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

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

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

Synovus Bank, Appellant,

v.

South Carolina Department of Revenue, Respondent.

APPELLANT'S RESPONSE TO RESPONDENT'S INITIAL BRIEF

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes

Other Authorities

I. Introduction

If the argument of the Department of Revenue (Department) to tax banks on "book income" is adopted, bank taxpayers in South Carolina (a major industry in the state) are burdened with a bank tax law that provides no justifiable definition of the bank tax base and no substantive instruction on how to calculate bank taxes, including the application of deductions.[1] Synovus, on the other hand, sets forth an argument consistent with the bank tax code, both today and since its inception. While scant, the bank tax, and thereby the Legislature, through S.C. Code Ann. § 12-11-40 instructs the Department and bank taxpayer to adopt and make Chapter 6 (the income tax code) part of the bank tax. S.C. Code Ann. §12-11-40. From the earliest days of the bank tax, this provision has included the adoption of tax deductions from the income tax code into the bank tax chapter. The Department has repeatedly relied on § 12-11-40 when an issue with the bank tax has arisen and has repeatedly used the income tax code for instruction when the bank tax is unclear or silent on an issue. Pet'r's Mot. Summ. J. at 15-17, Exs. 8 -12, July 25, 2018. Doing so is consistent with the 2005 income tax conformity statute applying income tax conformity to "*all of* Title 12," including the bank tax. Without reliance on Chapter 6, the bank tax has no substance. Once applied, Chapter 6 and conformity provide the bank tax with needed definitions and structure, including a definitive deduction for NOL carryforwards, while remaining in compliance with Generally Accepted Accounting Principles (GAAP) and other federally mandated financial accounting mechanisms for publicly traded banks.

[1] Synovus is not aware of any case, administrative proceeding, Department advice memorandum or policy document in which the application of a deduction to a bank in South Carolina has been directly adjudicated or addressed.

A. Arguments Made by the Department

The Department's Brief presents two arguments. First, the Department argues no statutory authority exists granting an NOL deduction to a bank. Resp't Bri. at 11 – 26, Dec. 11, 2020. Second, the Department argues it is reasonable to compute a bank's "entire net income" using GAAP and, in the Department's view, using GAAP provides no NOL deduction to a bank. Resp't Bri. at 27 – 49. Neither argument is persuasive and both points have been argued and applied inconsistently by the Department.[2] The Court must look no further than the introductory section of the Department's Brief to see the fallacy and inconsistency in the arguments presented. In the Introduction, the Department, for the first time in this litigation (and for the first known time ever), identifies the source of the definition of "entire net income." Resp't Bri. at 5. The Department identifies the 1926 Income Tax Act definition of "entire net income" as the base definition of "entire net income." The 1926 definition specifically *includes deductions* in its calculation of "entire net income." S.C. Code Ann. § 2451 (1932). Second, the Department admits the source of its position related to GAAP is based on the practices of accountants, not the instruction of the Legislature. Resp't Bri. at 2. This type of delegation of power would be unconstitutional. We address each point fully in the discussion below.

B. Explanation of Net Operating Loss Deductions for Banks

Before addressing the Department's arguments, we present an overview of the General Assembly's statutory grant of NOL deductions to banks. To determine the bank tax owed, a bank

[2] The Department has recognized that banks are allowed to take tax credits available under the IRC and Title 12, Chapter 6 of the state income tax section that are not specifically proscribed in the bank tax statute. Both tax credits and tax deductions, like an NOL carryforward, reduce the income on which taxes are paid. The Department allows a bank to take an income tax credit against the bank tax if the language in the credit does not limit the credit to income taxes in Chapter 6. Further, the Department allows banks to take other federal credits and deductions, including the IRC §162 Ordinary and Necessary Business Expenses without specific statutory authority. Hr'g Tr. at 198–201, Oct. 17, 2019. *See* Pet'r's Suppl. Bri. at n. 2, Feb. 20, 2020.

must compute its "entire net income" as required by S.C. Code Ann. § 12-11-20. "Entire net income" is not defined in the bank tax statutes but has always been defined and fully developed in the income tax statutes. The General Assembly intentionally chose not to define "entire net income" in the bank tax statutes throughout history because it intended banks to use the already defined term of "entire net income" in the income tax statutes.

Throughout this litigation, the Department has argued that the term "entire net income" equals "net income." "Net income," in turn, means "book income," which is a slang accounting term used to describe a company's financial accounting. Appellant's Bri. at 27-28, Sept. 14, 2020. The Department asserts through its expert that the term "entire" has no meaning – it is merely "duplicative," "descriptive" and "unnecessary in the final determination of 'net income.'" Hr'g Tr. 173. The Department has further argued that "net income" is limited to the number found on the income statement in annual GAAP financial accounting records, with no NOL carryforward.[3] Resp't Bri. at 39. The Department took this position despite its own expert acknowledging that to limit "entire net income" only to the income statement did not provide the full picture set forth by financial accounting measures. Hr'g Tr. 125. The Department repeatedly states, without statutory basis, that the income tax and bank tax do not have the same tax base.[4] The Department

[3] To hold that the bank tax is limited to one year as a basis for not allowing an NOL carryforward undercuts the very purpose for which NOL carryforwards were created and is inequitable. As stated by the U.S. Supreme Court, NOL carryforwards "ameliorate the unduly drastic consequences of taxing income strictly on an annual basis. They were designed to permit a taxpayer to set off its lean years against its lush years, and to strike something like an average taxable income computed over a period longer than one year." *Libson Shops, Inc. v. Koehler*, 353 U.S. 382, 386, 77 S. Ct. 990, 993, 1 L. Ed. 2d 924 (1957). *See also Lancaster Cotton Mills v. S.C. Tax Comm'n*, 132 S.C. 466, 129 S.E. 429, 431 (1925) (In 1922, when the first South Carolina income tax was passed, an NOL carryforward was allowed to be taken pursuant to conformity to the federal tax code).

