the company reports a "net loss" or "operating loss." The net income (or net loss) is commonly referred to as the "bottom line" because it appears on the last line of the income statement. *See* Tr. 127:16–129:21 **(R. __)**. Regardless of whether a company uses GAAP or some other method of accounting, its financial statements will always include an income statement with a bottom line that represents the company's net income (i.e. book income). *See* Tr. 45:17–18, 80:7–16, 95:5–10, 105:8–11, 110:7–12, 127:16–128:1 **(R. __)**. For financial or book accounting purposes, net losses are never carried forward to future years. *See* Tr. 177:9–14 **(R. __)**. However, where a statute specifically allows it, a net loss can be carried forward for taxable income purposes. *See* Tr. 78:23–79:5, 112:11–21, 227:9–229 **(R. __)**. This tax concept is referred to as an NOL.[2]

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[2] Technically, a "net loss" or "operating loss" is not exactly the same as a "net operating loss." The former are financial accounting terms and concepts; the latter is a tax law concept. A net loss occurs when a company's *expenses exceed its revenue*. A net operating loss occurs when a taxpayer's statutory *deductions exceed its taxable income*. *See* 1955 S.C. Act No. 234, § 6 (defining a "net operating loss" as "the excess of allowable deductions over gross income for the taxable year"); *see also* 26 U.S.C.A. § 172 (defining "net operating loss" to mean "the excess of the deductions allowed by this chapter over the gross income"). The two concepts are related, but distinct. (Tr. 178:1–179:4) **(R. __)** ("[Where a company's expenses exceed its revenue, that] is a net loss in financial accounting terms. Net operating loss is a product of tax law. . . The[y] are two different things.").

GAAP is the primary accounting method by which companies keep their books. *See* Tr. 72:9–72:18 **(R. __)**. GAAP is mandatory for publicly traded companies, *see* Tr. 104:7–17 **(R. __)**, and is the method used by South Carolina banks, *see* Tr. 134:24–135:8 **(R. __)**.[3] Synovus prepares its financial statements in accordance with GAAP. ASC 740 is the portion of GAAP that codifies generally accepted principles detailing how a reporting entity's financial statements should account for taxes based on income. *See* Tr. 82:6 to 82:13 **(R. __)**.

Mr. Beckwith provided unrebutted expert testimony that tax accountants and tax attorneys in South Carolina have long interpreted the term "entire net income" as found in the South Carolina tax to mean the net income or book income of a bank as determined under basic financial accounting principles and recorded on the bank's income statement. *See* Tr. 131:16–132:5, 134:3–135:15, 136:4–137:1 **(R. __)**. Mr. von Lehe similarly opined "[b]anks are taxed under section 12-11-10 through 12-11-60 *based on book income*." *See* Tr. 62:4-63:12 **(R. __)** (emphasis added); *see also* John C. von Lehe, *South Carolina Taxation and Economic Tax Incentives* 17 (3d ed. 2013). The standard practice for accountants is to calculate a bank's South Carolina tax liability by multiplying its book income by the tax rate (4.5%). *See* Tr. 138:22–139:6, 224:1–225:20 **(R. __)**. The general understanding and practice of tax accountants in South Carolina is that banks cannot claim NOL carryforward deductions on their bank tax returns. *See* Tr. 142:6–13 **(R. __)**.

[3] GAAP is an accrual-based accounting method. *See* Tr. 72:11 to 74:17 **(R. __)**. The Financial Accounting Standards Board (FASB) publishes the accounting standards known as GAAP. In 2009, FASB consolidated and reorganized the numerous GAAP pronouncements (which had typically been issued by FASB or the American Institute of Certified Public Accountants) and codified them into the Accounting Standards Codification (ASC). (*Id.*)

ARGUMENT

I. The ALC correctly held the Legislature has not authorized banks like Synovus to deduct NOL carryforwards when calculating their bank tax liability.

Both at summary judgment and in its Amended Final Order, the ALC rightly rejected Synovus' arguments that banks should be allowed to deduct NOL carryforwards like corporations or entities subject to the income tax in Chapter 6 of Title 12. Instead, the ALC correctly concluded there is no statutory authority for banks to deduct NOL carryforwards when calculating their bank tax liability. *See* Order Granting Partial Summ. J. **(R. __)**; Amended Final Order **(R. __)**. This Court should affirm the ALC's well-reasoned findings and conclusions.

a. <u>An NOL carryforward deduction is a creature of statute, and no South Carolina statute authorizes banks to claim a NOL deduction.</u>

The ALC correctly found that NOLs are "creatures of statute." *See* Am. Final Order at 35. This basic principle is fundamental to deciding this appeal. The NOL carryforward deduction is not a common law concept— it is a unique tax benefit created by Section 172 of the Internal Revenue Code (IRC) or authorized under the specific tax laws of some states. *See* Tr. 140:14–18, 179:6–13, 229:8–12 **(R. __)**. Case law is consistent: NOL carryforward deductions are "a matter of legislative grace" and exist only because a legislative body has specifically enacted such a deduction. *C. W. Matthews Contracting Co. v. S.C. Tax Comm'n*, 267 S.C. 548, 557, 230 S.E.2d 223, 227 (1976).[4]

Synovus does not contest this finding by the ALC, nor could it: at trial, the experts for both parties testified that NOLs exist only by virtue of federal or state tax law. *See* Tr. 110:21–112:14, 177:15–179:4, 229:8–20 **(R. __)**. In fact, Synovus admits the NOL deduction exists for corporate

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[4] *See also McJunkin Corp. v. W. Virginia Dep't of Tax & Revenue*, 457 S.E.2d 123, 124 (W.Va. 1995) (discussing how the "West Virginia Legislature enacted legislation which recognized a West Virginia net operating loss for the first time"); *Garofolo, Curtiss, Lambert & MacLean, Inc. v. Dep't of Revenue et al.*, 648 A.2d 1329, 1334 (Pa. 1994) ("The net operating loss carry-forward deduction is a creature of the legislature, subject to repeal, suspension or reinstatement by the legislature . . . ."). *Bodine Elec. Co. v. Allphin*, 389 N.E.2d 168, 173 (Ill. Ct. App 1979) ("The granting of a deduction for net operating losses is a privilege created by statute as a matter of legislative grace.").

income tax purposes only because the General Assembly relies "on IRC § 172 for the allowance of an NOL carryforward." *See* App. Br. at 6. The same must be true for any NOL deduction for bank tax purposes. It is undisputed, and Synovus has not appealed, that an NOL deduction must be authorized explicitly by legislative enactment.

The ALC's finding is important because Synovus concedes Chapter 11 (the bank tax) is "silent on the topic of *any* deductions, including a taxpayer's ability to deduct NOLs." *See* Stip. Facts, ¶ 1 **(R. __)**. This concession is critical. Synovus admits that no corporation (including banks) is inherently granted a tax deduction for NOLs. Synovus admits that deductions for NOLs must be authorized by statute. And Synovus admits that there is no provision anywhere in Title 12— including the bank tax in Chapter 11— that expressly authorizes *banks* to claim an NOL deduction. In short, Synovus has admitted the very thing it needs— an explicit statutory authorization for banks to deduct NOLs— does not exist.

b. **The NOL carryforward deduction created by the Internal Revenue Code does not apply to the South Carolina bank tax.**

Because no statute expressly authorizes banks to deduct NOLs, Synovus' theory of the case relies on importing an NOL deduction from some other statute(s) outside of the bank tax. Synovus argues that because the South Carolina corporate income tax in Chapter 6 has adopted the federal NOL deduction under IRC § 172, this deduction should apply to the South Carolina bank tax. *See* App. Br. at 31). Its argument here is threefold: (1) the bank tax is based on taxable income like the corporate income tax, (2) conformity with the Internal Revenue Code applies to the bank tax, and (3) the meaning of "entire" must include NOL carryforwards. *Id.* at 10. The ALC correctly rejected variations of these three arguments in its Amended Final Order, and rightly concluded the NOL deduction created by IRC § 172 does not apply to the bank tax. *See* Am. Final Order at 24 **(R. __)**. This Court should likewise reject Synovus' invitation to find an NOL carryforward deduction for the bank tax hiding in the shadows of the corporate income tax provisions.

i. **The tax base for the bank tax is different from the corporate income tax because it includes non-taxable interest on government obligations.**

At the heart of Synovus' appeal is the supposition that the General Assembly intended to treat the corporate income tax and bank tax as having the same tax base. *See* App. Br. at 48. Synovus cannot point to any evidence of this in the record. Moreover, rather than treating the two taxes as the same, the Department and other authorities have always distinguished the taxes as being different.

The ALC correctly concluded the bank tax is not based on "taxable income" like the corporate income tax, in part because of the ways the two taxes have been differentiated over the last eight decades. *See* Am. Final Order at 23 **(R. __)**. Since 1937, banks and corporations have been subject to different taxes under different acts in different chapters of Title 12. The General Assembly has repeatedly amended the corporate income tax, but left the bank tax effectively unchanged.

Historically, the bank tax has always been considered a franchise tax that is unique from the corporate income tax. *Id.* at 15–16 **(R. __)**. For example, shortly after the separate bank tax was enacted in 1937, the South Carolina Attorney General opined that

> whereas in the broad sense an income tax is imposed against banks, it is *not* a tax on income but a tax *measured by* or *according to income*. It is absolutely necessary to grasp this legal, technical distinction if one is to reconcile it with the interpretation of the Tax Commission.

See 1937 Att'y Gen. Op. - Tr. Ex. 25 at 9 **(R. __)**. A decade later, the Attorney General issued another Opinion on the "so-called income tax on Banks." *See* 1948 Att'y Gen. Op. - Tr. Ex. 25 at 6) **(R. __)**. The opinion further differentiated the bank tax from the corporate income tax in that the bank tax base "includes all income from whatever source derived, even income from non-taxable securities," for the reason it 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." *Id.* (emphasis added).

Consistent with the Attorney General's opinions, Regulations promulgated by the Department and approved by the General Assembly provide that "Chapter 11 of Title 12 imposes a franchise tax

on banks." S.C. Code Ann. Regs. 117-1500. The former Tax Commission held there are "special rules in this State applicable to the taxation of banks" because

> 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.*

See Re: Bank Tax, 1975 WL 23740, at *1 (S.C. Tax. Comm. January 24, 1975) (emphasis added). The Department has also published guidance to the public stating that "section 12-11-20 provides for a *franchise tax* based on net income on banks . . . ." *See* S.C. Revenue Ruling #92-9 – Tr. Ex. 27 at 2 (emphasis added) **(R. __)**.