[4] The bank tax form itself instructs bank taxpayers to calculate the bank tax based on federal taxable income from the bank's federal tax return, which includes an NOL deduction. The bank

also repeatedly states that the bank tax has always been calculated in accordance with GAAP.[5] The Department fails to identify how it landed on its position – when the Legislature never gave any indication of deviation of definition of "entire net income" between the bank tax and income tax statutes.

The Department has now acknowledged the basis of their argument in this litigation is flawed and incorrect. As stated above, the Department admits their argument related to GAAP is based upon "the long-held understanding and practice of South Carolina tax accountants," not Legislative authority. Resp't Bri. at 2. Further, the Department admits that the definition for "entire net income" originates from the 1926 income tax statute. Resp't Bri. at 5. In 1926, the term "entire net income" was not limited to the financial accounting definition of net income without deductions. In fact, the opposite is true. To calculate "entire net income," the Legislature instructed the taxpayer to first calculate "net income." "Net income" is to be calculated by *first* determining "gross income" and then *second,* applying all exemptions or deductions from the income tax code to reach "entire net income." 1927 S.C. Acts No. 1, §§ 7-9; *See also* Resp't Bri. at 5. This is the exact argument made by Synovus in this litigation[6] and is how Synovus

tax form instructs a bank taxpayer to begin its bank tax calculation based on federal taxable, which is identical to the income tax form for corporations. Joint Trial Ex. 45.

[5] This statement cannot be true as GAAP did not exist in 1937 when the bank tax was first passed. *See* Am. Final Order at 3.

[6] Synovus has consistently argued a tax cannot be enforced without the tax having a clear definition of the meaning of the tax basis. Synovus has argued, and the ALC agreed, there is no definition set forth in the bank tax statutes and the Department has never set forth a regulation, policy document or any other advice memorandum that consistently defines the term "entire net income." Am. Final Order at 25. Synovus consistently argued "entire net income" has a broader definition than "net income" as limited by the GAAP income statement. If not, the use of the word "entire" is superfluous and, as we know, the Legislature does not include words without intent. *See Giannini v. S.C. Dep't of Transp*., 378 S.C. 573, 587, 644 S.E.2d 450, 457 (2008) ("If the Legislature had intended for the $600,000 aggregate cap to be divided in proportion to the verdicts awarded to each plaintiff, it could have said so."); Appellant's Bri. at 45-48.

mathematically calculated its taxes for years 2011-2014 (the tax years in dispute herein).[7] *See* Joint Trial Exs. 8-17.

Thus, the question becomes, did the Legislature originally intend for the income tax code to apply to the bank tax. The answer is yes. The application of the income tax code to the bank tax follows historical precedent. The two taxes were, after all, originally one. When the Legislature chose to break out the bank tax in 1937, it did so to allow a change in the percentage of taxes charged to banks. It is clear that, based on the inclusion of the identical language "entire net income" for the tax basis of each, the two chapters did not diverge with the level of seismic shift the Department "*presumes."* Resp't Bri. at 31 If that had been the intent, the Legislature would have used different language to define the bank tax basis and/or provided a definition of "entire net income" that differed from that contained in the income tax code. It did not.

Instead, the Legislature did the opposite. In the original bank tax of 1937, the Legislature instructed the Department to "*adopt[ ] and ma[k]e part of [the bank] subsection*" the *entire* income tax code for "the purposes of administration, enforcement, collection, liens, penalties, and other provisions of enforcement." S.C. Code Ann. § 2676(4) (1942); *see also* S.C. Code Ann. § 12-11-40. The original adoption of the income tax code into the bank tax specifically included "Section 2435 through 2479." *Id.* These sections instructed the entire net income (§ 2440) to be calculated

[7] Synovus calculated "entire net income" by computing "net income" in accordance with "'the method of accounting [the taxpayer] regularly employed in keeping [its] books,' less any exceptions and deductions specifically allowed by the Act." This is the process the Department admits should be utilized and has been in place since the origin on the bank tax. Resp't Bri. at 5. Synovus calculated "net income" according to GAAP on its income statement and then applied the applicable deductions available to banks pursuant to S.C. Code Ann. § 12-11-40. These deductions include the NOL deduction available pursuant to IRC § 172. Following the mandates of GAAP ARC 740, the deduction was applied after "net income" was calculated on the income statement – resulting in the "entire net income" of Synovus for each year in question. This is the appropriate and statutorily correct method to account for a NOL deduction for a bank in South Carolina.

through net income which was defined as "the gross income of the taxpayer *less the deductions* allowed by this article" (§ 2443) (emphasis added). It also *specifically included allowable deductions* (§ 2449 and § 2450). It is clear that the Legislature's original intent was to instruct bank taxpayers to continue to look to the income tax code for all methods of *calculation and* instructed the bank taxpayer to apply *deductions* from the income tax code to reach "entire net income." "Entire net income" has always been, and is today, calculated based on a statutory definition that includes all deductions available in the income tax chapter.

The Legislature, throughout the years, has done little to address the bank tax. However, the actions taken have affirmed the position of Synovus – that reliance on the income tax section, and now conformity with the IRC, is required for the bank tax thus allowing for an NOL deduction.[8] Specifically, in 1976 and 1980, the Legislature extended the existing NOL deduction to include "*all taxpayers." See* 1976 S.C. Code Ann. § 12-7-700(12A) (Supp. 1979); S.C. Code Ann. § 12-7-705(2)(a) (1980). Through tax reform in 1985, the General Assembly revised the South Carolina Tax Code to conform to the Internal Revenue Code (IRC). The bank tax was not included in those sections of the tax code excluded from conformity. In 2005, the tax code was further revised and clarified. The language of the decoupling statute was amended and expanded to include "*all* of Title 12," which affirmatively includes Chapter 11, the bank tax. S.C. Code Ann. § 12-6-40 (2005). This language is consistent with the language found in S.C. Code Ann. § 12-11-40 (2005) adopting and making the income tax code part of the bank tax. There is an unbroken chain of Legislative

[8] The definition and calculation of "entire net income" argued by Synovus is consistent with the application of the term in both statutes, as shown above, and in case law. *Crescent Mfg. Co. v. Tax Comm'n*, 129 S.C. 480, 124 S.E. 761 (1924) found "entire net income" means the combination of all of the taxpayer's net incomes regardless of where earned or sourced and regardless of where the business earning the income was conducted. The General Assembly continued that meaning in the Income Tax Act of 1926 and carried it through to 1985's Federal Conformity Act.

authority supporting this position. Nowhere in the statutory history of the bank tax is there a creation of a separate measure of "entire net income" based on and limited to the accounting principles for banks, whether under GAAP or otherwise.

When the 2005 conformity language explicitly adopting the IRC for "*all* of Title 12" is placed next to the Legislature's explicit adoption of "*all*" the substantive sections of Chapter 6 through S.C. Code Ann. § 12-11-40 and its predecessors, there can be no conclusion other than one in which the Court finds the income tax code is adopted and made part of the bank tax. Without question, IRC § 172 and S.C. Code Ann. § 12-7-430(d)(2) allow for an NOL carryforward deduction to be taken. Thus, once conformity and the income tax code are adopted and made part of the bank tax, the ability for a bank to take an NOL deduction is clear.

In sum, the issue is straightforward. Did the General Assembly intend banks to follow the well-defined path computing "entire net income" as statutorily set by the income tax statutes or did the General Assembly intend to create a novel taxation scheme computing "entire net income" as "book income" as uniquely determined by each taxpayer using "whatever accounting method it wishes,"[9] including but not limited to GAAP guidelines related to their income statement? The ALC chose the limited "book income"; we urge the Court to reverse the ALC.

II. The Department Is Wrong: South Carolina Statutory Authority ***Does Grant*** NOL Deductions to Banks

The Department claims "there is no statutory authority for banks to deduct NOL carryforwards when calculating their bank tax liability." Resp't Bri. at 11. To support its claim, the Department submits three proposals. Each is addressed along with subparts as needed.

[9] *See* Am. Final Order, n. 33, June 22, 2020.

A. Contrary to the Department's View, South Carolina's Bank Tax Statutes Expressly Authorize NOL Deductions to Banks

The Department begins its no-statutory-authority claim with a bold accusation asserting "Synovus admits . . . the very thing it needs . . . does not exist." Resp't Bri. at 11. That false statement raises two questions. What does Synovus allegedly admit? What does Synovus need that the Department claims does not exist? We respond to both questions.

1. Synovus Does Not Admit No Statutory Authority Exists Within the Bank Tax Statutes Granting NOL Deductions to Banks

The Department asserts Synovus admits no statutory authority exists within the bank tax statutes granting NOL deductions to banks. Synovus has made no such admission and the only admission relative to the statutory authority for NOL deductions is Stipulation, paragraph 1. There, Synovus stipulates the bank tax chapter (Chapter 11) *is silent* on a specific grant of deductions. Two reasons establish Synovus does not concede the bank tax lacks statutory authority granting NOL deductions to banks.

First, a court will not adopt a construction of a stipulation that concedes a fact clearly in dispute or waives a right clearly contested. *Suddeth v. Knight*, 280 S.C. 540, 544, 314 S.E.2d 11, 14 (S.C. Ct. App. 1984) ("Stipulations will not be so construed as to give the effect of an admission of fact obviously intended to be controverted or the waiver of a right not plainly intended to be relinquished."). Here, the Department's construction of the stipulation treats Synovus as conceding its case by admitting no authority exists in the bank tax statutes to grant an NOL deduction. Such an admission contradicts the foundational position upon which Synovus brings this controversy; *i.e.*, Synovus has always asserted the bank tax statutes permit NOL deductions to banks under Title 12 through the income tax chapter. Since the issue is vigorously contested, the Court must dismiss the Department's strained interpretation.

Second, the Department asserts Synovus' stipulating Chapter 11 is silent on specific deductions means Synovus admits NOL deductions are unavailable under the bank tax statutes. Not so. The stipulation merely observes the bank tax chapter (Chapter 11) ***is silent*** on a specific grant of deductions in that Chapter. "Silent" means "making no mention"[10] and "making no mention" of deductions does not mean the bank tax statutes are devoid of deductions or deny deductions. If that were so, the logical extension of the Department's argument is the Department telling the Court Chapter 11's silence on deductions means banks lack authority to claim any deductions. That means banks have no authority to claim deductions for rent, for salaries paid, for utilities. The absurdity of the Department's position speaks for itself.

At the heart of the Department's argument is an error. The Department asks the Court to transform Chapter 11's "silence" into an affirmative statement. *Wooten v. Bank of Am., N.A.,* 290 Va. 306, 311, 777 S.E.2d 848, 850 (2015) (concluding that absent a duty to speak "silence alone . . . is generally not treated as an affirmative representation of anything."). When, as is the case here, a subsequent statutory section adopts all of the income tax chapter including the NOL deduction, the silence of the bank on a specific deduction is not an affirmative statement of anything. The Court should dismiss the Department's position.

2. Synovus Relies Upon Statutory Authority from the Bank Tax Statutes to Grant Deductions to Banks Including NOL Deductions

Because S.C. Code Ann. § 12-11-20 imposes the bank tax on "entire net income," banks pay tax on a net amount with "net" inherently meaning the bank tax statutes grant deductions. Thus, to find allowable deductions, a taxpayer must identify its "entire net income." As admitted by the Department, one must look to the 1926 Income Tax Act for the definition of "entire net

[10] Merriam-Webster.com Dictionary, accessed December 15, 2020 https://www.merriam-webster.com/dictionary/silent

income." Resp't Bri. at 5. In 1926, "entire net income" was calculated by determining net income. Net income was calculated based on gross income *minus* deductions. S.C. Code Ann. § 2451 (1932). Further, in 1937, common sense and *in pari materia* dictated that since the exact phrase of "entire net income" was already in use as the base for the corporate income tax under the Income Tax Act of 1926, the General Assembly intended banks and corporations to use "entire net income" as the tax base for both taxes. Appellant's Initial Brief tracks the legislative history of the corporate income tax and the bank tax from 1918 to the 2011–2014 tax years before the Court. Appellant's Bri. at 4-6, 12-31. That history shows the General Assembly in 1937 adopted the meaning of "entire net income" from the income tax provisions and never abandoned it.