As a franchise tax, the bank tax includes income in its "special base" that the corporate income tax does not. Generally, income earned from government obligations is not taxable, but a franchise tax is the exception to this rule. *See* Am. Final Order at 13 **(R. __)**. The South Carolina bank tax has always included in its tax measure[5] "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 Ann. Regs. 117-1500.1; *see also* S.C. Reg. BA-R-1 (December 6, 1967) (same). By contrast, the base for the corporate income tax has always excluded interest earned from government obligations. *See* 1927 S.C. Acts 1 § 7, *codified at* S.C. Code Ann. §§ 65-255 (1952) (specifically excluding interest on government obligations income from the calculation for gross income and net income); S.C. Code Ann. § 12-6-1120 (2014) (same). As Mr. Beckwith testified,

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[5] The Attorney General's opinion in 1948— that the bank tax is a franchise tax *measured by* entire net income— was critical in light of the prevailing case law at the time. In the years following the enactment of the bank tax in 1937, the United States Supreme Court had held that a state could not impose a direct income tax (e.g., a corporate income tax) on interest income earned from government obligations, but it had upheld a franchise tax measured by such income. *Compare Macallen Co. v. Com. of Mass.*, 279 U.S. 620, 629 (1929) (invalidating a state excise tax imposed on the "total net income" of domestic corporations), *with Educ. Films Corp. of Am. v. Ward*, 282 U.S. 379, 51 S. Ct. 170 (1931) (narrowing *Macallen* holding and concluding a franchise tax is valid even if it includes tax exempt property or income in the measure of that tax).

interest income on state and local bonds is included in a bank's financial statements as part of its "book income," but not in the bank's federal taxable income. *See* Tr. 130:20–131:6 **(R. __)**.[6]

Similarly, when calculating the bank tax, banks are permitted to deduct certain federal and state income taxes allowed as expenses under GAAP but disallowed by the IRC when calculating a corporations' "taxable income." *See* 1948 Att'y Gen. Op. – Ex. 25 at 6 **(R. __)**; *see also* SC Rev. Ruling # 16-x – Ex. 26 **(R. __)**; *but see* 26 U.S.C. § 275 (providing general rule in computing taxable income that "no deduction shall be allowed for . . . Federal income taxes").

The legislature and banking industry have also understood and treated the bank tax as a franchise tax that is different from the corporate income tax. In 2010, the South Carolina Taxation Realignment Commission (TRAC) reported to the General Assembly that banks "are exempt from South Carolina income taxes" but instead pay "a *franchise tax* based upon the 'entire net income' of banks," which is based on "net book income." *See* Final Report of S.C. Taxation Realignment Commission – Tr. Ex. 28 at 74–75, 140–41 **(R. __)** (emphasis added).[7] The TRAC's findings were uncontroversial: the President of the South Carolina Bankers Association testified to the TRAC that "the bank tax is a *franchise tax*" that is not based on "taxable income" but on "book income" that is calculated "without regard to the majority of the book/tax differences considered for federal income tax purposes, including the NOL carryforward." *See* Department Determination – Tr. Ex. 21 at 16 **(R. __)**. Even Synovus' expert provided testimony about "the history of the bank tax as a franchise

[6] This is further illustrated on Form 1101B, which uses a number of adjustments to work backward from a bank's federal taxable income to determine its "income recorded on books but not included in federal taxable income," which includes "interest on state and local obligations." See Form 1101B – Tr. Ex. 45 at 2 **(R. __)**; Tr. 194:4–195:21 **(R. __)**.

[7] The TRAC was charged by the General Assembly with conducting a thorough assessment of the State's current tax structure. S.C. Code § 12-3-10; *see* Final Report of S.C. Taxation Realignment Commission, p. 11 (Dec. 2010), *available at* https://www.scstatehouse.gov/Archives/CitizensInterestPage/TRAC/TRAC.php.

tax" and opined on the Department's "longstanding interpretation" of the bank tax as a franchise tax. *See* Tr. 35:12-15; 62:4-63:12 **(R. __)**; *see also* Synovus Expert Witness Designation - Tr. Ex. 29 at 1 **(R. __)**.

The ALC correctly found that the bank tax is a franchise tax. *See* Am. Final Order at 16 **(R. __)**. This finding, which Synovus has not appealed, along with the undisputed history of treating the bank tax differently from the corporate income tax, is directly contrary to Synovus' contention that the tax base for both taxes is the same.

ii. The corporate income tax is calculated based on "taxable income" as defined by the IRC, but the bank tax is not.

Synovus repeatedly argues "the bank tax and the corporate tax have both always been based on taxable income." *See* App. Br. at 1, 10, 32. Thus, if "entire net income" in the bank tax is based on taxable income like the corporate income tax, then "conformity to the IRC provides an undisputable application of an NOL carryforward deduction through the General Assembly's adoption of 26 U.S.C. §172." *Id.* at 10. The ALC rejected this argument, both at the summary judgment stage and after the contested case hearing. *See* Order Granting Partial Summary Judgment at 16 **(R. __)**; Am. Final Order at 23 **(R. __)**. The bank tax is not based on "taxable income."

The South Carolina Income Tax Federal Conforming Amendments of 1985 (the "1985 Conformity Amendments") made wholesale changes to the South Carolina income tax by conforming it to federal income tax laws and definitions. *See* 1985 S.C. Acts 280–314. The 1985 Conformity Amendments repealed the 1926 Act and changed the corporate income tax base from "entire net income" to "taxable income." *Id.* at 381.

Since 1985, corporations have computed their South Carolina taxable income as set forth in Article 9 of Chapter, which is entitled "Taxable Income Calculation":

- For South Carolina income tax purposes, gross income, adjusted gross income, and *taxable income* as calculated under the IRC are modified as provided in Article 9. *See* S.C. Code Ann. § 12-6-1110.

- South Carolina *taxable income* is computed by making certain modifications to deductions provided in the IRC. Those deductions include an NOL deduction computed in accordance with the IRC, except as provided in this statute. *See* S.C. Code Ann. § 12-6-1130.

- Certain other enumerated deductions are also allowed in computing South Carolina *taxable income*, as provided by the statute. *See* S.C. Code Ann. § 12-6-1210.

The 1985 Conformity Amendments reveal two important points. First, "taxable income" is a term of art as used in the statute. Synovus' oversimplified argument— the bank tax and corporate income tax are both based on taxable income— ignores legislative history and conflates terms and concepts. For any tax based on income, the measure of income that is taxable can rightly be considered the taxable income. But that is different from "taxable income" as defined in the 1985 Conformity Amendments and the code.

Second, the calculation of "taxable income" in Chapter 6 is tied directly to the IRC: it begins with "gross income" as defined by the IRC, less any deductions allowed by the IRC as modified in Article 9 of Chapter 6. "Taxable income" in South Carolina includes the net operating loss deduction as computed in accordance with IRS § 172 <u>only by way of express statutory permission</u>. *See* 1985 S.C. Acts 293 ("Any net operating loss deduction is computed in accordance with Internal Revenue Code Section 172 . . . ."), *codified at* S.C. Code Ann. § 12-6-1130(4) (2008) (authorizing a net operating loss deduction, computed in accordance with the Internal Revenue Code with certain exceptions).

By contrast, the 1985 Conformity Amendments made no changes to the provisions of Chapter 11, including how to compute the bank tax. The bank tax contains no reference to "taxable income" or calculating income (and deductions) as provided in the IRC. In fact, as the ALC correctly noted, 1985 Conformity Amendments specifically provided that banks are *exempt* from the corporate income tax and therefore *are not taxed* on "taxable income" as "provided in the Internal Revenue Code with

the modifications provided in Article 9." *See* 1985 S.C. Acts 287, *codified at* S.C. Code Ann. § 12-6-550 (2008); *see also* S.C. Code Ann. § 12-6-630 ("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 . . . .").

Synovus argues the ALC erred in concluding the tax base changed from "entire net income" to "taxable income" as a result of the 1985 Conformity Amendments. *See* App. Br. pp. 25–26.[8] But the 1985 Conformity Amendments did represent a change. Synovus admitted as much when it told the ALC the 1985 Amendments "*changed the tax base* in the corporate tax section (Chapter 6) from 'entire net income' to 'taxable income as determined under the [IRC] with modifications specified.'" *See* Synovus Pre-Hearing Statement at 4 (emphasis added) **(R. __)**. The 1985 Conformity Amendments adopted federal definitions of key terms (e.g. gross income and taxable income) for South Carolina income tax purposes. It modified those federal definitions. It adopted federal provisions relating to accounting periods and methods. *See* 1985 S.C. Acts 287. Even if the new "formula" or "computation methodology" was similar to the 1926 Act (e.g. "gross income minus deductions allowed") as Synovus claims, (App. Br. p. 22), the formula as a result of the 1985 Conformity Amendments now relied on federal law and federally-authorized deductions where it had not previously done so.

Synovus claims it is "noteworthy" that the 1985 Conformity Amendments (including the heading of the act) did not remove the phrase "entire net income" from the imposition provision of the income tax in Chapter 6. *See* App. Br. at 22. For Synovus, "taxable income" and "entire net income" must refer to the same tax base because both terms coexisted in the 1985 Conformity

[8] Synovus claims the "the ALC and the Department made a fundamental error by concluding Act 76 of 1995 replaced the imposition base of 'entire net income' by inserting and adopting a wholly new tax base of 'taxable income.'" *See* App. Br. at 25. The Department has never argued that any amendments in 1995 meaningfully changed the income tax provisions, and it does not appear the ALC ever discussed the 1995 amendments in its Amended Final Order.

Amendments; therefore, "entire net income" as calculated for banks in Chapter 11 must be the same as "taxable income" for corporations in Chapter 6. *Id.* at 25. The fact the 1985 Conformity Amendments left the term "entire net income" in section 12-7-230 is noteworthy, but only because it reveals a fatal weakness in Synovus transitive argument. Section 12-7-230 imposed the income tax on the "entire net income" of the corporation *as determined by the chapter*. But the very next provision in the chapter, Section 12-7-235, identified banks as "exempt from the tax imposed [on entire net income] by Section 12-7-230." *See* 1985 S.C. Acts 287, § 5, *now codified at* S.C. Code Ann. § 12-6-550.[9] Thus, using Synovus' own substitution argument, a proper harmonization of sections 12-7-230 and 12-7-235 as revised by the 1985 Conformity Amendments reads: "~~the following corporations~~ [banks] are exempt from the tax imposed [on ~~entire net income~~ taxable income].

The 1985 Conformity Amendments underscored the existing distinction that banks are taxed differently from corporations. By 1985, it was well-established that banks were subject to a franchise tax that was not based on "taxable income." If this interpretation was incorrect and the General Assembly intended to tax banks on "taxable income" like corporations, the 1985 Conformity Amendments were the perfect opportunity to correct the misunderstanding. *See State v. King*, 412 S.C. 403, 409, 772 S.E.2d 189, 192 (Ct. App. 2015) ("The Legislature is presumed to know how the terms and phrases it uses in a statute have been interpreted in the past.") This is especially true because conformity with the IRC meant that non-taxable government obligations (historically included in the bank tax base) were again excluded from the "taxable income" of corporations. Instead, the General Assembly left the bank tax unchanged, while specifically exempting banks from the significant changes it was making to the corporate income tax. The ALC was correct to conclude that banks are not taxed on "taxable income" as calculated under the IRC.