The intent of the Legislature to include deductions from the income tax code into the bank code becomes clear when the history of S.C. Code Ann. § 12-11-40 is examined. Since the initial bank tax, the Legislature has instructed the bank taxpayer to *adopt* and *make part* of the bank tax *all* of the provision of the income tax code. S.C. Code Ann. § 2676(4) (1992); S.C. Code Ann. § 12-11-40. As such, once an NOL was made available under the income tax statues, such was also made available to banks. [11]

According to the ALC and Department, "[t]he calculation of the tax base for the bank tax … is not related to enforcement or administration of the bank tax." Resp't Bri. at 22; *see also* Am. Final Order at 19. This statement is simply untrue. Today (and during the relevant time period),

[11] NOL deductions were originally available to South Carolina taxpayers through federal income tax law prior to1926. Following the 1926 adoption of a stand-alone income tax for South Carolina, the first NOL deduction in South Carolina became available in 1955 for new businesses. *See* S.C. Act of 1955 No. 234 (adding S.C. Code Ann. § 65-259(13)). The initial grant of an NOL was amended in 1979 to specifically include "*all* taxpayers." *See* 1976 S.C. Code Ann. § 12-7-700(12A) (Supp. 1979) (Emphasis added). By Act 343, Section 2, in 1980, the General Assembly in S.C. Code Ann. § 12-7-705(2)(a) again stated "there shall be allowed to *all* taxpayers as a deduction a net operating loss." (Emphasis added.)

S.C. Code Ann. § 12-11-40 specifically instructed the Department and taxpayer to "*adopt… and ma[k]e a part of" the bank tax* "*all* of the provisions of Chapter 6." The word *all* means every section of Chapter 6 is applicable to the bank tax. This includes the calculation of the taxes and deductions. Prior to the use of the word "*all,*" the historical statutes specifically included statutory sections by number. From the very beginning, the bank tax explicitly "*adopted and made part of* [the bank] subsection" the entire income tax code, "section 2435 thru 2479." S.C. Code Ann. § 2676(4) (1942). Like today's statute, the original statute was "for the purpose of administration …[and]… enforcement." S.C. Code Ann. § 2676(4) (1942). The original statutory adoption of the income tax into the bank tax affirmatively included the statutory sections that provide instruction for the *calculation of the tax base* and accounted for the application of deductions to "net income" to reach "entire net income." *See* S.C. Code Ann. § 2443 (1942) ("The words 'net income' mean the gross income of the taxpayer *less the deductions* allowed by this article." (emphasis added)) When the historical and current language of this statute is compared, it is abundantly clear that there is not now, nor has there ever been, a limitation that excludes deductions, definitions or calculation metrics in the adoption of "*all* of the provisions of Chapter 6" into the bank tax as the Department and ALC assert.

Current	Historical
Section 12-11-40 - Appropriate Chapter 6 provisions shall govern enforcement, administration, allocation and apportionment of income tax on banks	**§ 2676. Tax on income of banks.** **(4) Enforcement-administration.** –
For the purpose of administration, allocation and apportionment, enforcement, collection, liens, penalties, and other similar provisions, all of the provisions of Chapter 6 of this title that may be appropriate or applicable are adopted and made a part of this chapter for the enforcement and administration of this chapter, including the requirement to make	For the purposes of administration, enforcement, collection, liens, penalties, and other provisions of enforcement, all of the provisions of section 2435 thru 2479 [Article 1. Income Tax, § 2435-2479], that may be appropriate or applicable are hereby adopted and made a part of this subsection for the enforcement and admiration of this section."

declarations of estimated tax and make estimated tax payments." S.C. Code Ann. § 12-11-40	S.C. Code Ann. § 2676(4) (1942).

Since the tax base began in 1937 by adopting the income tax statutes, including the fully defined and well developed definition of "entire net income," to prevail the Department must show the Court that, during the period from 1937 to 2014, the General Assembly abandoned a joint tax base for banks and corporations and instead adopted a new and novel base—applied solely to banks—of "book income" or "financial income" or "economic income" that did not include deductions found in the income tax chapter. The Department has made no such showing; there has been no change; the bank tax base is computed using the income tax base, which includes deductions.

B. South Carolina's Adoption of the IRC Authorizes NOL Deductions to Banks

The above shows banks are taxed on "entire net income" and a bank's "entire net income" includes deductions from what is now Chapter 6 of Title 12. Thus, if banks are taxed on "entire net income," does the income tax base grant an NOL deduction? Yes.

In 1985, the General Assembly enacted the Federal Conformity Act.[12] Under that Conformity Act, the NOL deduction previously granted by statute was continued by adopting the NOL deductions of IRC § 172. Then, following recodification by Act 76 of 1995 moving the income tax laws from Chapter 7 to Chapter 6 of Title 12, an NOL deduction was obtained through S.C. Code Ann. § 12-6-40 adopting IRC § 172 as South Carolina law and § 12-6-1130(4) stating "[a] net operating loss deduction is [allowed as] computed in accordance with the Internal Revenue Code." Thus providing the statutory authority on which Synovus claimed NOL deductions for tax years 2011 – 2014 as part of "entire net income."