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[9] In 1995, section 12-7-230 was replaced with the current section 12-6-530 as part of recodification. *See* 1995 S.C. Act No. 76.

iii. The conformity and decoupling provisions in Chapter 6 (income tax) do not apply to Chapter 11 (bank tax).

In a variation of its "taxable income" argument, Synovus also contends that the "conformity statute" in Chapter 6, along with amendments to the "decoupling statute" in 2005, demonstrate an intent by the legislature for the NOL carryforward deduction provisions of the IRC to apply to banks. *Id.* at 29–30. The ALC correctly concluded that Synovus' arguments based on the conformity and decoupling statutes were unsupported by a close examination of the statutory language. *See* Am. Final Order at 22 **(R. __)**.

First, the conformity statute is limited. *See* S.C. Code Ann. § 12-6-40 (defining income to include "the modifications by Article 9 of this chapter" "unless a different meaning is required"). The 1985 Conformity Amendments enacted only partial conformity; it did not adopt the entirety of the IRC. *Id.* at 16 **(R. __)**. The "decoupling statute" specifically identifies sections of the IRC the General Assembly *did not* adopt through conformity. *See* 1985 S.C. Acts 308 § 12, *codified at* S.C. Code Ann. § 12-6-50. Particularly, the decoupling statute notes that "Sections 581, 582, and 585 through 596 relating to the taxation of banking institutions" are "specifically *not adopted* by this State." S.C. Code Ann. § 12-6-50 (emphasis added).

Second, the 1985 Conformity Amendments specifically state it did not impose the corporate income tax on banks. S.C. Code Ann. § 12-6-550(1) (exempting "banks as defined in Section 12-11-10" from "the tax imposed [on corporations] by Section 12-6-530"). Synovus claims the General Assembly intended to include banks as legal entities specifically covered by the conformity changes to the income tax because the definition of "taxpayer" includes a corporation— and banks are corporations. *See* App. Br. at 29 (citing S.C. Code Ann. § 12-6-30(1)). This argument completely ignores the plain meaning of § 12-6-550(1).

Nevertheless, Synovus contends subsequent amendments to the decoupling statute extended the applicability of the 1985 IRC conformity provisions to the bank tax. *Id.* at 31. In 2005, the General

Assembly amended various provision of Title 12, including sections 12-6-40 and 12-6-50, to "update the reference date by which this State adopts various provisions of the Internal Revenue Code of 1986 and clarify those provisions not adopted." *See* 2005 S.C. Acts 45, § 7, *codified at* S.C. Code Ann. § 12-6-40. Among other things, the 2005 Act amended the introduction of section 12-6-50 by removing the reference to "chapter" and replacing it with the following:

> For purposes of this ~~chapter~~ title and all other titles that provide for taxes administered by the department, except as otherwise specifically provided, the following Internal Revenue Code sections are specifically not adopted by this State:

Id., *codified at* S.C. Code Ann. § 12-6-50 (2014). Synovus contends this revision to the decoupling statute was a deliberate choice by the General Assembly to expand the scope of the IRC conformity provisions from Chapter 6 to other chapters in Title 12— including Chapter 11. Specifically, because section 12-6-50(6) does not adopt IRC § 172(b)(1) relating to net operating loss *carrybacks*, by implication it must mean the General Assembly intended to permit NOL *carryforwards* for *all* taxes, which means the NOL carryforward deduction in IRC § 172 applies to banks. *See* App. Br. at 30–31.

This is a strained reading of section 12-6-50. It presupposes the General Assembly had adopted the IRC for bank tax purposes, which it had not. The stated purpose for the amendment (as evidenced by the heading of the Act) was to clarify which provisions of the IRC were *not adopted*— it was not to adopt new deductions for banks that were not previously authorized. Moreover, the plain language of amended section 12-6-50 indicates it was not an unlimited application to *all taxes* administered by the Department because it was limited "except as otherwise specifically provided."[10]

[10] The General Assembly had a reason to change the provision's language to "[f]or purposes of this title." When Title 12 was reorganized and recodified in 1995, the term "Internal Revenue Code" was used in reference to other taxes administered by the Department and in chapters other than Chapter 6. *See, e.g.*, 1995 Act No. 76, § 3 (recodifying the corporate license fee and exempting nonprofit corporations organized under Section 501 of the Internal Revenue Code of 1986); *id.* at § 13 (adding understatement penalty in the case of corporate taxpayers, in the same manner as prescribed by the Internal Revenue Code). Other sections of Title 12 likewise used the term "Internal Revenue Code." *See* 2001 Act No. 89, § 5 (amending § 12-2-25 to note that "for purposes of this section, the Internal Revenue Code reference is as provided in Section 12–6–40(A)"); S.C. Code Ann. § 12-13-20

The bank tax may be included in Title 12, but the overall statutory framework does not support the overly simplistic interpretation that the decoupling statute expanded IRC conformity to the bank tax.

iv. **The fact that Chapter 11 relies on certain provisions of Chapter 6 for administration and enforcement, and that the Department has at times looked to the IRC for guidance when administering the bank tax, does not mean banks are entitled to an NOL deduction.**

Synovus argues the bank tax adopts portions of Chapter 6 for the administration, enforcement, and allocation and apportionment of the bank tax, which must mean the General Assembly meant for all portions of the IRC— including NOL carryforwards— to apply to banks. *See* App. Br. at 29–30. The ALC rightly dispensed with this argument. *See* Am. Final Order at 19–22 **(R. __)**.

The General Assembly has always included a provision in the bank tax chapter allowing for the limited adoption of certain provisions in the South Carolina Income Tax that may be appropriate *for administrative and enforcement purposes only*. *See* 1937 S.C. Acts 565, § 4, *codified at* S.C. Code Ann. § 12-11-40 (2014). As noted by the ALC, the plain language of section 12-11-40 is limited to adopting only those "appropriate or applicable" provisions necessary for the purposes of "administration, allocation and apportionment." *See* Am. Final Order at 20 **(R. __)**. The calculation of the tax base for the bank tax (i.e., the IRC conformity provisions of Chapter 6) is not related to enforcement or administration of the bank tax. This provision has never been interpreted to adopt the IRC conformity provisions or permit banks to deduct NOL carryforwards, nor should it be.[11]

(addressing bad debt reserves deduction for building and loan associations, pursuant to "the provisions of the Internal Revenue Code as defined in Section 12-6-40"). Thus, the 2005 amendment clarified that many IRC provisions were not adopted by conformity, regardless of whether some provisions in Title 12 made a blanket reference to the IRC.

[11] As the ALC noted, Chapter 13 (imposing tax on building and loan associations) includes a statute defining "net income" by referencing the definition of "taxable income as determined for a regular corporation in Chapter 6 of this title after [relevant deductions]." S.C. Code Ann. § 12-13-20 (2014). This provision in Chapter 13 demonstrates the General Assembly knows how to incorporate portions of Chapter 6 for calculating a tax base, but chose not to do so in Chapter 11.

Synovus also points to a number of policy documents issued by the Department post-conformity, which Synovus claims demonstrate the Department applied conformity to the bank tax. *See* App. Br. at 23. However, Synovus' argument hinges on phrases it has cherry-picked out of context and without reference to the administrative purpose of each policy document.[12] These policy documents referenced certain provisions of the IRC and Chapter 6 (or predecessor statutes) that are necessary only for enforcement and administrative purposes, but nothing in the language of these policy documents can credibly be construed as endorsing a wholesale adoption of the IRC to include an NOL deduction for banks. *See* Am. Final Order at 21 **(R. __)**.

For example, in a 1994 Information Letter, the Department issued an "administrative pronouncement" related to allocation of income for multi-state banks. *See* SCDOR Information Letter # 94-35 – Tr. Ex. 23 at 1 **(R. __)**. The Department issued the letter because "there ha[d] been some confusion as to whether the provisions of Chapter [6] apply to multistate banks for purposes of computing the bank income tax under Chapter 11." *Id.* The Department confirmed that Chapter 11 only adopts portions of Chapter 6— not the entire chapter. *Id.* Moreover, the Department's reliance on certain provisions of Chapter 6 was solely for the administration of the bank tax (i.e. the procedure for multi-state banks to file returns using the apportionment formula used by multi-state corporations), not to incorporate specific IRC deductions into the bank tax. The analysis in this information letter was ultimately adopted by the General Assembly. 1996 S.C. Act No. 248, § 1, *codified*

[12] Synovus points to an isolated sentence in a 2016 revenue ruling and asserts that prior to this dispute "the Department has agreed NOL carryforward deductions are allowed for *all taxpayers*." *See* App. Br. at 33 n.11 (citing S.C. Revenue Ruling # 16-7). This completely mischaracterizes Revenue Ruling # 16-7, which specifically applies to income taxes (not the bank tax) and repeatedly references corporations taxed under Chapter 6 but makes no mention of Chapter 11 or banks. *See* S.C. Revenue Ruling # 16-7, *available at* https://dor.sc.gov/resources-site/lawandpolicy/Advisory%20Opinions/RR16-7.pdf. It also ignores a second policy document circulated by the Department that same year, which specifically provides "the net operating loss deduction is part of the Internal Revenue Code which is adopted for South Carolina income tax purposes . . . but not for purposes of the bank tax." *See* S.C. Rev. Ruling # 16-x – Tr. Ex. 26 at 5 **(R. __)**.

at S.C. Code Ann. § 12-11-40.[13] If it was clear the General Assembly had already adopted conformity for purposes of the bank tax in 1985, as Synovus suggests, this Information Letter and resulting statutory revision would have been unnecessary.

In 1995, the Department considered a specific reorganization transaction involving a bank, holding company, and interim company. In a non-precedential private letter ruling (PLR) that applied only to the transaction and parties in question, the Department agreed to apply certain underlying principles in the IRC (that form over substance should not control for tax purposes) to the specific case. *See* SCDOR P.L.R. # 95-10 – Tr. Ex. 22 at 3 **(R. __)**. This decision was consistent with a prior Tax Commission decision holding that a "mere change in form as opposed to economic change should not be controlling for tax purposes." *See* Commission Decisions – Tr. Ex. 25 at 4 **(R. __)**. However, the Department's discussion explicitly noted the difference between the bank tax and corporate income tax, including that the corporate income tax adopts the IRC but "exclud[es] banks." *See* SCDOR P.L.R. # 95-10 – Tr. Ex. 22 at 2 **(R. __)**. The private letter ruling did not purport to adopt the entire IRC for purpose of computing the bank tax base, but only relied on a specific IRC regulation for guidance in *administering* the bank tax. *See* Am. Final Order at 21 **(R. __)**. The PLR should not be construed any more broadly than that.

[13] This change to section 12-11-40 is the only substantive change to the bank tax since 1937. It did not change the tax base for a bank, but merely imposed the allocation and apportionment provisions of Chapter 6 on whatever multistate income the bank must apportion to South Carolina. If section 12-11-40 or its predecessor statutes were a broad adoption of the Chapter 6 income-tax provisions for bank tax purposes as Synovus contends, there would have been no need for the General Assembly to adopt these allocation or apportionment provisions specifically for the bank tax in 1996. In addition, if the General Assembly had intended the bank tax to adopt the conformity provisions of Chapter 6, this was the perfect opportunity to do so. It did not.

c. **<u>Deduction statutes are construed narrowly, and whether Synovus can claim an NOL deduction is a question of law, not equity.</u>**

Synovus argues the bank tax statutes should be construed liberally, and that any ambiguities should be resolved in its favor because of the "equitable nature" of the ultimate issue in this case. *See* App. Br. at 7–8. This position is directly contrary to black letter law.