[12] *Id.*

1. The Department Is Incorrect in its Assertion the Bank Tax as a Franchise Tax Prohibits Synovus from Claiming NOL Deductions

Notwithstanding the above statutory process, the Department says banks cannot receive an NOL deduction because the bank tax is "a franchise tax . . . unique from the corporate income tax." Resp't Bri. at 13. The Department's view is both wrong and irrelevant. It is wrong because the alleged franchise tax and the corporate income tax both rely on the same "entire net income" as the measure of their respective taxes. That common characteristic is the essence of both taxes and thus removes the Department's claim of a "unique" franchise tax.[13]

The Department counters and continues its difference-analysis argument by stating "[a]s a franchise tax, the bank tax includes income [from government obligations] in its 'special base' that the corporate income tax does not." Resp't Bri. at 14. Again, the Department's statement is both wrong and irrelevant. The statement is wrong for two reasons. First, S.C. Code Ann. § 12-2-50 enacted as Act 50, South Carolina Laws of 1991, states "the . . . interest of all bonds, notes, and certificates of indebtedness, by or on behalf of the United States government . . . [is] *exempt from all state . . . taxes or assessments, . . . direct or indirect*, general or special, whether imposed for the purpose of general revenue or otherwise." (Emphasis added). Under this expansive statute, all government interest is exempt whether the tax is a direct income tax (*see Brushaber v. Union Pacific R.R.*, 240 U.S. 1 (1916) holding "[a]n income tax is a direct tax on income) or an indirect franchise tax (*see* BLACK'S LAW DICTIONARY (11th ed. 2019) where "[an] indirect tax [includes a] tax on a right or privilege such as . . . [a] franchise tax."); *Centerre Bank v. Director of Revenue*, 744 S.W.2d 754, 756 (Mo. 1988) stating "[federal law] permits an indirect tax on federal obligations . . . to the extent . . . the tax is a franchise tax."). Thus, by specific South Carolina law,

[13] The bank tax is a tax based on income, even if called a "franchise tax." As such, ASC 740 is applicable to the bank tax. Appellant's Bri. at 47.

neither the alleged franchise tax nor the corporate income tax impose taxation on government obligations.[14] [15]

Second, even if the treatments were different as to income from government obligations, the difference is irrelevant. The issue in the instant case has nothing to do with exempt income from government debt. All that is needed is the NOL deduction be common to both taxes. Thus, whether government interest is taxed or exempt makes no difference to the NOL deduction here under review. *See McCall v. Finley*, 294 S.C. 1, 4, 362 S.E.2d 26, 28 (Ct.App. 1987) ("[W]hatever doesn't make any difference, doesn't matter.").

2. The Department Is Incorrect in its Assertion the Bank Tax and the Corporate Income Tax Do Not Share the Same Tax Base

The Department asserts the bank tax base of "entire net income" cannot be computed by using the statutes of the corporate income tax. To prove its point, the Department relies on Act 101 of 1985; the ALC relies on Act 76 of 1995. Neither proves the point.

a. The 1985 Federal Conformity Act

The Department tells the Court the bank tax base and the corporate income tax base parted ways with Act 101, the 1985 Federal Conformity Act. The Department says "[t]he 1985 [Federal

[14] In South Carolina, the issue is NOT whether and by what authority federal law prohibits or allows South Carolina to tax government obligations. Long after the Attorney General Opinions of 1937 and 1948, the General Assembly in 1991 by S.C. Code Ann. § 12-2-50 eliminated the federal issue. South Carolina's statute preempts even asking the question of whether to tax government obligations since the General Assembly affirmatively and broadly exempts government obligations from all state taxes whether direct or indirect.

[15] S.C. Code Ann. Regs. 117-1500.1 states "entire net income . . . shall include . . . interest on obligations of the United States." "Shall include" is not "shall tax." While Synovus recognizes the Department's view is federal interest is taxable to banks under the bank tax, case law is clear that "[a]lthough a regulation has the force of law, it may not alter or add to a statute." *Goodman v. City of Columbia*, 318 S.C. 488, 490, 458 S.E.2d 531, 532 (1995); *Soc'y of Prof'l Journalists v. Sexton*, 283 S.C. 563, 567, 324 S.E.2d 313, 315 (1984) (a regulation "must fall when it alters or adds to a statute."). The Department's reading of Regs. 117-1500.1 is invalid because it alters S.C. Code Ann. § 12-2-50 by taxing what the statute exempts.

Conformity [Act] repealed the 1926 [Income Tax] Act and changed the corporate income tax base from 'entire net income' to 'taxable income'." Resp't Bri. at 16.

The Department is again incorrect—on both assertions. Act 101 of 1985 did not repeal the Income Tax Act of 1926. Act 101 of 1985 did not change the corporate income tax base from "entire net income" to "taxable income."

As to the "repeal" assertion, the heading of Act 101 makes clear the Act amends—not repeals—the 1926 Income Tax Act:

> *A Bill* to enact the South Carolina Income Tax Federal Conforming Amendments of 1985 by *amending* Sections 12-7-20, 12-7-210, 12-7-212, 12-7-235, 12-7-250, 12-7-1510, and 12-7-2418, Code of Laws of South Carolina, 1976, all relating to *the Income Tax Act of 1926*, so as to provide definitions, rate tables and adjustments, clarifications, exemptions, filing requirements, and corrections of cross references necessary to adopt for South Carolina income tax purposes the definitions of taxable income established by the Internal Revenue Code of 1954.

(Emphasis added.) Act 101 *builds* on the structure of the Income Tax Act of 1926 by adding a series of statutes conforming the 1926 Income Tax Act to the Internal Revenue Code.[16]

Further, Act 101 did not give a "change of tax base." Instead, the opposite is true. The General Assembly chose *not to abandon* the corporate income tax base of "entire net income" by choosing *not to repeal* S.C. Code Ann. § 12-7-230.[17] The General Assembly could have repealed § 12-7-230 if it wanted to since Act 101 repealed over 35 statutes "relating to the Income Tax Act of 1926." Appellant's Bri. at 23. Instead, § 12-7-230—not repealed and fully operational before

[16] In 1985, the General Assembly knew it was not repealing the Income Tax Act of 1926 since as late as the 1994 laws of South Carolina, the General Assembly identifies the income tax laws of Chapter 7 of Title 12 with the following moniker: "This chapter shall be known and may be cited as the "Income Tax Act of 1926." S.C. Code Ann. § 12-7-10 (1994).