Synovus cannot claim an NOL carryforward deduction— which is a matter of legislative grace— unless a statute specifically allows it and Synovus brings itself squarely within the terms of that statute authorizing such deduction. *See Davis Mech. Contractors, Inc. v. Wasson*, 268 S.C. 26, 29, 231 S.E.2d 300, 301 (1977); *see also C. W. Matthews Contracting Co. v. S.C. Tax Comm'n*, 267 S.C. 548, 557, 230 S.E.2d 223, 227 (1976) (affirming denial of net operating loss deduction to a corporation because it failed to meet exact requirements of the authorizing statute); *Chronicle Publishers, Inc. v. S.C. Tax Comm'n*, 244 S.C. 192, 194, 136 S.E.2d 261, 262 (1964) (denying deduction for net operating losses).

The general rule— that ambiguities in income tax statutes should be resolved in favor of the taxpayer— does not apply to the construction of tax deduction statutes.[14] *S. Soya Corp. of Cameron v. Wasson*, 252 S.C. 484, 489, 167 S.E.2d 311, 313 (1969); *accord SCANA Corp. & Subsidiaries v. S.C. Dep't of Rev.*, 384 S.C. 388, 683 S.E.2d 468 (2009) (Beatty, J., dissenting) (noting general rule, but "in cases involving a tax deduction, any ambiguity is strictly resolved against the taxpayer"). The Supreme Court has repeatedly held that deduction statutes— including NOL deduction statutes— must be construed strictly against the taxpayer. *CFRE, LLC v. Greenville Cty. Assessor*, 395 S.C. 67, 74–75, 716 S.E.2d 877, 881 (2011); *C. W. Matthews Contracting Company*, 267 S.C. at 557, 230 S.E.2d at 227.

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[14] Each of the cases cited by Synovus speak to the general rule relating to tax imposition statutes, but not the specific rule related to tax deduction statutes. *See Clark v. S.C. Tax Comm'n*, 259 S.C. 161, 169–70, 191 S.E.2d 23, 26 (1972) (We conclude that the law of South Carolina does not <u>impose</u> the burden of estate taxes, debts, and expenses upon that property passing to the surviving spouse . . . .") (emphasis added); *Hadden v. S.C. Tax Comm'n*, 183 S.C. 38, 190 S.E. 249, 251–52 (1937) (discussing the rule of construction when the "tax is *imposed*" and in "statutes *levying* taxes") (emphasis added).

Not only is Synovus' equity argument legally flawed, it cannot identify a specific NOL deduction statute that is allegedly ambiguous. The reason is obvious: no such deduction statute exists. Thus, what Synovus is really asking the Court to do is find that the absence of a specific statute (which Synovus concedes is necessary to create the deduction it is seeking) renders the entire statutory scheme of the bank tax ambiguous, such that the Court should resolve that ambiguity by judicially creating the missing statutory deduction. This exercise in statutory gymnastics is unsupported by law or logic.

That Synovus' argument on appeal begins with a discussion of equity is a revealing self-indictment of the fact Synovus cannot prevail on the necessary statutory argument. Equitable considerations have no place in its construction of tax deduction statutes— or the lack thereof. *See* Am. Final Order at 33-35, 39 **(R. __)**. The question is not one of fairness, but of straightforward statutory construction: did the General Assembly unambiguously authorize an NOL deduction for banks? *See United States v. Olympic Radio & Television*, 349 U.S. 232, 236, 75 S. Ct. 733, 736 (1955) ("But as we have said before, 'general equitable considerations' do not control the question of what [tax] deductions are permissible."); *see also Centex Int'l, Inc. v. S.C. Dep't of Rev.*, 406 S.C. 132, 151, 750 S.E.2d 65, 75, 2013 WL 3816542 (2013) ("The wisdom tax policy is exclusively within the purview of the legislature and may not be supplanted by this Court.") (*quoting Taiheiyo Cement U.S.A., Inc. v. Franchise Tax Bd.*, 138 Cal.Rptr.3d 536, 538-39 (2012) ("It is fundamental that the extent of allowable deductions is dependent exclusively upon legislative grace and does not turn upon equitable considerations and that a taxpayer claiming a deduction must bring himself *squarely within the terms of a statute expressly authorizing it.*")). Although the proposition of a carryforward deduction is grounded in principles of equity, the decision whether to pursue such public policy considerations of tax equity is a quintessentially legislative one. *Id.* at 33 **(R. __)**. For the relief Synovus seeks, it should lobby the legislature— not this Court.

II. The ALC correctly held it was reasonable for the Department to calculate Synovus' "entire net income" based on its net book income as computed in accordance with GAAP, where this calculation is consistent with the Department's longstanding administrative practice.

The ALC granted the Department's motion for summary judgment, finding there is no statutory entitlement for Synovus to claim an NOL carryforward deduction. *See* Order Granting Part. Summ. J. at 17 **(R. __)**. However, the ALC found there were questions of fact to be resolved before the ALC could determine how "entire net income" is calculated. *Id.* at 18 **(R. __)**. Accordingly, the ALC held a contested case hearing to determine whether (1) it was reasonable and appropriate for the Department to calculate Synovus' entire net income based on its "book income" as computed in accordance with GAAP, and (2) GAAP creates an independent basis by which Synovus can claim an NOL deduction for purposes of computing its bank tax liability.

When Synovus filed its original bank tax returns for 2011–2013, it reported its entire net income as computed based on its book income that it had reported on its federal returns. *See* Synovus Bank Tax Returns for 2011–2013 – Tr. Ex. 7 at 2, 20 **(R. __)**; Tr. Ex. 11 at 2, 17 **(R. __)**; Tr. Ex. 14 at 2, 20 **(R. __)**. Now, Synovus claims that "book income" is an unknowable, unreasonable proxy for "entire net income," and that the Department cannot rely on book income as computed under GAAP when determining Synovus' entire net income. *See* App. Br. at 43. The ALC affirmed the Department's position that calculating entire net income based on the book income of a bank is reasonable and consistent with the history of the bank tax and general accounting principles. *See* Am. Final Order at 37 **(R. __)**. This Court should affirm the ALC's decision.

a. <u>Net income and book income are synonymous, commonly understood financial accounting terms.</u>

The three experts on financial accounting unanimously testified that "net income" is a commonly understood financial accounting term and concept. *See* Tr. 49:19–50:3, 60:7–61:21, 80:7–16, 91:14–17, 95:5–10, 104:18–105:11, 166:5–22 **(R. __)**. The term "book income" does not appear

in GAAP, but it is a "slang" term for net income; the two concepts are synonymous. *Id.* at 131:22–132:5 **(R. __)**. Financial accounting and book accounting are also interchangeable terms. *Id.* at 47:21–24) **(R. __)**.

Net income represents all revenues minus all expenses generated by the bank during a 12-month period. *Id.* at 50:20–22, 91:12–17, 127:2–12 **(R. __)**. Net income is reflected in GAAP and other accounting methods; every financial accounting method generates a "bottom line" that represents a company's net income from the accounting period. *Id.* at 45:14–18, 47:21–24, 79:6–80:16, 95:5–10, 104:18–105:11, 110:7–12, 124:22–125:7, 127:16–128:1, 131:16–132:9, 170:7–12 **(R. __)**. Synovus routinely reports its "net income" for a variety of regulatory reporting purposes related to the banking industry. *Id.* at 132:10–134:2 **(R. __)**.[15]

b. The Department's use of net income (i.e. book income) as the tax base for the bank tax is consistent with the history of the bank tax.

The bank tax is imposed on the "entire net income" of banks. *See* S.C. Code Ann. § 12-11-20. Chapter 11 does not define "entire net income," but the Department has always calculated the tax based on a bank's net income as computed in accordance with financial accounting principles. *See* Revenue Ruling # 16-x – Ex. 26 at 4–5 **(R. __)**; *see also* Synovus Audit File – Tr. Ex. 19 at 11 **(R. __)**. GAAP is accrual based accounting and the predominant accounting method by which most modern

[15] For example, Synovus files a "call report" every quarter, which includes a specific line item for *net income*. Similarly, on SEC reporting and other financial statements that are presented to shareholders Synovus includes an amount labeled "net income" or loss. *See* Tr. 132:10–134:2 **(R. __)**. Net income is shown on the financial statements as an increase or decrease to the shareholder's equity, depending on whether it is *net income* or net loss. *Id.* at 133:8–134:2 **(R. __)**. In Synovus' 2014 Annual Report and Form 10-K it identified the increase in net income available to common shareholders from 2013 ($118.6 million) to 2014 ($185 million). *See* Synovus 2014 Annual Report – Tr. Ex. 44 at 4, 13 **(R. __)**. It also included several tables showing "Selected Financial Data" and "Consolidated Financial Highlights" from Synovus' Income Statement, including a line item showing its "Net income(loss)" for each year from 2010 to 2014. *Id.* at 48, 50, 85, 87 **(R. __)**.

Throughout its 2014 Annual Report, Synovus listed its net income as 195,249 (in thousands). *Id.* Likewise, on the Schedule M-3 that it filed with its 2014 Federal Tax Return, Petitioner listed its net income as $195,248,896. *See* Tr. Ex. 17 at 32 **(R. __)**.

financial institutions— like Synovus— keep their books. *See* Tr. 40:11–12, 75:22–76:11 **(R. __)**. Thus, a bank's net income will *generally* be computed in accordance with GAAP. *See* Revenue Ruling # 16-x – Ex. 26 at 5 **(R. __)**.

The Department's longstanding policy is reflected in formal Regulations promulgated by the Department, which define what is included in "entire net income" and how it is computed. *See* S.C. Code Regulation 117-1500. In particular, the Regulations explain the "*net income* of the taxpayer as provided for in section 12-11-20 shall be computed on either a cash or an accrual basis." Regulation 117-1500.2 (emphasis added).[16] The Regulations also permit banks to request permission to change its method of accounting, and directs banks reporting on a cash basis to deduct Federal income estimated tax payments in the year in which they are paid. *See* S.C. Code Regulation 117-1500.2, 117-1500.3.[17] The Regulations make clear the bank tax is based on *net income* computed in accordance with financial accounting methods.