[17] In relevant part, S.C. Code Ann. § 12-7-230 states "every corporation organized under the laws of this State, . . . shall pay annually an income tax equivalent to six percent of a proportion of its *entire net income* to be determined as provided in this chapter, and . . . every foreign corporation . . . shall pay annually an income tax equivalent to six percent of a proportion of its *entire net income*, to be determined as provided in this chapter." (Emphasis added.)

and after Act 101—unequivocally retains "entire net income" as the corporate income tax base.[18] Thus, banks and corporate taxpayers after 1985 continued to pay tax on "entire net income" with NOL deductions.

The argument of the Department becomes nonsensical when the historical definition of "entire net income" from the income tax and "taxable income" (todays' terminology) are compared.

IRC § 63 Post conformity	1926	1942
"**I.R.C. IRC § 63(a). In General** …, the term 'taxable income' means gross income *minus the deductions* allowed by this chapter (other than the standard deduction)." IRC § 63(a) (emphasis added)	**"§7. Article III- Computation of Tax-Net income defined. -** The words 'net income' mean the gross income of a taxpayer *less the deductions* allowed by this Act." 1927 S.C. Acts No. 1, § 7 (emphasis added)	"**§ 2443.** The words 'net income' mean the gross income of a taxpayer *less the deductions* allowed by this article." S.C. Code Ann. § 2443 (1942) (emphasis added)

To counter the above, the Department makes a puzzling and difficult-to-follow argument asserting the existence of S.C. Code Ann. § 12-7-230 "reveals a fatal weakness" in Synovus' NOL position. *See* Resp't Bri. at 18-19. In its argument, the Department agrees § 12-7-230 imposes an "income tax on the 'entire net income' of the corporation as determined by the chapter." Then, focusing on § 12-7-230's "as determined by the chapter" language, the Departments says § 12-7-235 is the "next provision in the chapter" and that section "identified banks as 'exempt from the tax imposed on entire net income by Section 12-7-230.'"" Apparently the Department believes that exempting banks from the corporate income tax rate through § 12-7-235(a)(1) disqualifies

[18] While we know the Court decides disputes based only on the facts and the law, we feel compelled to urge the Court not to be fooled by the Department's inflammatory rhetoric asserting Synovus "ignores legislative history and conflates terms and concepts." Resp't Bri. at 17. We believe we have heeded, not ignored, legislative history; we believe we have explained, not conflated, terms and concepts.

Synovus from an NOL deduction when computing "entire net income" for the bank tax. Nothing could be more of a misreading.

What happens to the bank tax computation when the bank tax computation of "entire net income" encounters the corporate income tax exemption of banks in § 12-7-235(a)(1)? Nothing. Section 12-7-235(a)(1) simply says the bank is not subject to the *corporate income tax rate*. That is it. There is no impact to the bank tax. After all, § 12-7-230 imposes *a corporate tax* by stating "[e]very corporation . . . shall pay annually an income tax" and § 12-7-235(a)(1) exempts banks "*from the tax imposed by Section 12-7-230*." Obviously, the bank tax is imposed by § 12-11-20, not § 12-7-230. Thus, when the bank computes "entire net income" as required by § 12-11-20 and reaches the exemption of § 12-7-235, § 12-7-235 exempts banks from the corporate tax rate with no impact on the bank tax computation of "entire net income" including applicable deductions. To read the statute as suggested by the Department would exempt banks from both the corporate tax and the bank tax. The General Assembly intended no such result.

b. The 1995 Recodification of the Income Tax Laws

In 1995, by Act 76, the General Assembly recodified the income tax laws of Title 12 by moving the income statutes from Chapter 7 to a new location in Chapter 6. In the recodification, former § 12-7-230 (the "entire net income" statute for corporate tax) became § 12-6-530.

As to the 1995 recodification, the Department tells the Court it has "never argued that any amendments in 1995 meaningfully changed the income tax provisions." Resp't Bri. at 18, n. 8. Thus, believing in and relying upon the Department as meaning what it states, the Department is not arguing to the Court that Act 76 of 1995 changed the tax base of the corporate income tax. But, while the Department makes no such argument, the ALC does:

> [A]lthough banks are corporations, they are expressly excluded from the corporate income tax under Chapter 6. This is an important distinction because *corporations*

> *Taxed under section 12-6-530 use "taxable income" as their tax base*, and the calculation of "taxable income" comprises the NOL carryforward deduction.

Am. Final Order at 19 (Emphasis added.)

Since pages 24 – 27 of our Initial Brief address the ALC's error, we submit here only two observations. First, both parties agree and are telling the Court no change in the tax base of "entire net income" resulted from Act 76 of 1995. Second, as to the ALC's error that Act 76 of 1995 changed the corporate tax base, such a holding is an unfounded, extraordinary conclusion given that Act 76 is a mere recodification. *See e.g. Dodge v. Bruccoli, Clark, Layman, Inc*., 334 S.C. 574, 583, 514 S.E.2d 593, 597 n.1 (Ct. App. 1999) ("Subsequently, section 72-305 was recodified as . . . S.C. Code Ann. § 42-15-60 (1976) [but t]his recodification did not, however, alter the original statutory language.").

3. The Department Is Incorrect in Asserting the Conformity and Decoupling Provisions in Title 12, Chapter 6 Do Not Apply to Title 12, Chapter 11

Synovus has fully briefed its position on this point in its Initial Brief. *See Generally* Appellant's Bri. 23, 31. The Legislature affirmatively stated in 2005 that conformity and the decoupling provision apply to *all* portions of Title 12. *See* S.C. Code Ann. § 12-6-50. The bank tax is part of Title 12 and was intended by the Legislature to be included in conformity. The interpretation put forth by Synovus is both historically consistent with the statutes and consistent with the adoption of the income tax into the bank tax pursuant to S.C. Code Ann. § 12-11-40.