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[16] The Regulations use both "entire net income" and "net income." As the ALC found, the 1926 Act also used those terms interchangeably. *See* Am. Final Order at 30. The only place the term "entire net income" appeared was in the imposition statutes in §§ 3 (individuals), 4(a) (corporations), and 15 (non-residents and foreign corporations). *See* 1927 S.C. Acts 1. The rest of the Act used the shorter term "net income." *See id.* at § 4(b) (explaining the "basis of ascertaining the *net income* of every [railroad] . . .") (emphasis added); *id.* at § 4(d) (imposing tax on fiduciaries on "that part of the *net income* of estates or trusts . . .") (emphasis added); *id.* at § 5 ("There shall be deducted from *net income* the following exemptions . . .") (emphasis added); *id.* at § 13 ("In computing *net income* there shall be allowed as deductions . . .") (emphasis added); *id.* at § 17 ("every resident . . . having a *net income* during the income year," and "the return . . . shall show the *net income* of the partnership . . .") (emphasis added); *id.* at § 18 (permitting consolidated returns showing the "consolidated *net income*" of the taxpayer) (emphasis added); *id.* at § 19 ("If a taxpayer, with the approval of the Tax Commission, changes the income year on the basis of which his *net income* is computed . . .") (emphasis added); *id.* at § 43-A ("[T]he South Carolina Tax Commission shall use . . . for filing returns for income tax, blanks as used by the United States down to the *net income* part of said blanks.") (emphasis added). In addition, section 15 of the 1926 Act used the terms "entire income," "entire net income," and "net income" interchangeably in describing the income tax base for non-residents and foreign corporations. *See also U. S. Rubber Prod.*, 189 S.C. 386, 1 S.E.2d 153 (1939) (examining computation of "net income" for a tax imposed on "entire net income" of a foreign corporation).

[17] This bank tax regulation has been in place since 1967. *See* S.C. Reg. BA-R-1 (December 6, 1967). Synovus' expert, Doug Branch, testified that cash-basis and accrual-basis are the two primary financial accounting methods by which banks keep their books. *See* Tr. 77:19–78:6 **(R. __)**.

In addition, Tax Commission decisions, Department Revenue Rulings, and the bank tax Form 1101B all provide further guidance that the bank tax is based on book income. For example, a 1967 decision by the Tax Commission permitted a deduction from entire net income for any "actual bad debts written off the books during the income year." *See* Commission Decisions - Tr. Ex. 25 at 2 **(R. __)**. A 1975 decision by the Tax Commission held that the bank tax is a franchise tax "measured by *net income*." *See* 1975 Comm'n Dec. - Tr. Ex. 24 at 2 **(R. __)** (emphasis added). This method of measuring the bank tax requires a bank to pay a tax "based on the economic gain generated by its business during the prior year," *id.* at 2 **(R. __)**, which is exactly what net income under financial accounting represents, *see* Tr. 50:20–22, 91:12–17, 127:2–12 **(R. __)**. A second 1975 decision also noted the "special base" of the bank tax is "economic income rather than taxable income." *See Re: Bank Tax*, 1975 WL 23740, at *1 (S.C. Tax. Comm. January 24, 1975). The reference to "economic income" signals to accountants that the bank tax is based on the financial accounting principles that the accountants typically rely on— namely book income under GAAP. *See* Tr. 136:18–137:1 **(R. __)**. The bank tax return also directs banks to compute the bank tax based on "income recorded on the books." *See* Form SC 1101B - Tr. Ex. 45 at 2 **(R. __)**.

Calculating the bank tax based on book income is consistent with the history of the bank tax. As the ALC found, tax laws typically describe the calculation of a tax base by defining gross income and then subtracting statutorily authorized deductions. *See* Am. Final Order at 36 **(R. __)**. Gross income has to begin with some measure of an entity's income during the accounting and tax period in question; that number is typically calculated based on the income recorded in a taxpayer's books for the accounting period that corresponds to that tax year.

For example, the 1926 Act imposed an income tax on the "entire net income of such corporation [including for-profit banks], as herein defined," but it never provided a definition for "entire net income." *See* 1927 S.C. Act No. 1, § 4(a). Instead, it defined net income, gross income, and

certain deductions. *Id.* at § 7, 8, 13. Net income was to be computed *in accordance with the method of accounting regularly employed in keeping the books of such taxpayer* less any deductions specifically authorized by the Act, *see* 1927 S.C. Act No. 1, § 9. Thus, contrary to Synovus' claim, "entire net income" as understood in the 1926 Act was *not* an "income tax concept wholly devoid of a financial or 'book income' concept." (App. Br. p. 15). Instead, the General Assembly statutorily required the computation of the tax to begin with a number (net income) that was calculated based on a financial or book income concept (the method of accounting regularly employed by the taxpayer in keeping its books).[18]

When the Legislature enacted a separate bank tax in 1937, it again used "entire net income" as the starting point for the tax base. *See* 1937 S.C. Act No. 349, § 2. Unlike the earlier 1926 Act, the 1937 Act did not provide a definition of net income. Presumably, the General Assembly intended net income for purposes of the bank tax to be computed in accordance with the method of accounting the banks regularly employed in keeping their books.

However, the important difference between the two Acts is that the 1937 Act did not include the specifically defined exemptions from gross income and deductions from net income that were included in the 1926 Act. Synovus concedes that gross income and deductions must be defined terms. *See* App. Br. at 15. Synovus also agrees with the ALC's finding that a standard way to calculate net income is gross income less any authorized deductions. *Id.* at 22–23.

Thus, the Department's longstanding reliance on net income or book income to calculate the bank tax is based on a harmonious reading of the 1926 Act, the 1937 Act, subsequent guidance, and general accounting principles. The corporate income tax started with book income, exempted certain

[18] Federal taxable income also starts with the net income from the books (income statements) of a company. *See* Tr. 223:14–224:18 **(R. __)**. As indicated on the federal Schedule M-3 (Form 1120), the net income from the income statement can be calculated using several different accounting standards. *See* Schedule M-3 - Tr. Ex. 47 at line 4a **(R. __)**.

income from gross income, and subtracted any specifically authorized deductions, which resulted in the "entire net income" of the corporation. Similarly, the bank tax begins with net or book income, but because the bank tax does not specifically exempt any income from gross income (e.g. non-taxable securities) or authorize any specific deductions (e.g. NOL carryforwards), the "entire net income" of a bank also ends with its net or book income.

c. The banking industry and tax professionals in South Carolina, including Synovus' expert, have always considered book income to be the tax base of the bank tax.

The Department's use of book income as a proxy for "entire net income" is consistent with how the banking industry and other tax professionals have interpreted the bank tax. The TRAC reported the bank tax is based on "net book income." *See* Final Report of S.C. Taxation Realignment Commission – Tr. Ex. 28 at 74–75, 140–41 **(R. __)** (emphasis added).[19] The President of the South Carolina Bankers Association acknowledged the bank tax is calculated on "book income." *See* Department Determination – Tr. Ex. 21 at 16 **(R. __)**. Synovus' expert, Mr. von Lehe, opined in his seminal book on South Carolina taxes that "banks are taxed . . . based on *book income*." John C. von Lehe, *South Carolina Taxation and Economic Tax Incentives* 17 (3d ed. 2013) (emphasis added); *see also* Tr. 62:9–63:12 **(R. __)**. He further opined that using "book income" or "financial income" to determine the tax base for banks is consistent with how he has always viewed the bank tax. *See* Tr. 61:2–14 **(R. __)**.

Similarly, unrebutted expert testimony established that tax accountants in South Carolina have long interpreted the term "entire net income" as found in the bank tax to mean the net income or book income of a bank as determined under basic financial accounting principles and recorded on the

[19] The TRAC was charged by the General Assembly with conducting a thorough assessment of the State's current tax structure. S.C. Code § 12-3-10; *see* Final Report of S.C. Taxation Realignment Commission, p. 11 (Dec. 2010), *available at* https://www.scstatehouse.gov/Archives/CitizensInterestPage/TRAC/TRAC.php.

bank's income statement. *See* Tr. 131:16–132:5, 134:3–135:15, 136:4–137:1 **(R. __)**. The standard practice within the accounting profession in South Carolina for calculating the tax liability of a bank is to multiply the bank's book income by the tax rate (4.5%). *Id.* at 138:22–139:6 **(R. __)**. In light of his knowledge and experience in the bank tax accounting industry within South Carolina, Mr. Beckwith testified:

> Q. In your opinion, is book income as determined by GAAP a reasonable proxy for entire net income?
>
> A. I believe it is. There's really no other process by which a bank would determine net income, and to interpret entire net income meaning anything and all of the income plus expenses that are shown on the financial statements as anything else I think would be beyond the way that ASC 740 works with – for financial recording purposes.
>
> Q. Okay. In your opinion is GAAP a reasonable standard for determining the tax base of a bank for South Carolina bank tax purposes?
>
> A. I think it is reasonable on the basis that there is no other alternative that would, at least in my opinion, be a better guide.

Id. at 166:6–22 **(R. __)**.

d. <u>The Department's longstanding interpretation and application of the bank tax is entitled to deference.</u>

Synovus argues the Department is not entitled to deference on *any issue* related to the bank tax, and therefore the ALC erred because it improperly gave deference to the Department throughout the Amended Final Order. *See* App. Br. at 33–34. Of course, there are a number of instances, referenced in Synovus' brief, in which the ALC indicates its findings are not based on the deference doctrine. *Id.* at 34 n.12. Regardless, the facts of this case and well-established case law on agency deference demonstrate the Department's longstanding interpretation is worthy of deference.

Under the deference doctrine, "courts defer to an administrative agency's interpretations with respect to the statutes entrusted to its administration or its own regulations 'unless there is a compelling reason to differ.'" *Kiawah Dev. Partners, II v. S.C. Dept' of Health & Envtl. Control*, 411 S.C. 16, 34–35, 766 S.E.2d 707, 718; *see also Sierra Club v. S.C. Dep't of Health & Envtl. Control*, 426 S.C. 236, 256, 826 S.E.2d 595, 606 (2019) ("The court [] *must* give deference to the agency's interpretation of

the statute or regulation, assuming the interpretation is worthy of deference."). If an agency charged with administering a statute or regulation has interpreted the statute or regulation, the Court should defer to the agency's interpretation unless it is "arbitrary, capricious, or manifestly contrary to the statute." *Kiawah*, 411 S.C. at 34, 766 S.E.2d at 718. This is especially true where an interpretation has been consistent and uniformly applied over time. *Media Gen. Commc'ns, Inc. v. S.C. Dep't of Rev.*, 388 S.C. 138, 149, 694 S.E.2d 525, 530–31 (2010) ("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.").

The record evidence and testimony establishes definitively that the Department has consistently interpreted the South Carolina bank tax as a franchise tax based on book income rather than federal taxable income. The record contains no evidence that the Department has ever calculated the bank tax based on "taxable income" as defined by the IRC. Synovus repeatedly complains that the Department has provided no guidance on how the bank tax is calculated under book income. *See* App. Br. at 39.[20] But experts for both parties and the record evidence shows the Department's interpretation

[20] Synovus suggests the Department's interpretation of the meaning or calculation of "entire net income" is only entitled to deference if its position is contained in a "published standard for compliance." *See* App. Br. at 35. Synovus cites no law for this proposition, and offers no definition of what constitutes such a "published standard." A formal ruling or publication may be *sufficient* evidence of an agency's longstanding interpretation of a statute, but it is not *necessary*. Similarly, although a position espoused in a formal document issued by the Department might be entitled to greater weight than an informal interpretation by Department staff, especially where the two interpretations conflict, *see Neal v. Brown*, 383 S.C. 619, 682 S.E.2d 268 (2009), the absence of a "published standard" does not mean the Department does not have an interpretation. This is especially true where, as is the case here, the Department's longstanding interpretation is reflected in a combination of Regulations, agency decisions and publications (including forms), and Attorney General opinions, all of which are known and understood by members of the banking industry and tax professionals.

has been consistent and understood by the banking industry and tax professionals for at least 40 years. *See* Tr. 51:25–53:8, 140:3–13 **(R. __)**.[21]

The ALC made no finding that the Department's interpretation of entire net income (computed based on the book income of the taxpayer, rather than federal taxable income) was arbitrary, capricious, or manifestly contrary to the statute. Instead, the Court found the exact opposite: it is *reasonable* to use Synovus' book income based on financial accounting principles (namely, GAAP) as its entire net income for purposes of the bank tax. *See* Am. Final Order at 37, 39 **(R. __)**. The Court's conclusion is firmly grounded in the legislative history, the testimony of the experts, and the history of GAAP and accounting principles. *Id.* at 38 **(R. __)**.

Therefore, to the extent this Court determines that the meaning of "entire net income" in section 12-11-20 is ambiguous, this Court should defer to the Department's longstanding administrative interpretation of computing the bank tax based on "book income."

e. **GAAP does not independently create an NOL carryforward deduction where state law has not expressly granted such a deduction.**

Synovus argues that even if "book income" calculated under GAAP is a reasonable proxy for "entire net income," the use of GAAP (namely, ASC 740) provides an alternative mechanism for it to claim an NOL carryforward deduction. *See* App. Br. at 41, 47. A close examination of Synovus' expert's testimony and the authoritative materials on this issue reveals that ASC 740 provides guidance on how

[21] Synovus accuses the Department— as it has throughout this litigation— of being "inconsistent" in its interpretation and application of the term "entire net income." *See* App. Br. at 36. However, Synovus did not (and cannot) cite to a single piece of evidence in the record showing that the Department has ever interpreted or applied the term "entire net income" to mean anything other than the book income of a bank. That is because the record establishes precisely the opposite. The only concrete example of "inconsistency" that Synovus has identified is the Department's use of different terms related to "entire net income." *Id.* But this is a hollow objection given the fact that Synovus' own expert testified that these "inconsistent terms" (net income, book income, GAAP, financial accounting, book accounting, etc.) are basically interchangeable and synonymous. *See* Tr. 47:21–24, 49:11–13 **(R. __)**.

an entity should report an NOL carryforward on its financial statements (as a deferred tax asset), but it is not the genesis of an NOL carryforward deduction.

ASC 740 is the portion of GAAP that codifies the standards regarding accounting for taxes based on income. *See* Tr. 42:20 to 43:20, 82:6–11, 130:4–7) **(R. __)**. ASC 740 is designed to address "financial accounting and reporting for the effects of income taxes that result from an entity's activities during the current and preceding years." *See* ASC 740 – Tr. Ex. 38 at 3 **(R. __)**; PWC Income Tax Guide – Tr. Ex. 39 at 14 **(R. __)**. Under ASC 740, a company (also referred to as a reporting entity) is required to "look everywhere that [it] may have tax impacts" (e.g. deductions or credits) and "reflect that impact onto [its] financial statements." *See* Tr. 84:22–85:7 **(R. __)**. An NOL deduction is considered a deferred tax asset because it provides an expected reduction of future taxes payable. *See* Tr. 101:4–16, 105:20–106:3, 114:3–7 **(R. __)**.[22] If a reporting entity has an NOL carryforward under federal or state law, GAAP and ASC 740 require the tax impact of that NOL carryforward to be recorded as a deferred tax asset reflected on the entity's balance sheet. *Id.*

The federal income tax benefit of an NOL carryforward is recognized on the company's balance sheet in the year the operating loss occurs, and the value of this deferred tax asset is the future tax savings the NOL is expected to create. The generation of an NOL impacts both the balance sheet and income statement in the year the NOL is generated, but the use of an NOL carryforward in any future year(s) impacts only the balance sheet— it does not impact the income statement. *See* Tr. 91:18–92:4, 107:14–108:15, 109:24–110:6, 159:21–160:18 **(R. __)**. In other words, even if a bank properly

[22] For example, if a company has $2 million in revenues and $3 million in expenses in year one, the company has an NOL of $1 million. Because federal law permits an NOL carryforward, the future deductible amount (the NOL carryforward) is $1 million. If the tax rate on the bank is 30%, then the future tax impact of that NOL carryforward is $300,000 ($1,000,000 x 30%). Thus, the value of the deferred tax asset is $300,000, and it would be shown as an increase of an asset (a debit) on the company's balance sheet in the year it was generated (year one). *See* Tr. 88:16–91:11, 143:11–145:24 **(R. __)**.

accounted for a valid NOL on its balance sheet, the subsequent use of that NOL would never decrease the bank's book income or bottom line in future years. *Id.*

Properly understood, ASC 740 is guidance on how reporting entities should account for a pre-existing tax benefit that arises by operation of the tax laws of the relevant taxing jurisdiction. ASC 740 does not independently create a tax benefit (like an NOL deduction) where it does not already exist. *See* Am. Final Order at 5, 7 **(R. __)**. ASC 740 is replete with references to the fact that different tax jurisdictions have different rules about whether excess deductions may be carried forward. Under ASC 740, a reporting entity cannot claim a deferred tax credit based on an NOL *unless the taxing jurisdiction allows that specific tax carryforward*. *See* ASC 740 – Tr. Ex. 38 at 4, 7, 8 **(R. __)**. The expert testimony also established that whether a company reports an NOL carryforward as a deferred tax asset on its financial statements depends on a "more likely than not" analysis of whether the taxing jurisdiction allows an NOL carryforward. *See* Tr. 111:20–113:12 **(R. __)**. This includes examining legislation, regulations, and administrative rulings. *See* ASC 740 – Tr. Ex. 38 at 15 **(R. __)**. ASC 740 specifically provides that "[w]hen the past administrative practices and precedents of the taxing authority in its dealings with the entity or similar entities are widely understood, for example, by preparers, tax practitioners and auditors, those practices and precedents shall be taken into account." *Id.* at 15 **(R. __)**. The undisputed testimony in this contested case hearing is that tax practitioners, preparers, and auditors have widely understood the Department's administrative practices and precedent that South Carolina law does not allow banks to claim an NOL carryforward deduction:

> Q. So in your experience preparing returns in South Carolina, could banks claim an NOL carryforward deduction on their return?
> A: No.
> Q: Would this have been generally understood by tax accountants or accountants in South Carolina?
> A: I believe so.

See Tr. 142:6–13 **(R. __)**; Synovus Audit File – Tr. Ex. 19 at 9 **(R. __)**.

Under ASC 740, a bank should account for an NOL as a future tax benefit on its financial statements only if the specific taxing jurisdiction allows the NOL. ASC 740 does not create NOL deductions— it provides guidance on how to account for the *effects* of those deductions. Mr. Branch conceded that if there is no statutorily authorized NOL for banks in South Carolina, there is no future tax benefit to be reported and the value of any deferred tax asset Synovus had claimed for those NOLs would be zero. *See* Tr. 115:6–19 **(R. __)**; *see also* Am. Final Order at 38.

f. **<u>The terms "entire" and "all expenses" do not inherently authorize banks to carryforward NOLs as a deduction from entire net income in future years.</u>**

As an alternative to its conformity argument, Synovus also argues the plain meaning of the terms "entire net income" and "all expenses" is inherently broad and must mean that excess expenses (e.g. NOLs) can be carried forward to reduce net income in future years. *See* App. Br. at 31–32, 47. Under Synovus' theory, if financial accounting is the basis for the bank tax, then "entire net income" must be based on all of the financial statements, not just the income statement. *Id.* at 45–46.[23] Similarly, "all expenses" should be included in the calculation of entire net income, and those expenses must include any deferred tax assets recorded on the balance sheet. *Id.* at 47–48. The ALC rightly rejected the various versions of these arguments that Synovus made during the contested case hearing, finding that NOL carryforwards are not inherently included in the terms "entire net income" or "all expenses." *See* Am. Final Order at 38 **(R. __)**.

[23] Synovus' experts offered previously undisclosed opinions at the contested case hearing that "entire net income" means something broader than book income under GAAP. *See* Tr. 48:9–49:7 **(R. __)**. Neither of these opinions are persuasive. Mr. von Lehe admitted that his testimony at the hearing was completely contrary to the opinions and sworn testimony he had provided at his deposition only a few months earlier, when he opined that entire net income and book income are synonymous terms and that it is reasonable and appropriate for the Department to calculate entire net income using GAAP. *Id.* at 49:1–50:19 **(R. __)**. Similarly, Mr. Branch testified that determining "*entire* net income" requires a consideration of all GAAP-mandated financial statements when calculating the bank's tax base and not merely the net income reported on the income statement. *Id.* at 80:23 **(R. __)**. However, he had no opinion— nor was he asked to render one— whether this consideration would actually change Synovus' tax base or its bank tax liability. *Id.* at 109:17–115:19 **(R. __)**.

First, Synovus fails to provide any concrete explanation of how a consideration of a bank's deferred tax assets (which may include NOLs) will change a bank's net income in future years. *Id.* at 37 **(R. __)**. GAAP may require the "use of multiple financial documents in conjunction with each other," *see* App. Br. at 46, but that is because GAAP explains how to report a host of financial information— not just how to calculate net income. It is the income statement— not the balance sheet— that "reflects the metrics important to an annual income tax— mainly, the revenues and expenses of a business within its fiscal year or the calendar year, depending upon how it keeps its books." *See* Am. Final Order at 37 **(R. __)**. This is consistent with the testimony from both GAAP experts: the income statement— not the balance sheet— is the part of the financial statements that shows a company's net income (i.e. all revenues less expenses) for that specific reporting period. *See* Tr. 91:12–17, 127:2-9, 224:1–225:20 **(R. __)**. Moreover, even if an NOL is authorized by a taxing jurisdiction, the use of that NOL carryforward in future years impacts only the balance sheet— it does not impact the net income recorded on the income statement for future years. *Id.* at 91:18–92:4, 107:14–108:15, 109:24–110:6, 159:21–160:18 **(R. __)**.

Second, the legislative evolution of NOLs in South Carolina demonstrates the term "entire net income" does not inherently authorize NOL carryforwards. *See* Am. Final Order at 32. In 1955, the General Assembly amended the corporate income tax to include an NOL deduction. *See* 1955 S.C. Act No. 234, § 6 (1955 Act). At the time, the corporate income tax was imposed on "entire net income," and "net income" was calculated as "gross income . . . less the deductions allowed by this chapter." S.C. Code § 65-255 (1952). If the phrase "entire net income" inherently authorized taxpayers to carryforward and deduct NOLs in future tax years, there would have been no need for the General Assembly to specifically enact an NOL deduction in 1955. *TNS Mills, Inc. v. S.C. Dep't of Revenue*, 331 S.C. 611, 620, 503 S.E.2d 471, 476 (1998) ("The Court must presume the legislature did not intend a futile act, but rather intended its statutes to accomplish something.").