4. The Department Is Incorrect When It Denies Chapter 11's Reliance on Chapter 6 for Administration and Enforcement Supports Granting Banks NOL Deductions

As stated above, and admitted by the Department, the bank tax mandates reliance on the income tax portion of the tax code for the bank tax. Resp't Bri. at 22. The question becomes is the reliance by the bank tax on the income tax "limited" as argued by the Department and ALC? The

answer is no. *See Supra* at 10. At all times since the inception of the bank tax, the income tax chapter has been adopted and made part of the bank tax, including the definition of "entire net income, calculation of "entire net income," and deductions.

C. The Department and the ALC Are Wrong in Framing the Disputed Issue as a Tax Deduction Dispute

The Respondent Brief (pp. 25-26) mischaracterizes the required statutory construction analysis. The Department views the disputed issue as requiring a narrow construction of statutes granting deductions. Synovus disagrees. The dispute is a tax imposition dispute.

The Court must decide whether the ambiguous imposition statute of S.C. Code Ann. § 12-11-20 requires Synovus pay tax on "book income" governed by rules and policies dictated and *limited* by the GAAP definition of "net income" from the financial income statement or pay tax on "entire net income" governed by the income tax statutes established by the General Assembly and adopted into the bank tax per their explicit instruction. Deciding which imposition process applies requires construing the statute in favor of the taxpayer. *Ryder Truck Lines, Inc. v. South Carolina Tax Commission*, 248 S.C. 148, 149 S.E.2d 435 (1966) ("a taxing statute must be construed most favorably to the taxpayer, and . . . any doubt should be resolved against the taxing authority."); *Alltel Commc'ns, Inc. v. S. Carolina Dep't of Revenue*, 399 S.C. 313, 315 (S.C. 2012) ("[I]f the statute were ambiguous, Petitioners would prevail under the rule that an ambiguity in a taxing statute must be construed in favor of the taxpayer."). Here, construing the imposition statute in Synovus' favor imposes a bank tax on "entire net income" as defined by the General Assembly using the income tax statutes.

When such is done, no ambiguity exists regarding Synovus' ability to obtain an NOL deduction. *See* IRC § 172; S.C. Code Ann. § 12-6-1130(4) ("[a] net operating loss deduction is computed in accordance with the Internal Revenue Code."). Thus, the statutory ability to obtain

an NOL carryforward deduction has no ambiguity. The only statutory dispute with ambiguity is the imposition statute of § 12-11-20. As to that statute, the construction should be in favor of the taxpayer, Synovus.

III. The ALC Wrongly Concluded "Entire Net Income" is Computed as Book Income Under GAAP.

The ALC and Department are incorrect in their assertion that the calculation of "entire net income" is to be restricted to the "net income" of a bank as determined and limited by the GAAP financial income statement.

A. The Department's Use of Book Income as the Base for Entire Net Income Is Inconsistent with the Bank Tax Statute.

First, the term "entire net income" does not appear in financial accounting. Am. Final Order at 6. Only the term "net income" is used in financial accounting. The "net income" found on an income statement is calculated and defined based on GAAP principals. While "net income" under GAAP is accurate pursuant to financial rules, this number is limited and does not include losses (deductions) that are located on the balance sheet for financial accounting purposes. There are four documents that make up a company's financial accounting picture. Hr'g Tr. at 174-175. The income statement is only one of those four documents. To have a true and accurate accounting of a company's financial position all four must be accounted for simultaneously. *Id.*; Am. Final Order at 5.

The Legislature always intended taxable "net income" to be calculated in conjunction with financial principles.[19] After all, there must be some rhyme or reason to the math applied. The

[19] The ALC incorrectly interpreted Accounting Research Bulletin, No. 23 to mean in 1944 an NOL was not shown on the income statement. Am. Final Order at 4. The Research Bulletin, in fact, plainly states the opposite. In 1944, taxes based on income were to be computed and shown on the income statement without the benefit of the carry-forward. The carry-forward was also to be "shown in the income statement as a separate item." In other words, both the income tax and NOL were included on the income statement, but the NOL was to be shown as a separate line item to

Legislature has always stated "net income" was to be calculated in accordance with the method of accounting regularly employed." 1927 S.C. Acts No. 1, § 9. At no point in time has this definition ever interpreted as meaning "book income" or the GAAP income statement for the corporate taxpayer. The Department and ALC incorrectly interpret this statute to be a limiting statute for *only* the bank tax. There is no statutory basis on which the Department can rely any such limitation. In fact, the Department admits its position is based only on a "**presumption**." Resp't Bri. at 31. The part of the equation the Department ignores is the definition of "net income" in the statutes and its inclusion of *all deductions* available. 1927 S.C. Acts No. 1, § 7. GAAP itself acknowledges this is the normal process. Through ASC 740, GAAP provides the accounting method to apply a loss to net income through a deduction, including an NOL deduction.[20] In accordance with GAAP and ASC 740, the GAAP "net income" is calculated on the income sheet and then the loss/deduction is applied from the balance sheet to reach the total taxable income or "entire net income." Hr'g Tr. at 82-88.

The Department and ALC incorrectly determine it is appropriate to limit "net income" only to the GAAP definition and calculation of the term found on the income statement – which ignores

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not cause confusion. Showing both numbers on income tax expense gave the reader of the income statement a better understanding of the financial health of the company. *See* Pet'r's Suppl. Bri., Ex H at 185. Since that time, the accounting profession has changed how an NOL is calculated. Today, accountants instruct that the calculation for an NOL deduction occur after the net operating figure on the income statement is calculated through ASC 740. The NOL, which is a deferred tax asset, is now shown as a footnote on the income statement. Hr'g Tr. at 168. ASC 740 alone has changed over fifty times since its inception. Hr'g Tr. at 75. According to the Department's argument, the "entire net income" of a bank is limited to the income statement. The problem, again, is that when the bank tax was originally passed, the NOL would have been located on the income statement as a line item. It is the changes in accounting, none of which have been approved or affirmed by the Legislature, which now result in the NOL now residing on the balance sheet with relegation to a footnote on the income statement.

[20] ASC 740 makes clear it applies to any income tax whether not the income tax is called a franchise tax. Hr'g Tr. at 82.

the balance sheet and loss/deductions contained thereon. This incorrect determination ignores that "entire net income" has, since 1926, been defined and calculated as "net income *minus* deductions," not net income *without* deduction.[21] It also provides no method for a bank to account for *all* income and *all* expenses. Appellant's Bri. at 11. Synovus asserts the order of the ALC ignores the statutory history, S.C. Code Ann. § 12-11-40 and the adoption of conformity to *all* of Title 12, including the application of an NOL deduction pursuant to IRC § 172 and S.C. Code Ann. § 12-7-430(d)(2).

B. Banking Industry and Tax Professionals Viewing the Tax Base for Banks as Book Income Cannot Be Allowed to Contravene the Taxing Statutes

There is no statute, regulation or other written guidance that instructs a bank taxpayer to ignore current and historical statutory guidance and apply only the limited GAAP definition of "net income" from the income statement to its calculation of "entire net income" under the bank tax. If one does not look to the income tax code for the definition and calculation metric of "entire net income," the tax basis has no meaning. Instead, banks in South Carolina are left to their own devises and to the devises of accountants to apply and interpret ever changing accounting principles to determine how bank taxes are to be calculated in South Carolina. The Department admits such is true in its introduction when the Department states:

> 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.

Resp't Bri. at 2.

While at first blush this statement may appear to support the position of the Department, it underscores the problem at the core of the Department's position in this litigation. Accountants

[21] By definition, GAAP earnings cannot capture all income and expense of a taxpayer if limited to the income statement. Accounting standards allow taxpayers to charge excess expense items to their balance sheet. Hr'g Tr. at 82-88.

and the principles of accounting—not the Legislature—have been improperly allowed by the Department to define the substantive aspects of the bank tax. The record shows the Department does not even bother to review changes in GAAP reporting or evaluate the potential implications on bank taxation. The Department also does nothing to take the GAAP changes and provide additional definition. Hr'g Tr. at 41. This is a critical factor as GAAP provides accounting principles, not accounting rules. Having a third party, accountants and the authors of GAAP, define the confines of the bank tax basis in this manner is unconstitutional. Appellant's Bri. at 38-41. The Legislature in 1937 intended no such result and it is not the intent of the Legislature today.

IV. No Deference Should Be Afforded to the Department's Interpretation of the Bank Tax

As initially briefed, in Appellant's Initial Brief (pages 32-38), deference to the Department is not warranted in this instance. The Department has made no substantive pronouncements on the bank tax.[22] Now, the Department wishes to rely on the methods used by accountants versus regulations that it failed to pass. The Department had eighty plus years to provide clear guidance on the bank tax. It failed to do so. As such, no deference to the Department in this litigation should be given.

V. Challenges of Due Process and Equal Protection Are Preserved for Review

Synovus has not waived any challenge to equal protection or due process in this matter. Neither argument has been raised for the first time on appeal and both issues were raised in the motion for reconsideration. *State v. 192 Coin-Operated Video Game Machines*, 338 S.C. 176, 525

[22] At most, the Department relies on the bank tax form to assert that it has never allowed an NOL deduction. Even this argument, when analyzed, is convoluted and not as straightforward as the Department would like the Court to believe. The South Carolina bank return, for the years at issue, contains a computation which reconciles from US Form 1120 for taxable income to the bank taxable income. *Supra* n. 4, Ex. 45. The form begins with taxable income. If the bank tax was not based on taxable income, the Department would have simply stated use "GAAP earnings as reported on financial statements" and ignored references to federal taxable income.

S.E.2d 872 (2000) (equal protection argument not preserved for review where lower court did not address it and appellant did not raise it in motion to reconsider). At all times in this matter, Synovus has challenged the notion that "book income" is a defined legal or accounting term. The vagueness of the term has always been at issue in this litigation and one on which the ALC ruled. As noted by the Department, this was a point of contention and dispute by the experts in the hearing. Resp't Bri. at 46. Further, Synovus has not waived the equal protection argument. The original order issue by the ALC raised the issue of equal process for the first time when the ALC determined a bank can use "whatever accounting method" while at the same time relying on one accounting method, GAAP, to determine the merits of this matter. Am. Final Order at 39. Synovus raised the argument at the first instance once it was first made a part of the litigation by the ALC, and the ALC was given an opportunity to rule on the issue in the Motion for Reconsideration, thus complying with all preservation requirements. Pet'r Mot. to Reconsider at 7, May 5, 2020; *See In re LaBerge NOV*, 2016 WL 4582182 (Vt. Sept. 2, 2016) (argument noise ordinance so vague it violated due process and constitutional rights to equal protection not waived even if technical requirement not met as the original forum was given an opportunity to rule on the issue prior to the supreme court review). The merits of each argument are contained in Synovus' Initial Brief. Resp't Bri. at 43-44.

VI. Conclusion

Simply put, if the decision of the ALC is affirmed, bank taxpayers in South Carolina are burdened with a tax law that provides no substantive instruction on how to apply the bank tax and is inequitable. While the issue presented appears convoluted, the resolution is simple and rests in the bank tax code itself. The Legislature specifically conformed the bank tax to the IRC and adopts and makes part of the bank tax "*all*" of Chapter 6 (the income tax code). This statutory code, which has always been a part of the bank tax, is all encompassing, not limiting. Without reliance on Chapter 6, the bank tax has no substance. Once applied, Chapter 6 provides the bank tax with

needed definitions and structure, including a definitive definition for "entire net income" and a specific deduction for NOL carryforwards. The application of the income tax code to the bank tax follows historical precedent, is in accord with conformity and provides a method of calculation for "entire net income" that is in compliance with both statute and GAAP accounting principles applicable to publicly traded banks. Despite the best arguments of the Department, the statutory formula for the bank tax has not changed since its inception and the Department has failed to point to any statutory instruction to the contrary.

As such, the ruling of the ALC must be overturned.

Dated this 15th day of January 2021.

Respectfully submitted,

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Proof of Service

I certify that I have served Appellant's Response to Respondent's Initial Brief by U.S. First Class Mail.

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