Third, Synovus' broad interpretation of "entire net income" is inconsistent with the finite time periods in financial accounting upon which South Carolina's corporate income tax and bank tax are based. Synovus claims "no statute or regulation limits the use of such expenses/losses to one year for a bank," so "entire net income" must mean all income earned minus all expenses deducted without limitation to only those expenses that can be taken in a single year. *See* App. Br. at 31-32. This completely ignores how the 1926 Act treated financial "accounting methods and periods."

Under financial accounting principles, relevant financial information is reported in twelve-month accounting periods— whether calendar year or fiscal year. *See* Tr. 228:11-20 **(R. __)**. Synovus reports its financials on an annual basis. *Id.* at 132:10-133:7 **(R. __)**; *see* Tr. Ex. 44 at 48, 50, 85, 87) **(R. __)**. Financial accounting principles do not allow a company to take a loss generated in one year and use it in future years to calculate net income. *See* Tr. 227:21-228:20 **(R. __)**. Because the income statement reflects a company's net income during the accounting period, it is limited to showing only the revenues and losses from that one-year accounting period. *See* Tr. 127:2-12 **(R. __)**. Thus, it would be both illogical and inconsistent with accounting practices for the income statement to include income or expenses from outside the accounting period. *See NCNB Corp. v. United States*, 651 F.2d 942, 949 (4th Cir. 1981), *vacated*, 684 F.2d 285 (4th Cir. 1982) ("The balance sheet summarizes an enterprise's position at a moment in time; the income statement summarizes the results of operations of the enterprise over a period of time."); *see also* U.S. Securities & Exchange Commission, *Financial Reporting Manual* § 1400 (describing basis of reporting, requiring the financial statements and reporting to comply with GAAP, and providing the "fiscal years may not exceed 12 months").

The fact that an accounting period is typically limited to twelve months is consistent with the "accounting methods and periods" that were part of the 1926 Act.[24] Income taxes are annual taxes,

[24] The 1926 Act defined "income year" as the "calendar year or the fiscal year upon the basis of which the net income is computed under this chapter"; similarly, "fiscal year" was defined as "an income year ending on the last day of any month other than December." *See* 1927 S.C. Act No. 1, § 2, *codified*

and it makes sense for an *annual tax* to be computed based on the standard *annual accounting period*. *See* 1927 S.C. Act No. 1, § 2, *codified at* S.C. Code Ann. §§ 65-202 (1952).

Fourth, Synovus' claim that "entire net income" inherently authorizes NOL carryforwards is inconsistent with the limits legislatures normally impose on NOL deductions. For example, when the General Assembly first enacted an NOL deduction in 1955, it was limited only to those corporate income taxpayers specifically authorized in the statute. *Chronicle Publishers, Inc. v. S.C. Tax Comm'n*, 244 S.C. 192, 136 S.E.2d 261 (1964) (discussing NOL limited to a taxpayer that had "established a new business or industry in this State" within the meaning of section 65-259(12)); *C. W. Matthews Contracting Co. v. S.C. Tax Comm'n*, 267 S.C. 548, 230 S.E.2d 223 (1976) (same). The deduction was also limited to certain time periods. *S. Soya Corp. of Cameron v. Wasson*, 252 S.C. 484, 167 S.E.2d 311 (1969) (analyzing the timing requirements of the statute and when the taxpayer must make the election to claim the NOL deduction); *see also* 1955 S.C. Act No. 234, § 6 (limiting how many years the NOL can be carried forward). And the deduction was limited to those taxpayers who had taken affirmative steps to claim the deduction. *Wasson*, 252 S.C. at 488, 167 S.E.2d at 312 (finding failure to meet certain requirements— make an election in writing to the Commission in the first return filed after completion of the facility— barred taxpayer from claiming the deduction). If merely using the term entire net income (without further statutory authority) is sufficient to permit a taxpayer to claim an NOL deduction, then *any* corporation or bank could claim an NOL carryforward deduction without any limitation as to *when* the taxpayer could claim the NOL, *what* it must do to claim it, or *how long* the NOL could be carried forward.

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at S.C. Code Ann. §§ 65-202 (1952). The "net income" of a taxpayer was required to be "computed in accordance with the *method of accounting* regularly employed in *keeping the books* of such taxpayer." *Id.* at § 65-281 (1952) (emphasis added). A taxpayer whose "accounting period of twelve months ends as of the last day of some month other than December and whose books are kept accordingly" could seek approval use a fiscal year instead of a calendar year for reporting its "net income." *Id.* at § 65-282.

Finally, Synovus's argument— that "entire net income" inherently permits losses to be carried forward and deducted in future years— is inconsistent with the undisputed fact that NOL deductions must be specifically authorized by statute. Synovus argues that "nothing in Section 12-6-1130(4) authorizing the NOL deduction excludes banks (or franchise taxes) from an NOL carryforward deduction." *See* App. Br. at 32. The statutory analysis here is incomplete. The context of the statutory scheme in Chapter 6 shows that the deductions being discussed in section 12-6-1130— including the NOL deduction— are specific to the corporate income tax in Chapter 6. Besides, it would be completely redundant for the legislature to include a statement in section 12-6-1130(4) excluding banks from claiming a deduction relating to the corporate income tax when the legislature has already stated in section 12-6-550 that banks are exempt from the corporate income tax. What Synovus is really suggesting here is that a bank must be able to claim an NOL deduction unless a specific statute prohibits it. But the history of NOL carryforward deductions demonstrates the opposite: deductions are not the default rule, but the exception.

The terms "entire" or "all expenses" are not some talisman that magically transforms "net income" (which does not include an NOL deduction) into a statutory authorization for an NOL deduction. This Court should affirm the ALC's holding that NOL deductions are not inherently authorized by the terms "entire net income" or "all expenses." *See* Am. Final Order at 35, 38.

g. It is not unconstitutional to use book income as the tax base for the bank tax.

i. There is no unconstitutional delegation of the State's taxing power.

Contrary to Synovus' assertion, there is no unconstitutional delegation of the State's taxing authority if "book income" is the appropriate tax base for calculating "entire net income." *Id.* at 38–41. The ALC correctly rejected this argument. *See* Am. Final Order at 24–25 **(R. __)**.

Every tax on income begins with a taxpayer's book income as the measure of the tax base. Under the 1926 Act, computing entire net income began with a corporation's book income. *See* 1927

S.C. Act No. 1, § 9. Book income is the starting point for computing federal taxable income. *See* Tr. 131:12–15 **(R. __)**; *see also* Schedule M-1 – Tr. Ex. 46 at 1 **(R. __)**.[25] Because the corporate income tax also uses federal taxable income as the starting point, the South Carolina corporate income tax also implicitly relies on book income under GAAP as the starting point for determining taxable income. *See* Tr. 219:14–21 **(R. __)**.

Synovus' reliance on *E. Fed. Corp. v. Wasson*, 281 S.C. 450, 316 S.E.2d 373 (1984) is misplaced. In *Wasson*, the Supreme Court examined a statute that imposed a 20% admissions tax on movies that were rated "X" or not rated by the Motion Picture Association of America (MPAA). The Court concluded this delegation was improper. *Id.* The primary concern underlying the *Wasson* Court's decision was that the "statute impose[d] no guidelines for rating of films," so the determination of whether the movie was taxable ultimately rested "solely [in] the discretion of the MPAA." *Id.* at 452, 316 S.E.2d at 374. That defect is absent here. The legislative history and administrative guidance related to the bank tax provide guidance on how entire net income is computed. The determination of entire net income is not left solely to the discretion of FASB. *See, e.g.*, Reg. 117-1500 (addressing what income is included in "entire net income," requiring the method of reporting net income to be on a cash or accrual basis, and requiring a bank to request permission from the Department before it changes its method of reporting). Moreover, there is a fundamental difference between delegating authority to determine whether a transaction is actually taxable (as in *Wasson*) and relying on generally

[25] It is completely inconsistent for Synovus to claim that it should be taxed under the income tax provisions of Chapter 6, which ultimately begins with GAAP-based book income, while simultaneously claiming that any tax based that starts with GAAP is unconstitutional. It is also inconsistent for Synovus to argue the Department has unconstitutionally delegated its taxing authority by requiring that banks *must* use GAAP to calculate entire net income, but demand the Department *must* permit an NOL carryforward deduction *because Synovus believes GAAP allows such a deduction*. Synovus is effectively asking this Court to require the Department to permit an NOL deduction based on an authority that— in the same breath— Synovus claims the Department is constitutionally prohibited from relying on.

accepted accounting principles as the standards for determining the value accruing from such transaction(s).

The Texas Court of Appeals decision in *Cent. Power & Light Co. v. Sharp*, 919 S.W.2d 485 (Tex. App. 1996) is more persuasive and instructive than *Wasson*. In *CP&L*, a corporate taxpayer was required to report and pay an annual franchise tax for the privilege of transacting business in Texas. The amount of tax was based in part on the company's surplus capital, *id.* at 487, and the Texas tax code required corporations to compute their surplus "according to generally accepted accounting principles." *Id.* The Comptroller had interpreted "generally accepted accounting principles" to include the rules of accounting set forth in FASB (i.e. GAAP). *Id.* The taxpayer claimed the Comptroller's interpretation of "generally accepted accounting principles" constituted an unconstitutional delegation of legislative power to the FASB. *Id.* at 492. The court rejected CP&L's argument, finding that the Comptroller's interpretation of the tax code did not confer any legislative authority to FASB, it "simply incorporates [FASB]'s pronouncements as standards to be used in computing taxes under the laws set forth in the Franchise Tax Act." *Id.* at 493.

The court's analysis in *CP&L* applies in this case as well. GAAP is a compilation of rules under which net income is computed and can properly be used as a reasonable tool to calculate entire net income as set forth in Chapter 11 of Title 12. Therefore, "it does not constitute an unconstitutional delegation of regulatory authority to the FASB." *See* Am. Final Order at 24 **(R. __)**.[26]

[26] Throughout this dispute, Synovus has repeatedly mischaracterized the Department's position as requiring or mandating the use of GAAP. *See* App. Br. at 41. This is incorrect. The Department's position does not require a particular accounting method to determine the bank tax base. Rather, it relies on a particular concept— net income— that the experts agreed exists within all financial accounting methods. *See* Tr. 104:18–105:11 **(R. __)**.

ii. Synovus's due process and equal protection challenges were not preserved for review.

Synovus raises two additional constitutional arguments that the use of "book income" to determine the tax base for the Bank Tax creates due process and equal protection issues. However, the first time Synovus ever made an equal protection or due process challenge was in its Motion to Reconsider. An issue raised for the first time in a motion to reconsider is not preserved if the issue could have been raised prior to judgment but was not. *Jackson v. Clack*, 2020 WL 3832992, at *1 (Ct. App. 2020) (citing *Kiawah Prop. Owners Grp. v. Pub. Serv. Comm'n of S.C.*, 359 S.C. 105, 113, 597 S.E.2d 145, 149 (2004)). Both of these arguments could have been raised prior to judgment. Synovus' failure to do so means those challenges are not appropriate for appellate review.

iii. There is no due process violation.

Even if Synovus can raise a due process challenge on appeal, this Court should reject it. Synovus' contention is that the "concept of 'book income'" fails to meet the "minimum degree of definiteness" required by due process and therefore is void for vagueness. *See* App. Br. at 43. Synovus claims the Department had a duty to issue a regulation defining "book income" but failed to so, and the ALC erred by accepting the Department's "standardless-standard." *Id.* at 41–43.

Synovus appears to be making a "void for vagueness" argument. A law is "unconstitutionally vague if it forbids or requires the doing of an act in terms so vague that a person of common intelligence must necessarily guess as to its meaning and differ as to its application." *S.C. Dep't of Soc. Servs. v. Michelle G.*, 407 S.C. 499, 506, 757 S.E.2d 388, 392 (2014). "The degree of definiteness required to satisfy due process is measured by the common understanding and knowledge of the group [affected by the law]." *See Huber v. S.C. State Bd. of Physical Therapy Examiners*, 316 S.C. 24, 26–27, 446 S.E.2d 433, 435 (1994). Synovus bears the burden to overcome the presumption of constitutionality. *S.C. Dep't of Soc. Servs. v. Michelle G.*, 407 S.C. 499, 757 S.E.2d 388 (2014) ("[A] legislative act will not

be declared unconstitutional unless its repugnance to the Constitution is clear and beyond a reasonable doubt.").

The analysis here is twofold: did Synovus have fair notice that its bank tax would be calculated based on "book income," and was it sufficiently clear how "book income" is determined? The answer to both questions is "yes."

As chronicled above, the Department has a longstanding practice of calculating the bank tax based on book income, a position that is indisputably part of the "common understanding and knowledge" of the banking industry and tax accountants who dealt with the South Carolina bank tax. *See* Tr. 35:12-15, 62:4-63:12, 131:16–132:5, 134:3–135:15, 136:4–137:1, 138:22–139:6, 224:1–225:20 **(R. __)**; *see also* Tr. Ex. 28 at 6 **(R. __)**. Synovus itself filed its original Bank Tax returns for 2011–2013 using its book income as the starting point for computing its tax base. It makes no sense that South Carolina tax accountants and attorneys, TRAC, and the President of the South Carolina Banking Association could uniformly divine how to calculate a bank's book income if the Department's interpretation is as mysterious or indecipherable as Synovus suggests. There is no question Synovus had fair notice the tax is based on "book income."

Similarly, Synovus makes the specious claim that book income is an "undefined amorphous concept" and "the banking industry still has no certainty as to how the bank tax is calculated." *See* App. Br. at 42, 43. This claim is belied by the record. Both of Synovus' experts, as well as the Department's expert, testified that net income and book income are commonly understood financial accounting terms. *See* Tr. 47:21–24, 104:18–105:11, 124:22–125:7, 131:16–132:9 **(R. __)**. The standard practice within the accounting profession in South Carolina for calculating the tax liability of a bank is to multiply the bank's book income by the tax rate (4.5%). *Id.* at 138:22–139:6) **(R. __)**. Synovus' brief acknowledges that "GAAP sets forth the principals [sic] to calculate 'net income' based on financial income." *See* App. Br. at 41. For the tax years in question, Synovus reported its company-

wide book income (i.e. net income) on both its federal and state tax returns. *See* Tr. Exs. 7, 11, 14 **(R. __)**. Synovus— and the banking industry— knows what book income is, and how to calculate it.[27]

iv. <u>There is no equal protection violation.</u>

Synovus also contends the ALC's decision creates equal protection issues because allowing a bank to use "whatever accounting method it wishes . . . is inherently irrational and arbitrary." *See* App. Br. at 43. Synovus alleges there are "equal protection concerns in a 'whatever accounting method' world of banking," but does not specify how. *Id.* at 44. Synovus also suggests there may be a "different bank tax result" between a bank that uses accrual-based accounting versus a bank that uses cash-based accounting, but it provides no fact-based evidence to support this conclusory suggestion. *Id.*[28] Of course, Synovus bears the burden of proof on its equal protection claim. *Bodman v. State*, 403 S.C. 60, 72, 742 S.E.2d 363, 369 (2013) (noting challenger bears the burden of proving beyond a reasonable doubt that a tax statute violates the equal protection clause). Simply alleging a violation, without

[27] Synovus argues the Department has "failed in its duty" to issue a regulation that defines "entire net income" to the level of specificity that Synovus demands. *See* App. Br. at 43. But the Department has issued a regulation that "address[es] various aspects of this franchise tax as administered by the South Carolina Department of Revenue." S.C. Code Regs. 117-1500 (defining what is included in "entire net income" and explaining the "method of reporting" a taxpayer's "net income"). The Regulation and other administrative pronouncements were not secret, but readily available to taxpayers.

[28] Contrary to Synovus' suggestion, equal protection is not implicated in a scenario where a mortgage broker that processes mortgages in South Carolina can deduct NOL carryforward losses incurred as a result of mortgage defaults, but a bank in South Carolina cannot. *Id.* at 45. This distinction does not implicate equal protection, because it is does not treat similarly situated persons in a disparate manner. By definition, the "bank *in* South Carolina" is not the same as a "mortgage broker . . . [that] has *no physical location in* South Carolina." *Id.* (emphasis added). The Tax Commission dealt with this issue in a 1983 memorandum, noting that banks are exempt from the corporate income tax but subject to a "separate" bank tax. *See* Commission Decisions - Tr. Ex. 25 at 11 **(R. __)**. The Tax Commission concluded that if a foreign bank's only business in South Carolina is the origination and servicing of mortgage loans, these limited activities do not rise to the level of "banking" in South Carolina sufficient to implicate the bank tax rather than the income tax. *See* Tr. 211:18–213:23 **(R. __)**. This distinction has nothing to do with "entire net income" or different accounting methods, but whether a financial institution is "doing a banking business within this State." S.C. Code Ann. § 12-11-20.

offering proof as to why the classifications created are not supported by any rational basis, is not enough to prevail on this equal protection claim. *Id.*

The ALC correctly found that "book income" can be determined regardless of what accounting method is used. *See* Am. Final Order at 39 n.34 **(R. __)**. This finding is consistent with the language of Regulation 117-1500.2, which allows a bank to compute its "net income" on "either a cash or an accrual basis." It is also consistent with the unanimous testimony of the experts that regardless of whether a company uses GAAP or some other method of accounting, its financial statements will always include an income statement with a bottom line that represents the company's net income or book income. *See* Tr. 45:17–18, 80:7–16, 95:5–10, 105:8–11, 110:7–12, 127:16–128:1 **(R. __)**.

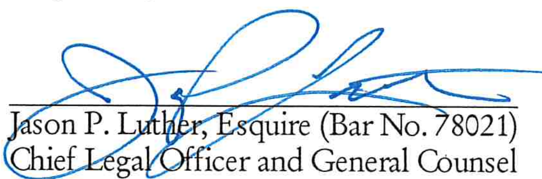
Even if there were a different tax result for banks using accrual-based accounting versus cash-based accounting (the record contains no evidence of this), it does not mean the bank tax is unconstitutional. In *United States v. Olympic Radio & Television*, 349 U.S. 232, 75 S. Ct. 733 (1955), the Supreme Court examined a similar issue involving net operating loss deductions and the difference between cash or accrual basis accounting. The IRC permitted an NOL deduction depending on when a certain tax was "paid or accrued," which was determined in accordance with whatever accounting method the taxpayer employed in keeping its books. *Id.* at 235, 75 S.Ct. at 735. The taxpayer kept its books with accrual-based accounting, which prevented the taxpayer from claiming the deduction for excess profits taxes that accrued in one year even though they were not paid until the following year. The taxpayer contended that if the definition of "paid or accrued" depended on the accounting method, it rendered the deduction "illusory . . . so far as taxpayers on the accrual basis of tax accounting are concerned." *Olympic Radio & Television v. United States*, 108 F. Supp. 109, 110 (1952). The Supreme Court rejected this argument grounded in the "inequity of the results," finding that deductions are "obtain[ed] not as of right, but as of grace," and the "taxpayer has the burden to show

that it is within the provision allowing the deduction." *Olympic Radio*, 349 U.S. at 235, 75 S. Ct. at 736. The Court concluded that although a strict construction of the statute "favors the taxpayer on the cash basis and discriminates against the taxpayer on the accrual basis," this did not render the statute defective. *Id.* Any perceived inequity merely "suggest[s] that changes in the law are desirable. But if they are to be made, Congress must make them." *Id.* The same is true here.

CONCLUSION

The ALC correctly held the Legislature has not authorized banks to claim an NOL carryforward deduction when calculating their entire net income for purposes of the bank tax. No South Carolina statute expressly authorizes an NOL deduction for banks, and the statutory provisions allowing NOL deductions for the corporate income tax in Chapter 6 or the IRC do not apply to the calculation of the bank tax in Chapter 11. Likewise, the ALC correctly affirmed the Department's use of "book income" as the basis for determining a bank's "entire net income" for the bank tax. The Department's longstanding interpretation is reasonable, consistent with the history of the applicable statutes, and supported by decades of administrative guidance. Moreover, the ALC rightly rejected Synovus' arguments that if book income is the basis for calculating the bank tax, then GAAP and ASC 740 provide an alternative basis for claiming an NOL carryforward deduction. The Department respectfully urges this Court to affirm the ALC's findings and conclusions.

Respectfully submitted,



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December 11, 2020

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

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Honorable Ralph King Anderson, III, Chief Administrative Law Judge

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

Synovus Bank... Appellant,

v.

South Carolina Department of Revenue,.. Respondent.

PROOF OF SERVICE

I certify that I have served the Respondent South Carolina Department of Revenue's Initial Brief via electronic mail and by depositing a copy of the Brief in the United States Mail, postage prepaid, on December 11, 2020, at the following address(es):

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December 11, 2020

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Re: Synovus Bank v. South Carolina Department of Revenue
ALC Docket No: 17-ALJ-17-0418-CC
Appellate Case No.: 2020-000999

Dear Ms. Kitchings:

Enclosed please find the South Carolina Department of Revenue's Initial Brief and Designation of Matter, along with a Proof of Service, in the above-referenced matter.

By copy of this letter I am serving all counsel of record with a copy of same.

If you have any questions or need anything further from me please do not hesitate to contact me at 803-898-5785 or Jason.Luther@dor.sc.gov. If I am not available you can reach my paralegal, Amber Hogan, at 803-898-5008 or Amber.Hogan@dor.sc.gov.

With my regards, I am

Sincerely,

Jason P. Luther, Esquire
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JPL/anh
Enclosures
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